



**Stanford – Vienna  
Transatlantic Technology Law Forum**

A joint initiative of  
Stanford Law School and the University of Vienna School of Law



# **TTLF Working Papers**

**No. 69**

**Initial Coin Offerings in the United States  
and the European Union: Development,  
Status Quo and the Path Forward**

**Martin Miernicki**

**2020**

# TTLF Working Papers

**Editors: Siegfried Fina, Mark Lemley, and Roland Vogl**

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## **Suggested Citation**

This TTLF Working Paper should be cited as:

Martin Miernicki, Initial Coin Offerings in the United States and the European Union: Development, Status Quo and the Path Forward, Stanford-Vienna TTLF Working Paper No. 69, <http://tlf.stanford.edu>.

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## **Abstract**

Since the hype around crypto-assets and initial coin offerings in 2017, the legal implications of these phenomena have gained considerable attention, especially in the realm of securities regulation and enforcement. This paper compares the respective approaches to the regulation of ICOs in the United States and the European Union and highlights possible future developments.

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## 1. Introduction

Companies rely on various means for the purpose of raising capital for investments or the development their business models. “Traditional” instruments of the capital market include, for instance, shares and bonds. Recently, new forms to raise capital – which are sometimes also associated with crowd-funding – have developed in connection with the emergence of crypto-assets<sup>1</sup> which are based on blockchain-technology. Among the different terms that are commonly used to described these phenomena, one usually refers to Initial Coin Offerings (ICOs) or Initial Token Offerings (ITOs).<sup>2</sup> In the course of an ICO, a company essentially issues tokens in exchange for other crypto-assets or, as the case might be, fiat money; the exchange itself is usually performed by employing so-called “smart-contracts” that automatically carry out the transfer of the involved crypto-assets.<sup>3</sup> In this light, ICOs can provide a fast and convenient way to collect funds. Moreover, it is possible to attract a great number of potential investors; corresponding investment campaigns can easily be backed up by marketing via social media. At the same time, however, there are different risks for investors associated with acquiring tokens. Clearly, the risks for investors (and the stability of financial systems overall) are a concern of law-makers and regulators. In fact, several regulatory authorities have issued warnings in connection with crypto-assets and ICOs.<sup>4</sup>

Even though ICOs often do not correspond to “traditional” instruments of the capital market, the do not operate in a legal vacuum and capital market law can apply to the emission of tokens. The securities laws are of special relevance in this context, as the emission of tokens in the

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<sup>1</sup> See section 2 for the terminology used hereinafter.

<sup>2</sup> For the sake of simplicity, hereinafter, reference is only made to ICOs

<sup>3</sup> See for the different stage of an ICO, e.g., Moran Ofir & Ido Sadeh, *ICO v. IPO: Empirical Findings, Information Asymmetry, and the Appropriate Regulatory Framework*, 53 Vand. J. Transnat'l L., 525, 547-551 (2020).

<sup>4</sup> See, e.g., Bundesanstalt für Finanzdienstleistungsaufsicht, Consumer warning: the risks of initial coin offerings [https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Meldung/2017/meldung\\_171109\\_ICOs.html](https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Meldung/2017/meldung_171109_ICOs.html) (last visited Sept. 10, 2020); European Securities and Markets Authority, European Banking Authority & European Insurance and Occupational Pensions Authority, *ESMA, EBA and EIOPA warn consumers on the risks of Virtual Currencies*, <https://eba.europa.eu/documents/10180/2139750/Joint+ESAs+Warning+on+Virtual+Currencies.pdf> (last visited Sept. 10, 2020); Jay Clayton, *Statement on Cryptocurrencies and Initial Coin Offerings*, <https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11> (last visited Sept. 10, 2020).

course of an ICO can, under certain circumstances, be considered as a public offering of securities. However, since the ICO hype in 2017, the relevant definitions contained in these laws have not changed and several uncertainties as to the application of the securities framework to ICOs remain. At the same time, authorities responsible for the oversight of securities have gained experiences in dealing with this new form of raising capital.

It is the purpose of this research to explore the application of securities regulation in the U.S. and the E.U.; other areas of regulation are addressed where necessary. For this purpose, the research is structured as follows: section II sets out the terminology used in this research. Section III outlines the foundations of securities regulation in the U.S. and the E.U. Section IV and V explain how the general regulatory rules are applied to crypto-assets in both jurisdictions; section VI highlights legislative initiatives. Section VII comments on the legal status of crypto-assets under U.S. and E.U. securities regulation and highlights common and divergent approaches. Section VIII discusses perspectives for the future regulation of crypto-assets; section XI contains concluding remarks.

## 2. Terminological Remarks

The tokens emitted in the course of an ICO can take different forms. To help classify the various kinds of tokens, a general token taxonomy has developed. Commonly, the legal literature distinguishes three archetypes of tokens: Currency, utility, and investment tokens.<sup>5</sup> Several supervisory authorities have also endorsed this classification.<sup>6</sup> In general, currency tokens are

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<sup>5</sup> See, e.g., Valeria Ferrari, *The regulation of crypto-assets in the EU – investment and payment tokens under the radar*, 2020 Maastricht J. European and Comp. L. XX(X), 5-6; Philipp Hacker & Chris Thomale, *Crypto-Securities Regulation: ICOs, Token Sales and Cryptocurrencies under EU Financial Law*, 15 ECFR 648, 652-653 (2018); Philipp Maume & Mathias Fromberger, *Regulation of Initial Coin Offerings: Reconciling U.S. and E.U. Securities Laws*, 19 Chicago J. Int. L. 548, 558-560 (2019). It should be noted that this token taxonomy is mostly used in connection with regulatory laws and might therefore not be suited to be applied to other areas, like private law, for instance.

<sup>6</sup> See, e.g., Bundesanstalt für Finanzdienstleistungsaufsicht, *Merkblatt, Zweites Hinweisschreiben zu Prospekt- und Erlaubnispflichten im Zusammenhang mit der Ausgabe sogenannter Krypto-Token* 5-6, [https://www.bafin.de/SharedDocs/Downloads/DE/Merkblatt/WA/dl\\_wa\\_merkblatt\\_ICOs.pdf?\\_\\_blob=publicationFile&v=1](https://www.bafin.de/SharedDocs/Downloads/DE/Merkblatt/WA/dl_wa_merkblatt_ICOs.pdf?__blob=publicationFile&v=1) (last visited Sept 10, 2020); European Banking Authority, *Report with advice for the Commission on crypto-assets* 7 (2019), available at <https://eba.europa.eu/documents/10180/2545547/EBA+Report+on+crypto+assets.pdf> (last visited March 3, 2019)



considered to function as a means of payment (like, *e.g.*, Ether or Bitcoin), while utility tokens convey access to the a product or service that is, in many cases, still in development; often, utility token are created on the Ethereum Blockchain. Lastly, investment tokens (sometimes also referred to as security tokens) come with the expectation of future profit, *e.g.*, in the form of dividends by an underlying company.<sup>7</sup> However, it should be highlighted that the distinction is as not clear-cut as it might seem and many tokens can be best described as hybrid forms (“hybrid tokens”). For instance, many tokens that for the most part could be considered as utility tokens can also have an investment component because tokens can usually be traded and, therefore, sold for profit.<sup>8</sup> In the following, the term “crypto-asset” is used to refer to all blockchain-based digital assets, be it “cryptocurrencies” like Bitcoin, Ether, etc. or tokens that are issued in the course of an ICO.<sup>9</sup>

### 3. Regulatory Environment for ICOs

ICOs can be subject to capital market law both in the E.U. and the U.S. The following section lays down the most relevant legal instruments in the ambit of securities regulation in both jurisdictions.

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[hereinafter: EBA Report 2019]; ESMA, *Advice Initial Coin Offerings and Crypto-Assets* 8 (2019), [https://www.esma.europa.eu/sites/default/files/library/esma50-157-1391\\_crypto\\_advice.pdf](https://www.esma.europa.eu/sites/default/files/library/esma50-157-1391_crypto_advice.pdf) [hereinafter: ESMA Advice 2019]; Financial Conduct Authority, *Guidance on Cryptoassets* 4 (2019), <https://www.fca.org.uk/publication/policy/ps19-22.pdf>.

<sup>7</sup> Hacker & Thomale, *supra* at 553.

<sup>8</sup> Hacker & Thomale, *supra* at 653.

<sup>9</sup> Since many other authors have already done so, it is not necessary to recount the technical foundations of the blockchain technology – *see* for an excellent introduction, *e.g.*, Primavera De Filippi & Aaron Wright, *Blockchain and the Law* 13-57 (2018) – or the historic development of the distributed ledger technology since the inception of Bitcoin in 2008/2009, *see* Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, <https://bitcoin.org/bitcoin.pdf> (last visited Sept. 10, 2020).

### 3.1. European Union

The public offering of securities is regulated, first and foremost, by the so-called Prospectus Regulation<sup>10</sup> that came into effect in 2019.<sup>11</sup> As a regulation, it is directly applicable in the member states.<sup>12</sup> Under this framework, “securities shall only be offered to the public in the Union after prior publication of a prospectus” in accordance with the Prospectus Regulation.<sup>13</sup> The prospectus consists of a minimum set of contents<sup>14</sup> that are designed to provide investors with sufficient information about the offering and the issuer to enable informed decisions and to facilitate the functioning of the internal market.<sup>15</sup> Clearly, the term “securities” is crucial for the application of the regulatory rules. This concept is defined in the “Markets in Financial Instruments Directive” (MiFID II):<sup>16</sup>

‘transferable securities’ means those classes of securities which are negotiable on the capital market, with the exception of instruments of payment, such as:

- (a) shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares;
- (b) bonds or other forms of securitised debt, including depositary receipts in respect of such securities;
- (c) any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures;

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<sup>10</sup> Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC, 2017 O.J. (L168), 12-82 [hereinafter: Prospectus Regulation].

<sup>11</sup> However, it should be noted that some exceptions had already entered into force before, *see* Prospectus Regulation art. 49(2). Before the Prospectus Regulation, national laws on public security offerings were harmonized, *inter alia*, by Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC, 2003 O.J. (L345) 64-89.

<sup>12</sup> TFEU art. 288.

<sup>13</sup> Prospectus Directive art. 3(1).

<sup>14</sup> Prospectus Regulation art. 6.

<sup>15</sup> *Cf.* Prospectus Regulation recital 7 (“The aim of this Regulation is to ensure investor protection and market efficiency, while enhancing the internal market for capital”), art. 6(1); *see also* *Beheer BV v. Van den Dungen Vastgoed BV*, C-441/12 at 31 (ECJ 2014).

<sup>16</sup> Prospectus Regulation art. 2(1)(a) in connection with art. 4(1)(44), art. 94 of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, 2014 O.J. (L173) 349-496. Money market instruments within the meaning of the MiFID II having a maturity of less than 12 months are not securities under the Prospectus Regulation.

The regulation provides for exceptions with regard to public offerings of securities with a total consideration of less than 1 Mio. EUR.<sup>17</sup> Furthermore, member states can exempt offers below the threshold of 8 Mio. EUR from the obligation to publish a prospectus.<sup>18</sup> While the mandate of the European Securities and Markets Authority (ESMA)<sup>19</sup> includes a wide variety of tasks (e.g., drafting technical standards and guidelines), supervision and enforcement of the Prospectus Regulation are largely left to national authorities that cooperate with ESMA and each another.<sup>20</sup> Besides the framework set up by the EU rules on public offerings, member states are generally free to regulate public offerings under national law. Furthermore, details on questions related to the liability for the prospectus are determined by the member states' laws.<sup>21</sup>

The MiFID II regulates financial instruments as specified in Section C(1) of its Annex I.<sup>22</sup> Besides many other different instruments (e.g., certain options, futures or swaps related to commodities, and many more), the term includes transferable securities as defined above; setting up an exchange for the trading of securities could thus, for instance, be considered as a “regulated market” within the meaning of the directive.<sup>23</sup> Regulated markets require authorization under the MiFID II-framework.<sup>24</sup> Furthermore, the applicability of the Market Abuse Regulation (MAR)<sup>25</sup> turns on the term “financial instrument”.<sup>26</sup>

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<sup>17</sup> Prospectus Regulation art. 1(3).

<sup>18</sup> Prospectus Regulation art. 3(2).

<sup>19</sup> Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC, 2010 O.J. (L331) 84-119.

<sup>20</sup> Cf. Prospectus Regulation art. 31 et seq.

<sup>21</sup> Hacker & Thomale, *supra* at 658; *see also* Prospectus Regulation art. 11.

<sup>22</sup> MiFID II art. 4(1)(15).

<sup>23</sup> MiFID II art. 4(1)(21) (“‘regulated market’ means a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments – in the system and in accordance with its non-discretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with Title III of this Directive;”). Further types of trading forums can be regulated as “multilateral trading facility”, MTF, and “organised trading facility”, OTF, *see id.* art. 4(1)(22)-(23).

<sup>24</sup> MiFID II art. 44 et seq.

<sup>25</sup> Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC, 2014 O.J. (L173) 1-61 [hereinafter: MAR].

<sup>26</sup> MAR art. 2(1) 3(1)(1); *see* ESMA Advice 2019 at 29.

### 3.2. United States

Public offerings of securities are regulated by the Securities Act of 1933.<sup>27</sup> Under this act, it is unlawful to carry out such an offering or sale of securities unless a registration statement is filed with the SEC.<sup>28</sup> The obligations attached to the offering a security are ultimately designed to protect investors and enable informed investment decisions by promoting full disclosure of information.<sup>29</sup> Accordingly, the concept of “security” is of crucial importance. The Securities Act defines this term as follows:

The term “security” means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security”, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.<sup>30</sup>

Thus, the definition of the term is very specific, mentioning countless of examples of which forms a security could take, but remains, at the same time, ambiguous, as it includes various unclarified expressions that are open to interpretation. Against this background, it is not surprising that U.S. courts have often times given their opinion on the interpretation of the statutory language. The landmark case for the definition of the term “security” is *SEC v. Howey*.<sup>31</sup> In this decision – that centered on an offering of units of a citrus grove development coupled with a service contract for cultivating and harvesting that entitled the investor to a share of the profits – the Supreme Court set forth the basic characteristics of a security; the several

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<sup>27</sup> 15 U.S.C. §§ 77a et seq.

<sup>28</sup> 15 U.S.C. § 77(e).

<sup>29</sup> *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953).

<sup>30</sup> 15 U.S.C § 77b(a)(1).

<sup>31</sup> *SEC v. Howey*, 328 U.S. 293 (1946).

factors identified by the court are nowadays known as the *Howey* test. In its analysis, the Supreme Court put focus on the term “investment contract” which was taken to mean

a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.<sup>32</sup>

Thus, an investment contract is an “investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.”<sup>33</sup>

It should be noted that the Supreme Court takes a pragmatic rather than a formalistic approach to this concept;<sup>34</sup> it “embodies a flexible, rather than a static, principle”, in order to apply to the many different forms a security can take.<sup>35</sup> Accordingly, the concept of securities is rather broad and courts have found even whiskey and casks<sup>36</sup> or chinchillas<sup>37</sup> to involve an investment contract. Conversely, where an investor buys an asset to use or consume it, he or she will not be driven by an expectation of profits and thus there will be no investment contract;<sup>38</sup> the same applies to cases where the value of a good is determined by the free market and not the efforts of the issuer of the asset.<sup>39</sup> Furthermore, an offering is not covered by the Securities Act if it is not “public”.<sup>40</sup> Rule 506 provides for further details in this respect.<sup>41</sup> Besides the enforcement

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<sup>32</sup> *SEC v. Howey*, 328 U.S. 293, 299.

<sup>33</sup> *SEC v. Edwards*, 540 U.S. 389, 393 (2004) citing *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975); as can be seen, the *Howey* test’s use of the word “solely” is not interpreted literally, see *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, 481-482 (9th Cir. 1973); see also *Balestra v ATB Coin, LLC*, at 16. The same applies to the word “money”, so that also goods and services in general can be considered as an investment; see, e.g., *Uselton v. Commercial Lovelace Motor Freight*, 940 F.2d 564, 574 (10th Cir. 1991).

<sup>34</sup> *SEC v. Howey*, 328 U.S. 293, 298 (“Form was disregarded for substance, and emphasis was placed upon economic reality”); see also *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967).

<sup>35</sup> *SEC v. Howey*, 328 U.S. 293, 299.

<sup>36</sup> *Glen-Arden Commodities, Inc. v. Costantino*, 493 F.2d 1027 (2d Cir. 1974).

<sup>37</sup> *Miller v. Cent. Chinchilla Gr., Inc.*, 494 F. 2d 414 (8th Cir. 1974).

<sup>38</sup> *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852-853. In this vein, memberships in a system of outdoor resort campgrounds was not considered as a security, see *All Seasons Resorts v. Abrams*, 68 N.Y.2d 81 (N.Y. Court of Appeals 1986).

<sup>39</sup> *Noa v. Key Futures, Inc.*, 638 F.2d 77, 80 (9th Cir. 1980) (“There is a national market for silver which is not dependent upon Key Futures. Thus, although the buy-back agreement here saved the customer a brokerage fee, it does not indicate that the plaintiffs were engaged in a common enterprise with any defendant. [...] The risk they assumed was that which any buyer takes when he pays in advance for goods to be delivered in the future”).

<sup>40</sup> 15 U.S.C. § 77d(a)(2). On the interpretation of this notion see *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953).

<sup>41</sup> 17 C.F.R. § 230.506. See for more details on exemptions from the registration requirement, e.g., Jonathan Rohr & Aaron Wright, *Blockchain-Based Token Sales, Initial Coin Offerings, and the Democratization of Public Capital Markets*, 70 *Hastings L. J.* 463, 502-511 (2019).

tools that the Securities Act gives to the SEC,<sup>42</sup> the importance of other remedies should not be underestimated. In particular, private parties that purchase unregistered securities have the right to rescind the transaction.<sup>43</sup>

Under the Securities Exchange Act of 1934,<sup>44</sup> any broker, dealer or exchange must register as a national securities exchange when using any facility of exchange to effect any transaction in a security or reporting any such transaction, unless an exception applies.<sup>45</sup> Further details on the definition<sup>46</sup> of the term “exchange” are set forth by Exchange Act Rule 3b-16(a),<sup>47</sup> specifying, inter alia, that an exchange uses “established, non-discretionary measures” for trading securities.<sup>48</sup>

## 4. Crypto-Assets as Securities under E.U. law

### 4.1. General Remarks

Case law on crypto-assets on the EU level remains sparse. Bitcoin, as the best-known example of crypto-assets, first came into wider focus in the wake of the frequently cited decision of the ECJ in *Hedqvist*.<sup>49</sup> While the ruling focuses on the interpretation of the Directive on the common system of value added tax,<sup>50</sup> it reveals a lot about the ECJ’s understanding of a crypto-assets like Bitcoin. According to the court, Bitcoins constitute a “contractual means of payment” and can neither be regarded as a current or deposit account nor a debt, or checks;

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<sup>42</sup> Cf. 15 U.S.C. § 77t.

<sup>43</sup> 15 U.S.C. § 77l.

<sup>44</sup> 15 U.S.C. § 78a et seq.

<sup>45</sup> 15 U.S.C. § 78e. See for the registration and regulation of brokers and dealers *id.* at § 78o.

<sup>46</sup> See 15 U.S.C. § 78c(a)(1): “The term ‘exchange’ means any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such exchange.”

<sup>47</sup> 17 C.F.R. § 240.3b-16(a).

<sup>48</sup> For the definition of the term “security” see 15 U.S.C. § 78c(10); this definition refers – like the Securities Act – to an “investment contract”. Overall, the definition is considered as largely identical, see, e.g., *SEC v. Blockvest, LLC*, 18CV2287 at 13 (S. D. Cal. 2018), 2018 U.S. Dist. LEXIS 200773.

<sup>49</sup> *Skatteverket v. Hedqvist*, C-264/14 (ECJ 2015).

<sup>50</sup> Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, 2006 O.J. (L347) 1-118 [hereinafter: VAT Directive].

Bitcoin “is a direct means of payment between the operators that accept it”.<sup>51</sup> However, the court held that art. 135(1)(e) of the VAT Directive – that refers to “currency, bank notes and coins used as legal tender” – also covered a service consisting of the exchange of fiat currencies for units for Bitcoins.<sup>52</sup> In doing so, the court acknowledged the similarities between “traditional currencies” and “another currency”.<sup>53</sup> Yet, it should be stressed that the ECJ gave its opinion in the highly specific context of the VAT Directive: Crypto-assets in general – whatever form they take – are not considered as legal tender in the Eurozone. According to the TFEU, “[t]he banknotes issued by the European Central Bank and the national central banks shall be the only such notes to have the status of legal tender within the Union”,<sup>54</sup> a principle that is further specified by EU secondary law.<sup>55</sup> Furthermore, cryptocurrencies like Bitcoin or Ether are not electronic money<sup>56</sup> according to the Electronic Money Directive<sup>57</sup> and are likewise not covered by the definition of the term “funds” within the meaning of the PSD II.<sup>58</sup> Conversely, some tokens emitted via ICOs might fulfill the definition of electronic money,

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<sup>51</sup> *Hedqvist*, C-264/14 at 42 (on VAT Directive art. 135(1)(d)).

<sup>52</sup> *Hedqvist*, C-264/14 at 53.

<sup>53</sup> *Hedqvist*, C-264/14 at 46 et seq.

<sup>54</sup> TFEU art. 128(1).

<sup>55</sup> Council Regulation (EC) No 974/98 of 3 May 1998 on the introduction of the euro, 1998 O.J. (L139) 1-5; *see also* Opinion of the European Central Bank of 12 October 2016 on a proposal for a directive of the European Parliament and of the Council amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directive 2009/101/EC, 2016 O.J. (C459) 3-6 at 1.1.3.

<sup>56</sup> *See, e.g.*, European Central Bank, Virtual currency schemes – a further analysis (2015) 24-25, <https://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemesen.pdf>.

<sup>57</sup> Art. 2(2) of the Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC, 2009 O.J. (L267) 7-17 (“‘electronic money’ means electronically, including magnetically, stored monetary value as represented by a claim on the issuer which is issued on receipt of funds for the purpose of making payment transactions as defined in point 5 of Article 4 of Directive 2007/64/EC, and which is accepted by a natural or legal person other than the electronic money issuer”).

<sup>58</sup> Art. 4(25) of the Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC, 2015 O.J. (L337) 35-127 (“‘funds’ means banknotes and coins, scriptural money or electronic money as defined in point (2) of Article 2 of Directive 2009/110/EC”). *See also* Hossein Nabilou, *The dark side of licensing cryptocurrency exchanges as payment institutions*, 14 Law & Financial Markets Rev. 39, 40-42 (2020).

albeit in rather exceptional cases; for the purpose of this appraisal, a case-by-case analysis is required.<sup>59</sup>

In light of this sparse case law, it is necessary to analyze the different elements of the securities definition. First, it should be highlighted that “instruments of payment” are expressly exempted from the definition of transferable securities. Thus, it can be assumed that tokens that merely fulfill payment functions fall outside the scope of this definition.<sup>60</sup> In fact, the ECJ clearly distinguished cryptocurrencies like Bitcoin from securities in *Hedqvist*.<sup>61</sup> Again, however, these parts of the ruling refer to the very specific use of the terms in the VAT Directive. While there are goods arguments for exempting “pure” currency tokens from the securities definition, one might come to a different result in cases where a currency token also possesses an investment component.<sup>62</sup>

Every transferable security must meet a set of positive requirements under the definition of the MiFID II. While the majority of tokens are likely to meet the requirements of transferability, negotiability and standardization, the crucial point of the definition relates to the comparability of the token at issue with the non-exhaustive list of MiFID II art. 44(1)(44)(a)-(c).<sup>63</sup> Against this background, investment tokens (that convey, e.g., profit or voting rights) are usually

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<sup>59</sup> See for more details, e.g., Georg Tuder, *Initial Coin Offerings im Lichte des Bankenaufsichtsrechts*, in *Kryptowährungen* 275, 305-309 (Sabine Kirchmayr-Schliesselberger, Wolfgang Klas, Martin Miernicki, Stefanie Rinderle-Ma & Arthur Weiling, eds., 2019); see also Robby Houben & Alexander Snyers, *Crypto-Assets* 58-59 (2020), available at <https://www.europarl.europa.eu/cmsdata/150761/TAX3%20Study%20on%20cryptocurrencies%20and%20block%20chain.pdf>.

<sup>60</sup> Cf. *Hedqvist*, C-264/14 at 49 (“Transactions involving non-traditional currencies, that is to say, currencies other than those that are legal tender in one or more countries, in so far as those currencies have been accepted by the parties to a transaction as an alternative to legal tender and have no purpose other than to be a means of payment, are financial transactions”) and 52 (“In the case in the main proceedings, it is common ground that the ‘Bitcoin’ virtual currency has no other purpose than to be a means of payment and that it is accepted for that purpose by certain operators”).

<sup>61</sup> *Hedqvist*, C-264/14 at 55 (“It is common ground that the ‘Bitcoin’ virtual currency is neither a security conferring a property right nor a security of a comparable nature”).

<sup>62</sup> Hacker & Thomale, *supra* at 676-680, 685-686; see also Maume & Fromberger, *supra* at 581-582.

<sup>63</sup> Hacker & Thomale, *supra* at 663-670 (“functional comparability”); this view is agreed to by Ferrari, *supra* at 8-9. According to Maume & Fromberger, *supra* at 574-583, however, the different elements of the definition are i) transferability, ii) capital markets, iii) negotiability, iv) standardization and v) no payment instrument. The authors reject the comparability test but reach similar results by interpreting the notion “capital markets”.



considered as transferable securities within the meaning of the MiFID II, whereas the contrary is typically the case with regard to utility tokens.<sup>64</sup> Again, a different result is conceivable if utility tokens possess an investment component.<sup>65</sup>

#### **4.2. ESMA Advice on Initial Coin Offerings and Crypto-Assets**

In 2019, ESMA<sup>66</sup> published a comprehensive advice on crypto-assets,<sup>67</sup> covering the most important questions on crypto-assets with respect to the different regulatory regimes in the EU. After setting forth the foundations for its legal analysis by explaining the development, risks and benefits as well as the technological foundations of crypto-assets,<sup>68</sup> ESMA reports on a survey among regulatory authorities in the member states.<sup>69</sup> The report revealed that most authorities considered the presented case examples – certain hybrid tokens containing investment and utility components as well as hybrids with all components – as transferable securities (or other types of financial instruments) within the meaning of the MiFID II. However, ESMA highlighted that there was some variation among national authorities that were linked to the different approaches with regard to the transposition of the European rules.<sup>70</sup> Some national authorities disagreed on the question whether profit rights, without necessarily conveying ownership or governance rights, should be regarded as securities.<sup>71</sup> The consensus was clearer with regard to pure utility tokens that were not considered as transferable securities

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<sup>64</sup> See, e.g., Bundesanstalt für Finanzdienstleistungsaufsicht, *supra* at 5-6; Hacker & Thomale, *supra* at 671-675 (arguing that the expectation of profits forms part of the analysis whether there is a security, even though this element is not expressly mentioned by the definition); Maume & Fromberger, *supra* at 577 (pure utility tokens are no transferable securities, even if they are transferrable and potentially negotiable).

<sup>65</sup> Hacker & Thomale, *supra* at 680-684.

<sup>66</sup> See Regulation (EU) No 1095/2010 art. 9(4).

<sup>67</sup> ESMA Advice 2019, *supra*.

<sup>68</sup> ESMA Advice 2019 at 7-18.

<sup>69</sup> ESMA Advice 2019 at 19-21, Annex 1.

<sup>70</sup> ESMA Advice 2019 at 20.

<sup>71</sup> ESMA Advice 2019 at 20.

or a financial instruments.<sup>72</sup> Explicitly, ESMA confirmed that “pure payment-type crypto-assets” were “unlikely to qualify as financial instruments”.<sup>73</sup>

Furthermore, ESMA also analyzed platforms for trading crypto-assets. Such platforms would likely fall under the regime of the MiFID II if services with regard to financial instruments are offered.<sup>74</sup> In particular, ESMA expressed its preliminary view that platforms trading crypto-assets with a central order book and/or matching orders under other trading models could potentially be considered as regulated markets, MTFs or OTFs.<sup>75</sup>

### **4.3. Hydrominer as an Example for an ICO under the E.U. Securities Laws**

It is generally said that companies conducting an ICO tend to avoid the regulatory rules by relying on exceptions or designing the token in a corresponding way. However, even though this is seldom the case in practice, complying with the EU rules on the prospectus – which is associated with considerable costs – is an option. One example is Hydrominer’s ICO that is sometimes reported to be the first ICO in the E.U. under the European capital market rules.<sup>76</sup> The prospectus<sup>77</sup> was approved by the Austrian Financial Market Authority (Finanzmarktaufsichtsbehörde – FMA) in 2018.

In a nutshell, Hydrominer’s (main) business model consisted in the mining of cryptocurrencies: The plan was to purchase electricity from hydro power plants in Austria at a low price, thereby achieving a competitive advantage over competitors in the mining business.<sup>78</sup> At the center of

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<sup>72</sup> ESMA Advice 2019 at 20 (“The rights that they convey seem to be too far away from the financial and monetary structure of a transferable security and/or a financial instrument”).

<sup>73</sup> ESMA Advice 2019 at 19.

<sup>74</sup> ESMA Advice 2019 at 24-25.

<sup>75</sup> ESMA Advice 2019 at 25; *see also* Ferrari, *supra* at 9-10.

<sup>76</sup> *See, e.g.*, <https://en.bitcoinwiki.org/wiki/Hydrominer> (last visited Sept. 10, 2020).

<sup>77</sup> The prospectus (ISIN: AT0000A21J49) can be accessed via the ESMA’s website (<https://registers.esma.europa.eu/publication/searchProspectus>) or via this direct link <https://webhost.fma.gv.at/prospcontent/GetDocument.aspx?PROSPID=29F412061AE84CB392912CA05577D4B5> [hereinafter: Hydrominer-Prospectus].

<sup>78</sup> Hydrominer-Prospectus at 22-23.

the ICO were “tokenized Participation Rights”,<sup>79</sup> constituting qualified subordinated obligations; all rights should be linked to the possession of a token (“H3O” on the Ethereum Blockchain) and it was possible to participate by either paying Euros or selected cryptocurrencies (Bitcoin, Dash and Ether, among others).<sup>80</sup> The basic right of the token holder was the participation in the profits (and the loss) of the issuer, and any pay out would be carried by transferring Ether on the Ethereum Blockchain.<sup>81</sup> However, the plan did not work out and Hydrominer was forced to declare bankruptcy in 2019.<sup>82</sup>

## 5. Crypto-Assets as Securities under U.S. law

### 5.1. General Remarks and the “DAO report”

Similar to the Euro zone, cryptocurrencies are not legal tender in the U.S.<sup>83</sup> and are generally not considered as securities under the *Howey* test.<sup>84</sup> Apart from that, the problem is comparable to the E.U.: One must apply the general laws that were not written with crypto-assets in mind to new technological phenomena. While crypto-assets had been dealt with in the U.S. before,<sup>85</sup> the so-called DAO-Report<sup>86</sup> issued in 2017 marks the beginning of intensive enforcement activities by the SEC. The following section outlines the DAO report; afterwards, some of the

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<sup>79</sup> This translates to “Genussrechte” in German. It should be noted that the participation rights were subject to Austrian law, *see* Hydrominer-Prospectus at 78-79.

<sup>80</sup> Hydrominer-Prospectus at 28.

<sup>81</sup> Hydrominer-Prospectus at 29-30.

<sup>82</sup> Stefan Mey, *Wiener Krypto-Startup Hydrominer meldet Insolvenz an*, <https://www.derbrutkasten.com/hydrominer-insolvenz/> (last visited Sept. 10, 2020).

<sup>83</sup> 31 U.S.C. § 5103 (“U.S. coins and currency [including Federal reserve notes and circulating notes of Federal reserve banks and national banks] are legal tender for all debts, public charges, taxes, and dues. Foreign gold or silver coins are not legal tender for debts”); *McDonnell*, 287 F. Supp. 3d 213 at 217.

<sup>84</sup> *SEC v. Telegram Grp. Inc.*, 19-CV-9439 at 3-4 (S. D. N. Y. 2020), 2020 U.S. Dist. LEXIS 53846; *see also United States v. Zaslavskiy*, 17-CR-647 at 22-23 (E. D. N. Y. 2018), 2018 U.S. Dist. LEXIS 156574; *cf. also SEC v. Shavers*, 4:13-CV-416 (E. D. Tex. 2013), 2013 U.S. Dist. LEXIS 110018. However, the SEC has, on occasion, demonstrated its willingness to deal with former, *see, e.g.*, Order Disapproving a Proposed Rule Change, Exchange Act Release No. 34-80206 (Mar. 10, 2017); *see also* Marco Dell’Erba, *From Inactivity to Full Enforcement: The Implementation of the “Do No Harm” Approach in Initial Coin Offerings*, 26 Mich. Tech. L. Rev. 175, 196-197 (2020).

<sup>85</sup> *See, e.g., In Re Coinflip, Inc.*, CFTC No. 15-29 (Sept. 17, 2015); *see also* James M. Blakemore, *New Things under the Sun: How the CFTC is Using Virtual Currencies to Expand its Jurisdiction*, 73 Ak. L. Rev. 205, 209 (2020).

<sup>86</sup> Securities and Exchange Commission, *Report of Investigation Pursuant to Section 21(a) of the U.S. Securities Exchange Act of 1934: The DAO*, Securities Exchange Act Release No. 81207 (2017), available at <https://www.sec.gov/litigation/investreport/34-81207.pdf> (last visited Sept. 10, 2020) [hereinafter: DAO Report]; “DAO” stands for “Decentralized Autonomous Organization”.

cases the SEC has dealt with are summarized to give an overview of the treatment of ICOs under U.S. securities laws.<sup>87</sup> To give a more complete image of the U.S. legal landscape, the section concludes with an excursus on the treatment of crypto-assets as commodities.

In the report, the SEC investigated the case of the DAO, a decentralized organization created by Slock.it, a German company, in the wake of an ICO in 2016 where 1.15 billion DAO Tokens were sold in exchange for approximately 12 million Ether.<sup>88</sup> The token holders could transfer the tokens on the Ethereum Blockchain or on the secondary market and were entitled to vote and to obtain rewards; the profits generated would stem from projects funded by the organization.<sup>89</sup> Project proposals were only accepted upon a majority vote of the token holders, however, so-called “Curators” – individuals chosen by Slock.it – had the power to review proposals and maintained the ultimate control over the crucial decisions.<sup>90</sup>

In light of these facts, the SEC applied to *Howey* test to the DAO and concluded that investors in the DAO invested “money”<sup>91</sup> with a reasonable expectation of profits because the promotional materials disseminated by Slock.it had portrayed the DAO as a for-profit entity with the aim of funding projects that should lead to a return on investment.<sup>92</sup> Furthermore, since the activities of Slock.it, its co-founders and the “Curators” were essential for the proper functioning and the further operations of the DAO, the expectation of profit was derived from the managerial effort of others, despite there being voting rights.<sup>93</sup> The SEC concluded that the DAO tokens possessed the characteristics of an investment contract, thus falling within the scope of the term “security”. The authority also highlighted that platforms for the trading of

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<sup>87</sup> Note that many of the cases outlined in the following are settlements.

<sup>88</sup> DAO Report at 2-3. Later, due to an error in the DAO’s code, an attacker was able to divert crucial amounts of Ether from the DAO’s address. As a response, a hard fork was conducted and the attack could be undone, *see id.* at 9-10.

<sup>89</sup> DAO Report at 3-6.

<sup>90</sup> *Id.* at 6-8.

<sup>91</sup> *See supra* at FN 33.

<sup>92</sup> DAO Report at 11-12.

<sup>93</sup> *Id.* at 12-13.

tokens that are securities are, in principle, subject to regulation under the Security Exchange Act.<sup>94</sup>

It should be noted that the SEC highlighted the technology neutrality of the legal framework stating that “securities law may apply to various activities, including distributed ledger technology, depending on the particular facts and circumstances, without regard to the form of the organization or technology used to effectuate a particular offer or sale”.<sup>95</sup> In a string of cases,<sup>96</sup> the SEC further pursued this approach and repeatedly considered tokens as securities under section 2(a)(1) of the Securities Act.

## **5.2. Overview of the SEC’s Activities Relating to ICOs after the DAO Report**

### **5.2.1. In Re Munchee**

*Munchee* is one of the first examples of the application these principles.<sup>97</sup> In this case, Munchee, Inc., a California business, created an app for the review of restaurants. To fund improvements of the app, Munchee made plans to issue the MUN token to the public on the Ethereum Blockchain. The goal was to raise 15 Million USD by selling 225 million MUN tokens in exchange for Bitcoin or Ether, while Munchee would reserve a significant amount of the MUN tokens for paying rewards in the app, employees and advisors.<sup>98</sup> Eventually, the tokens should be used to buy goods and services; meanwhile, Munchee proposed several activities – creating an “ecosystem” – to raise the value of Munchee token (*e.g.*, paying for food reviews in MUN tokens or selling advertising to restaurants and in-app purchases in exchanges for MUN tokens).<sup>99</sup> The MUN tokens as well as the expected rise in value was furthermore actively marketed online.<sup>100</sup> Against this background, the SEC considered the MUN tokens as securities

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<sup>94</sup> *Id.* at 16-17.

<sup>95</sup> *Id.* DAO Report at 10.

<sup>96</sup> *See also, e.g., SEC v. PlexCorps*, 17 Civ. 7007 (E. D. N. Y. 2017), 2017 U.S. Dist. LEXIS 206145; *In Re SimplyVital Health, Inc.*, Securities Act Release No. 10671, File No. 3-19332 (SEC Aug. 12, 2019).

<sup>97</sup> *In Re Munchee Inc.*, Securities Act Release No. 10445, File No. 3-18304 (SEC Dec. 11, 2017).

<sup>98</sup> *Id.* at 1-8, 25.

<sup>99</sup> *Id.* at 10-13.

<sup>100</sup> *Id.* at 14-20.

because the token sale involved an investment contract: Investors paid Ether or Bitcoin in exchange for the token while having a reasonable expectation of profits because of the expected rise of the MUN tokens' value; at the same time, the potential profits were to be derived from the entrepreneurial and managerial efforts of Munchee at and its agents.<sup>101</sup> This resulted in a violation of the Securities Act.<sup>102</sup>

### **5.2.2. In Re Tomahawk Exploration**

Tomahawk Exploration LLC, an oil and gas exploration company, desired to raise funds for an exploration project by issuing “Tomahawkcoins” (TOM). In promoting the offering, the company highlighted several benefits associated with the tokens, stating that the TOM was backed by the profits of the exploration efforts; furthermore, the tokens could be traded on the secondary market and possessed an “equity conversion feature”, meaning that the tokens could ultimately be exchanged for shares in the company.<sup>103</sup> In the following, TOM tokens were issued on a decentralized platform (primarily to pay for online promotional efforts), however, the ICO failed to raise any money.<sup>104</sup> In the following, the SEC considered TOM tokens to constitute securities. Especially, the SEC underscored the option to convert the tokens into equity share.<sup>105</sup>

### **5.2.3. In Re Tokenlot**

In *Tokenlot*, the SEC considered an online platform that sold digital tokens issued . The tokens were marketed on behalf of the issuers in exchange for a fee and/or sold in connection with ICOs of other entities or secondary market trading.<sup>106</sup> In this context, the platform acted as a

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<sup>101</sup> *Id.* at 30-35.

<sup>102</sup> *Id.* at 37.

<sup>103</sup> *In Re Tomahawk Exploration LLC*, Securities Act Release No. 10530 at 9-20, File No. 3-18641 (SEC Aug. 14, 2018).

<sup>104</sup> *Id.* at 21-24.

<sup>105</sup> *Id.* at 31 (“TOM represented the right to an equity share of Tomohawk, including returns based on the issuer’s profits, and holders had the absolute right to transfer them on a decentralized trading platform such that TOM were in economic substance analogous to ordinary shares of stock”); *see also* Section 3(a)(11) Exchange Act.

<sup>106</sup> *In Re Tokenlot, LLC*, Securities Act Release No. 10543 at 6-8, File No. 3-18739 (SEC Sept. 11, 2018).

broker or dealer in handling investor purchase orders.<sup>107</sup> However, no registration with the SEC had been filed. For this reason, the authority found a violation of the Exchange Act and the Securities Act.<sup>108</sup>

#### **5.2.4. In Re Paragon Coin**

The *Paragon* case involved an ICO that aimed to raise funds for the development of blockchain products related to the cannabis industry as well as for the support for the legalization of cannabis; for this reason, it was planned to issue the “ParagonCoin” (PRG).<sup>109</sup> The collected amounts should be spent on the development and implementation of the business model, especially on the acquisition of real-estate for co-working space (“ParagonSpace”) for cannabis-related businesses.<sup>110</sup> This was part of the more general aim to build an ecosystems that would lead to an increase in value of the PRG tokens. This was coupled with a “deflation algorithm” and “burning” of certain tokens – which was meant to control the supply of the tokens to increase their value – as well as a “Controlled Reserve Fund” to keep the price stable.<sup>111</sup> Eventually, the ICO raised digital assets (Bitcoin, Ether, Monero and many others) corresponding to about 12 million USD and PRG tokens were distributed on the Ethereum Blockchain. Furthermore, the tokens could be traded on various trading platforms.<sup>112</sup> Against this background, the SEC found that investors had a reasonable expectation of obtaining future profits and the profits would be derived from the Paragon’s and its agents’ efforts.<sup>113</sup> As a consequence, the SEC concluded that the PRG tokens met all elements of the *Howey* test and found a violation the Securities Act since no registration had been filed.<sup>114</sup>

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<sup>107</sup> *Id.* at 11-13.

<sup>108</sup> *Id.* at 14.

<sup>109</sup> *In Re Paragon Coin, Inc.*, Securities Act Release No. 10574 at 1-10, File No. 3-18897 (SEC Nov. 16, 2018).

<sup>110</sup> *Id.* at 11.

<sup>111</sup> *Id.* at 20-28.

<sup>112</sup> *Id.* at 15-18.

<sup>113</sup> *Id.* at 29-37.

<sup>114</sup> *Id.* at 38-47.

### **5.2.5. In Re Crypto Assets Management**

In this case, the SEC dealt with Crypto Asset Management (CAM), a company that acted as managing member of and manager to Crypto Asset Fund, LLC (CAF), managing about 37 million USD in assets.<sup>115</sup> In 2017, an amount of over 3,6 million USD was raised from investors.<sup>116</sup> According to the SEC, CAF met the definition of an “investment company” within the meaning of the Investment Company Act and violated the act due to its failure to register properly with the Commission.<sup>117</sup> In addition, the SEC found that CAF had negligently misrepresented information about the company.<sup>118</sup> With respect to CAM, the SEC found a violation of the Securities Act and the Advisers Act.<sup>119</sup>

### **5.2.6. In Re CarrierEQ (AirFox)**

The *AirFox* case revolved around a business that sold technology to mobile communications companies that enabled the customers of those companies to earn free or discounted airtime or data by viewing advertisements. Soon after, AirFox released an app directed towards consumers which allowed users to earn “AirTokens” by viewing advertisements in the app; the tokens could be exchanged for free airtime or data from several prepaid mobile telecommunications providers.<sup>120</sup> In the following, AirFox launched an ICO with the aim of selling AirTokens on the Ethereum Blockchain. AirFox intended the tokens to be used to buy mobile data and, ultimately, other goods and services, and added a microloan component for token holders. AirFox required purchasers to agree that they were buying the tokens as a medium of exchange, and as not an investment; in parallel, however, the white paper envisioned the creation of an AirToken ecosystem. Moreover, plans were made to trade the tokens on the secondary market and AirFox’s marketing efforts – that were primarily geared towards investors – at least implied

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<sup>115</sup> *In Re Crypto Assets Management, LP*, Securities Act Release No. 10544 at 1-4, File No. 3-18740 (SEC Sept. 11, 2018).

<sup>116</sup> *Id.* at 5.

<sup>117</sup> *Id.* at 7-8.

<sup>118</sup> *Id.* at 9.

<sup>119</sup> *Id.* at 22-24 (as well as rule 206(4)-8 thereunder).

<sup>120</sup> *In Re Carriereq, Inc.*, Securities Act Release No. 10575 at 1-3, File No. 3-18898 (SEC Nov. 16, 2018).



that the tokens would rise in value as a result of the company's efforts.<sup>121</sup> The ICO eventually collected 15 million USD by selling over a billion tokens to more than 2,500 investors.<sup>122</sup> In light of these developments, the SEC considered the elements of the *Howey* test to be fulfilled and classified the AirTokens as securities.<sup>123</sup> As a consequence, the SEC found a violation of the Securities Act.<sup>124</sup>

### 5.2.7. In Re Coburn

In the *Coburn* case, the SEC investigated into the activities of EtherDelta, a platform for the trading of Ether and ERC20 tokens. The platform possessed features similar to online securities platforms, providing access to an orderbook for each Ether/ERC 20 token pair, user accounts for deposits, withdrawals and trading interest, as well as daily transaction volumes and related information.<sup>125</sup> EtherDelta's business operations were defined and executed via a special smart contract that ran on the Ethereum Blockchain.<sup>126</sup> Before tokens were officially listed and thus available for trading on EtherDelta, a due diligence analysis was performed on these tokens by the person in control of the platform.<sup>127</sup> Fees were charged to the "takers" – *i.e.*, the persons who responded to an order to buy or sell a particular crypto-asset – and were expressed as a percentage of a transaction's trade volume.<sup>128</sup> According to the SEC's analysis, EtherDelta constituted an exchange within the meaning of the Exchange Act because it operated as a market place for trading of tokens that included securities.<sup>129</sup> Since no registration had been filed with the Commission, the SEC found a violation of the Exchange Act.

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<sup>121</sup> *Id.* at 7-16.

<sup>122</sup> *Id.* at 6.

<sup>123</sup> *Id.* at 17-23.

<sup>124</sup> *Id.* at 24-26.

<sup>125</sup> *In Re Coburn*, Securities Exchange Act Release No. 84553 at 7, File No. 3-18888 (SEC Nov. 8, 2018). For more details on the design and functioning of the order book *see id.* at 14-19.

<sup>126</sup> *Id.* at 9-10.

<sup>127</sup> *Id.* at 13.

<sup>128</sup> *Id.* at 14, 22.

<sup>129</sup> *Id.* at 23-27.

### **5.2.8. In Re Gladius Network**

*Gladius* involved a company that developed a blockchain-based P2P network for the provision of cybersecurity services, especially against Distributed Denial-of-Service (DDoS) Attacks. Based on autonomously negotiated contracts, participants would be able to purchase spare bandwidth and storage space from individuals and businesses that were grouped into “pools” and organized by “pool managers”.<sup>130</sup> *Gladius* conducted an ICO – emitting the “GLA Token” on the Ethereum Blockchain – to fund the further development of the project; at the same time, the only way to make purchases in the network would be said tokens.<sup>131</sup> The SEC was of the opinion that purchasers of the token had a reasonable expectation of profits derived from *Gladius*’s efforts, regardless of the fact that the GLA token was primarily directed at the provision of a service (access to the network). This was because *Gladius* had suggested during its marketing campaign that the token would increase in value and would be available for trading on the secondary market.<sup>132</sup>

### **5.2.9. SEC v. Telegram**

A recent case centered on Telegram (a company that is best known for its messenger service) and its plan to issue crypto-assets (“Grams”) on a new blockchain (“Telegram Open Network”, “TON”).<sup>133</sup> The blockchain was conceived as a Proof of Stake system and validators would receive Grams for their efforts. In 2018, Telegram sold Grams (to be transferred upon the launch of the TON Blockchain) to 175 entities and individuals for fiat money, and filed a Form D, claiming an exception under Rule 506(c).<sup>134</sup> In its marketing materials, Telegrams had expressed, inter alia, the intention to promote Grams as a “mass market cryptocurrency”, also to be used in its messenger.<sup>135</sup> In the proceeding, Telegram conceded that the sale of Grams to

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<sup>130</sup> *In Re Gladius Network LLC*, Securities Act Release No. 10608 at 6-8, File No. 3-19004 (SEC Feb. 20, 2019).

<sup>131</sup> *Id.* at 9-11.

<sup>132</sup> *Id.* at 20-23.

<sup>133</sup> *Telegram*, 2020 U.S. Dist. LEXIS 53846 at 9.

<sup>134</sup> *Id.* at 9-14.

<sup>135</sup> *Id.* at 14-15.

the initial purchasers involved a security – however, subject to the exception from registration under Regulation D – and argued that the delivery of the sold Grams upon launch of the TON Blockchain constituted a different set of transactions: Upon launch, Grams should be considered as a commodity and not a security because they would have “functional consumptive uses” and could be used (like a currency) to store and transfer value.<sup>136</sup> The court, however, took a different view and assessed the purchase agreement, the future delivery and the resale of grams “in their totality” under the *Howey* test.<sup>137</sup> Analyzing the different factors of the test, the court concluded that the different transactions constituted investment contracts; in the court’s opinion, “a reasonable investor expected to profit from Telegram’s continued support for Grams and the underlying TON Blockchain through the distribution of Grams by the Initial Purchasers to the public”.<sup>138</sup> In particular, the court deemed the common enterprise element to be fulfilled (horizontal commonality) since the funds raised by Telegram were used to develop the TON Blockchain and to maintain and develop the messenger; the horizontal commonality also extended to the time after the launch of the TON-Blockchain.<sup>139</sup> Furthermore, the court found that investors had the expectation of profits stemming from the efforts of Telegram.<sup>140</sup> Lastly, the court confirmed that the exception contained in Section 4(a)(2) of the Securities Act and Rule 506(c) did not apply because the initial purchasers would function as statutory underwriters, forming part of an “ongoing public distribution of securities”.<sup>141</sup>

#### **5.2.10. United States v. Zaslavskiy**

*Zaslavskiy* centered on two companies founded by the same person. On the one hand, Recoin, a real estate investment company, planned to develop a real estate-related smart contract; on the other hand, Diamond was a company that allegedly invested in diamonds. Both companies

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<sup>136</sup> *Id.* at 25-26.

<sup>137</sup> *Id.* at 26-27, 59-60.

<sup>138</sup> *Id.* at 28.

<sup>139</sup> *Id.* at 31-36 (also stating that the SEC had showed vertical commonality).

<sup>140</sup> *Id.* at 36-47 and 47-59 (Telegram had argued that the initial purchasers acquired Grams with the expectation to use them as a currency).

<sup>141</sup> *Id.* at 61-62.

emitted tokens in connection with ICOs, offering investment opportunities.<sup>142</sup> While the Recoin tokens were promoted as being backed by real estate investments, the Diamond ICO was marketed as an Initial Membership Offering (IMO) that offered Recoin investors the option to obtain a refund on their investments or to convert their tokens into diamond-backed tokens.<sup>143</sup> However, neither of the tokens were developed and the marketed investment activities (real estate/diamonds) never took place.<sup>144</sup> The court was of the opinion that a reasonable jury could, based on the facts alleged by the indictment, consider the Recoin and Diamond ICOs as investment contracts and thus securities.<sup>145</sup>

### **5.3. Excursus: Crypto-Assets as Commodities**

#### **5.3.1. General Remarks**

As mentioned before, the securities laws are not they only area of the law regulating crypto-assets, and the SEC is not the only authority that has asserted jurisdiction over such assets. This especially applies to the Commodity Futures Trading Commission (CFTC) that has concurrent authority with other competent authorities over certain crypto-assets.<sup>146</sup> The most important act in this respect is the Commodity Exchange Act.<sup>147</sup> Amongst other objectives, this act serves to prevent price manipulation, ensure financial integrity and to “protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets.”<sup>148</sup> The CFTC’s authority to the enforce the Commodity Exchange depends on whether a “commodity” is at issue.<sup>149</sup> Again, it is crucial to note the meaning of this central term:

The term “commodity” means wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, *Solanum tuberosum* (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock

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<sup>142</sup> *Zaslavskiy*, 2018 U.S. Dist. LEXIS 156574 at 3.

<sup>143</sup> *Id.* at 3-6.

<sup>144</sup> *Id.*

<sup>145</sup> *Id.* at 14-23.

<sup>146</sup> *McDonnell*, 287 F. Supp. 3d 213 at 217, 220.

<sup>147</sup> 7 U.S.C. §§ 1 et seq.

<sup>148</sup> 7 U.S.C. § 5(b).

<sup>149</sup> *Cf. Salomon Forex, Inc. v. Tauber*, 8 F.3d 966, 972 (4th Cir. 1993).

products, and frozen concentrated orange juice, and all other goods and articles, except onions (as provided by section 13–1 of this title) and motion picture box office receipts (or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in.<sup>150</sup>

Looking at the examples given by the definition (that mainly relate to the agricultural sector), it might seem odd that the notion can extend to crypto-assets. However, the statutory language includes more generally “all other goods and articles [...], and all services, rights, and interests [...] in which contracts for future delivery are presently or in the future dealt in.” Hence, the notion is unquestionably broad. For instance, courts have deemed the definition to include intangible assets.<sup>151</sup> However, as the last sentence of the definition indicates,<sup>152</sup> the Commodity Exchange Act primarily aims to regulate the futures market; however, nowadays, the power of the CFTC also extends to spot markets in order to prevent fraud or manipulation.<sup>153</sup> Furthermore, the act regulates exchanges that futures are traded on.<sup>154</sup>

### 5.3.2. In Re Coinflip

In the *Coinflip* case, the CFTC dealt with Coinflip, a corporation that operated a platform for the trading of standardized Bitcoin options and futures contracts.<sup>155</sup> The CFTC found that the definition of a commodity was “broad”, that Bitcoin and other virtual currencies were commodities within the meaning of the Commodity Exchange Act and that Coinflip had conducted activity related to commodity exchange transactions.<sup>156</sup> Hence, since Coinflip had not registered with the Commission, a violation of the Commodity Exchange Act was found.<sup>157</sup>

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<sup>150</sup> 7 U.S.C. § 1a(9).

<sup>151</sup> See, e.g., *CFTC v. McDonnell*, 287 F. Supp. 3d 213, 225-226 (E.D.N.Y. 2018), 2018 U.S. Dist. LEXIS 36854.

<sup>152</sup> Cf. *United States v. Brooks*, 681 F.3d 678, 694 (5th Cir. 2012) (“Natural gas is plainly a ‘good’ or ‘article.’ The questions thus turns on whether it is a good ‘in which contracts for future delivery are presently or in the future dealt with’”).

<sup>153</sup> Blakemore, *supra* at 220-223, 225-226 (summarizing the legislative developments); 7 U.S.C § 9, § 13(a)(2); cf. also *McDonnell*, 287 F. Supp. 3d 213 at 242.

<sup>154</sup> 7 U.S.C. § 6(a)(1); for the registration requirement for “futures commission merchants” see *id.* at § 6(d)(a).

<sup>155</sup> *In Re Coinflip*, CFTC No. 15-29 at 2-3.

<sup>156</sup> *Id.* at 3-4.

<sup>157</sup> *Id.* at 4-5.

### 5.3.3. CFTC v. McDonnell

This case involved a business that offered trading and investment services related to virtual currencies.<sup>158</sup> Investors could obtain a membership in exchange for paying virtual currency. However, the services promised were never provided to a material extent and the promised profits were never achieved; moreover, the invested funds were misappropriated. Thus, the CFTC sued and sought injunctive relief.<sup>159</sup> The court upheld the action and granted a preliminary injunction. Most importantly, the court confirmed that virtual currencies constituted commodities for being goods “exchanged in a market for a uniform quality and value”.<sup>160</sup>

### 5.3.4. CFTC v. My Big Coin Pay

The *My Big Coin* case dealt with a scheme that marketed the sale of “My Big Coin” by making several untrue and/or misleading statements (*e.g.*, that the Coin would be “backed by gold”).<sup>161</sup> The defendants argued that My Big Coin was not a commodity under the Commodity Exchange Act; however, the court sided with the CFTC, applying a broad reading to the act’s definition in connection with the anti-fraud enforcement provision of Section 6(c)(1) and finding that a virtual currency was actually a commodity.<sup>162</sup> The court stated that “there is futures trading in virtual currencies (specifically involving Bitcoin)” and considered this as sufficient for My Big Coin to be covered by the definition.<sup>163</sup>

## 6. Legislative Initiatives and Developments

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<sup>158</sup> The court used the term “virtual currency”; *see* for the court’s understanding *McDonnell*, 287 F. Supp. 3d 213 at 218.

<sup>159</sup> *Id.* at 217-218.

<sup>160</sup> *Id.* at 228 citing Mitchell Prentis, *Digital Metal: Regulating Bitcoin As A Commodity*, 66 Case W. Res. L. Rev. 609, 626 (2015).

<sup>161</sup> *CFTC v. My Big Coin Pay, Inc.*, 334 F. Supp. 3d 492, 494-495 (D. Mass. 2018), 2018 U.S. Dist. LEXIS 164932.

<sup>162</sup> *Id.* at 496-497, *see also id.* at 498-499.

<sup>163</sup> *Id.* at 498.

Both in the U.S. and E.U., the developments in legal practice were paralleled by reform projects. The following section gives an overview of legislative initiatives in the ambit of crypto-assets.

## 6.1. European Union

A reform of the European regulatory laws to specifically address crypto-assets has been on the European Commission's agenda at least since 2018. In its FinTech Action plan,<sup>164</sup> the Commission stated that it would “continue monitoring the developments of crypto-assets and Initial Coin Offerings” and that it would assess whether regulatory action was required.<sup>165</sup> Also EBA<sup>166</sup> and ESMA<sup>167</sup> urged for the assessment of the regulatory landscape with a view to potential harmonized legislation. In a similar vein, a mission letter from president-elect of the Commission von der Leyen to vice president Dombrovskis, referred to a “common approach with Member States on cryptocurrencies” to “make the most of the opportunities they create and address the new risks they may pose”.<sup>168</sup>

In a 2019 study mandated by the Commission, the Expert Group on Regulatory Obstacles to Financial Innovation (ROFIEG) gave its opinion on the legal status quo on a wide array of topics relating to FinTech and made various recommendations for improvements. With regard to “distributed financial networks” based on the blockchain technology, ROFIEG underlined that the applicability of the current regulatory rules and the relationships between the different

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<sup>164</sup> European Commission, Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, *FinTech Action plan: For a more competitive and innovative European financial sector*, COM(2018) 109 final, available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018DC0109>.

<sup>165</sup> *Id.* at 7.

<sup>166</sup> EBA Report 2019 at 29 (“[...] EBA advises the European Commission to carry out a cost/benefit analysis to assess, on a holistic basis, whether EU-level action is appropriate and feasible at this stage to address the issues identified”).

<sup>167</sup> ESMA Advice 2019 at 40-41. This was continued in the ESMA orientation for 2020-2022, see *European Securities and Markets Authority, ESMA Strategic Orientation 2020-2022* (2020) [https://www.esma.europa.eu/sites/default/files/library/esma22-106-1942\\_strategic\\_orientation\\_2020-22.pdf](https://www.esma.europa.eu/sites/default/files/library/esma22-106-1942_strategic_orientation_2020-22.pdf) (“The dangers of cyberthreats to the financial system as a whole and a sound legal framework for crypto-assets are increasingly becoming areas of focus for ESMA together with the other ESAs, the ESRB, the ECB and the European Commission”).

<sup>168</sup> Ursula von der Leyen, *Mission Letter* 6 (2019), [https://ec.europa.eu/commission/sites/beta-political/files/mission-letter-valdis-dombrovskis-2019\\_en.pdf](https://ec.europa.eu/commission/sites/beta-political/files/mission-letter-valdis-dombrovskis-2019_en.pdf).

network participants were not fully clarified, specifically stressing the need to define the addressees of the different legal instruments as well as private key management.<sup>169</sup> With regard to crypto-assets, ROFIEG highlighted the lack of a common taxonomy and the need for a harmonized approach to address risks flowing from, inter alia, money laundering, terrorist financing, tax evasion, governance and operation resilience etc.<sup>170</sup> Furthermore, special rules for a “commercial law of crypto-assets” were proposed, especially in respect of instruments such as the Insolvency Regulation,<sup>171</sup> the Settlement Finality Directive<sup>172</sup> or the Bank Winding Up Directive.<sup>173</sup> Here, ROFIEG suggested enacting relevant conflict-of-laws rules as well as considering whether further aspects of commercial needed to be harmonized on the EU level, making reference to “property, corporate and insolvency law aspects” of crypto-assets.<sup>174</sup>

Furthermore, the EU Commission started a public consultation on the regulatory framework for crypto-assets in 2019.<sup>175</sup> Currently, the Commission is working on a proposal for a regulation that is expected to be published later this year.<sup>176</sup>

## 6.2. United States

With regard to the U.S., three reform projects shall be specifically mentioned.<sup>177</sup> Frist, the Token Taxonomy Act of 2019 was introduced in 2019.<sup>178</sup> In a nutshell, the bill aims to exclude

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<sup>169</sup> Expert Group on Regulatory Obstacle to Financial Innovation, 30 *Recommendations On Regulation, Innovation and Finance* 48 (2019), [https://ec.europa.eu/info/sites/info/files/business\\_economy\\_euro/banking\\_and\\_finance/documents/191113-report-expert-group-regulatory-obstacles-financial-innovation\\_en.pdf](https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/191113-report-expert-group-regulatory-obstacles-financial-innovation_en.pdf) (Recommendation 6).

<sup>170</sup> ROFIEG, *supra* at 52 (Recommendation 7).

<sup>171</sup> Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings, 2015 O.J. (L141), 19-72.

<sup>172</sup> Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems, 1998 O.J. (L166), 45-50.

<sup>173</sup> Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions, 2001, O.J. (L125), 15-23.

<sup>174</sup> ROFIEG, *supra* at 58 (Recommendation 8).

<sup>175</sup> European Commission, *Financial services – EU regulatory framework for crypto-assets*, <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12089-Directive-regulation-establishing-a-European-framework-for-markets-in-crypto-assets/public-consultation> (last visited Sept. 10, 2020).

<sup>176</sup> *Id.* (“Third quarter 2020”).

<sup>177</sup> See also, e.g., U.S. Virtual Currency Market and Regulatory Competitiveness Act of 2018, H.R.7225, 115th Cong. (2017-2018); Virtual Currency Consumer Protection Act of 2018, H.R.7224, 115th Cong. (2017-2018).

<sup>178</sup> Token Taxonomy Act of 2019, H.R. 2144, 116th Cong. (2019-2020).



digital tokens from the notion of “security” under the Securities Act and to introduce further changes, also relating to matters of taxation. For this purpose, the bill contains, first, amendments to the Securities Act of 1933, adding a detailed definition of “digital token” and altering the definition of “security” itself in order to exclude “digital tokens” from its scope.<sup>179</sup> Second, an exception would be added to § 4(a) of Securities Act of 1933<sup>180</sup> relating to “transactions involving the offer, promotion, or sale of a digital unit”. Should the SEC determine that the digital unit is considered to be a security, it would notify the respective person and further steps would have to be taken by this person. This includes taking reasonable efforts to cease all sales and return all proceeds from any sales of the digital unit; however, this does not relate to amounts reasonably spent on the development of technology associated with the digital unit.<sup>181</sup> Furthermore, the bill provides for the preemption of state laws with respect to digital tokens.<sup>182</sup> Digital tokens would also be excluded from the scope of the concept “security” under the Securities Exchange Act of 1934, the Investment Advisers Act of 1940 and the Investment Company Act of 1940.<sup>183</sup>

Second, in spring 2020, new legislation was introduced in the form of the Crypto-Currency Act of 2020.<sup>184</sup> The main objective of the bill is to “clarify which Federal agencies regulate digital assets” as well as “to require those agencies to notify the public of any Federal licenses, certifications, or registrations required to create or trade in such assets”. For this purpose, the draft legislation, on the one hand, provides for an array of definitions of the terms “crypto-commodity”, “crypto-currency”, “crypto-security”, “decentralized cryptographic ledger”, “digital assets” etc.<sup>185</sup> On the other hand, the bill delineates the areas of primary regulatory oversight and the competent authorities: The CFTC’s jurisdiction would cover crypto-

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<sup>179</sup> Token Taxonomy Act of 2019 § 2.

<sup>180</sup> 15 U.S.C. § 77d(a).

<sup>181</sup> Token Taxonomy Act of 2019 § 2(c).

<sup>182</sup> Token Taxonomy Act of 2019 § 2(d).

<sup>183</sup> *Id.* at §§ 3-5.

<sup>184</sup> Crypto-Currency Act of 2020, H.R. 6154, 116th Cong. (2019-2020).

<sup>185</sup> Crypto-Currency Act of 2020 § 2.

commodities, the Secretary of the Treasury and the Comptroller of the Currency would have jurisdiction with respect to crypto-currencies (other than synthetic stable coins) and the SEC would deal with crypto-securities and synthetic stablecoins.<sup>186</sup> Exchanges trading the mentioned digital assets would have to register with the respective authority.<sup>187</sup> Lastly, the bill primarily deals with transparency and the tracing of transaction in crypto-currencies.<sup>188</sup>

Third, the Uniform Law Commission<sup>189</sup> completed its draft of the Uniform Regulation of Virtual-Currency Businesses Act (URVCBA) in 2017.<sup>190</sup> At the basic level, the act applies to the “virtual currency business activity of a person, wherever located, that engages in or holds itself out as engaging in the activity with or on behalf of a resident.”<sup>191</sup> In this case, the act provides for a licensing requirement unless the activity in question is covered by an exception.<sup>192</sup> Besides the provisions relating to the licensing process, regulatory oversight and enforcement, the act provides for disclosure obligations when dealing with residents.<sup>193</sup> It is important to note that this act aims at issues that are regulated on the state level, not on the federal level. According to its website, Rhode Island has already enacted the URVCBA, while California, Oklahoma and Hawaii have introduced it.<sup>194</sup> Furthermore, the Uniform Law Commission published the Uniform Supplemental Commercial Law for the Uniform Regulation of Virtual Currency Businesses Act<sup>195</sup> that further specifies the relationship between the person that is licensed or registered under the URVCBA and a user/resident. For this

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<sup>186</sup> Crypto-Currency Act of 2020 § 3.

<sup>187</sup> Crypto-Currency Act of 2020 § 4.

<sup>188</sup> Crypto-Currency Act of 2020 §§ 5-6.

<sup>189</sup> Uniform Law Commission, *Overview*, <https://www.uniformlaws.org/home> (last visited Sept. 10, 2020); the Commission is also known as the National Conference of Commissioners on Uniform State Laws.

<sup>190</sup> The document can be accessed via <https://www.uniformlaws.org/viewdocument/final-act-no-comments-64?CommunityKey=e104aaa8-c10f-45a7-a34a-0423c2106778&tab=librarydocuments> (last visited Sept. 10, 2020).

<sup>191</sup> URVCBA § 103(a); the definitions are listed in § 102.

<sup>192</sup> URVCBA § 201 et seq.

<sup>193</sup> URVCBA § 501.

<sup>194</sup> Uniform Law Commission, *Virtual-Currency Businesses Act, Regulation of*, <https://www.uniformlaws.org/committees/community-home?CommunityKey=e104aaa8-c10f-45a7-a34a-0423c2106778> (last visited Sept. 10, 2020).

<sup>195</sup> The document can be accessed via <https://www.uniformlaws.org/viewdocument/final-act-no-comments-70?CommunityKey=fc398fb5-2885-4efb-a3bb-508650106f95&tab=librarydocuments>.

purpose, section 4 of the act incorporates article 8 of the Uniform Commercial Code into the corresponding agreements.

## **7. Observations and Discussion on the Application of the Securities Laws to Crypto-Assets**

The following section builds on the developments highlighted above and compares the European and U.S. experiences with regard to the regulation of crypto-assets and the enforcement of the securities laws.

### **7.1. The Old Story of Technology, Fragmentation and Confusion**

In many respects, the emergence of crypto-assets and the blockchain technology is a tale of lawyers and regulators struggling with the advent of new technologies. Financial market law is but one example of this struggle that one has been able to observe in multiple other areas of law. One example would be copyright law that has constantly adapted to new technological developments (such as the internet) by extending rights of rights holders also to these new areas.<sup>196</sup> Obviously, the emergence of the distributed ledger technology in the financial markets poses particular challenges: As evidenced by the experiences during the last years, fraudulent ICOs have the potential to cause enormous losses for investors and one must also clearly take seriously the concern that crypto-assets might be used to fund criminal purposes. Certain crypto-assets might even have the potential to put at risk the financial system as such or threaten the autonomy of countries with regard to the fiscal policies.<sup>197</sup> In this light, it is not surprising that many regulators prefer to take a conservative approach to the new technology, at least as far as its functioning and implications are not fully understood. At the same time, numerous enterprises and startups have a legitimate interest in using the advantages of the new technology

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<sup>196</sup> Cf. Martin Miernicki, *Collective Management of Copyrights between Competition, Regulation, and Monopolism* 25-27 (2017) (discussing the development of copyright law in the context of the collective management of copyrights).

<sup>197</sup> Great concerns exist regarding Facebook's Libra; see, e.g., Godfrey Benjamin, *Five EU Member States Take Position Against Stablecoins*, <https://blockchain.news/news/five-eu-member-states-take-position-stablecoins> (last visited Sept. 13, 2020).

and too heavy regulatory burdens – let alone total bans – run the danger of making innovation impossible. At this point, finding the right balance between regulatory oversight, prohibited activities and unregulated areas resembles walking on a tight rope that seems to be a task for law-makers rather than for enforcement agencies. From this perspective, the emergence of the blockchain technology and its various applications also test the “elasticity” of the current regulatory framework, revealing regulatory gaps and room for legislative improvements.

As the experiences in both the E.U. and the U.S. show, the regulatory framework for crypto-assets is fragmented in at least two respects: First with regard to the competent authorities and second with regard to the territorial scope of the different laws. The former is closely related to the different characteristics that crypto-assets can possess (commodity, “currency”, security) and is demonstrated by the different regulatory authorities that have given their opinion on crypto-assets on both sides of the Atlantic. As can be seen, it is strongly considered as necessary to standardize the relevant terminology and to clarify the competence of the different authorities. The Crypto-Currency Act of 2020 addresses this issue by attempting to clearly delineate the respective competencies of the relevant regulatory authorities. Territorial fragmentation especially exists to the E.U.. This is implied by the enforcement structure that rests on national competent authorities and suggested by the reports on the varying implementation and interpretation of the MiFID II, as well as additional national legislation. However, as federal legislation is generally confined to interstate commerce, territorial fragmentation might also exist in the in the U.S.; legislation on the state level specifically dealing with crypto-assets has been reported<sup>198</sup> and the model acts drafted by the Uniform Law Commission described above are non-binding recommendations. The foregoing goes to show that the problems connected to the regulation of crypto-assets are, by their nature, not specific

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<sup>198</sup> See, e.g., Marco Dell’Erba, *supra* at 217 (mentioning legislation in the state of Wyoming).

to those assets<sup>199</sup> but have occurred and have been dealt with before in other contexts. However, the complexities of the financial markets and the potentially far-reaching implications of a regulatory decision explain why a solution has not come over night.

Another problem that is not new but rather a lawyer's basic task is the application of existing general laws to specific new developments. The interpretation of the notions "security" or "commodity" are prime examples for this challenge. However, legal certainty and the predictability of the authorities' decision are at stake here; especially in the earlier days of ICOs, there appeared to be a wide gap between regulators and crypto-enthusiasts and it is not clear whether this gap has been bridged.<sup>200</sup> This wide gap partly stems from the uncertainty how to apply the existing rules. The unclear legal landscape has been identified by many commentators as the main problem for ICOs and companies in the blockchain scene.<sup>201</sup> While it has certainly been established that crypto-assets do not operate in a legal vacuum, communicating this fact to those affected by the regulation has certainly been a bumpy journey. The tendency of regulators to issue several enforcement actions rather than general rules is sometimes criticized as "regulation by enforcement".<sup>202</sup> However, this could also be understood as a reflection of the underlying laws: Where a definition is vague, details must be clarified in the individual case. With the DAO Report, the SEC arguably made a successful effort in communicating its opinion on crypto-assets; on this basis, a string of cases ensued that applied the principle laid down beforehand. A related tendency that can be observed in practice is that supervisory authorities establish "points of contact" and websites specially dedicated to ICOs to make the regulatory

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<sup>199</sup> Cf. also Board of the International Organization of Securities Commissions, *Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms* 6 (2020), available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD649.pdf> ("Many of the issues and risks associated with trading on [Crypto-asset Trading Platforms] are similar to the issues and risks associated with trading traditional securities or other financial instruments on Trading Venues") (in connection with trading platforms).

<sup>200</sup> Cf. Usha R. Rodrigues, *The Rise of FinTech: Embrace the SEC*, 61 Wash. U. J. L. & Pol'y 133, 147-150 (2020).

<sup>201</sup> See, e.g., ESMA Advice 2019 at 18; Hacker & Thomale, *supra* at 690.

<sup>202</sup> James J. Park & Howard H. Park, *The Rise of FinTech: Regulation by Selective Enforcement: The SEC and Initial Coin Offerings*, 61 Wash. U. J. L. & Pol'y 99, 99-101 (highlighting that this is not only the case with regard to ICOs, but also to insider trading, securities fraud etc.).

rules more accessible to potential crypto-entrepreneurs, thereby enhancing transparency.<sup>203</sup> However, should regulation *de lege lata* simply not be suited for crypto-assets, this can only constitute a preliminary measure until proper solutions are found.

## 7.2. The Different Treatment of Utility and Hybrid Tokens under U.S. and European Securities Law

The outline of regulatory environments and enforcements activities show that, from a legal point of view, crypto-assets are a rather inhomogeneous collection of different assets; the fact that crypto-assets are based in some form on the distributed ledger/blockchain technology does not mean that the same regulatory rules apply. U.S. and E.U. securities laws are applied in a convergent way at least in respect of “pure” investment tokens (that are certainly covered by existing regulation) and “pure” payment tokens (that are likely not). However, it is hard to draw the line between rather clear-cut cases like the DAO and hybrid forms of tokens that involve several essential components. According to the SEC’s enforcement policy, it appears that utility tokens will usually be subject to the Securities Act – even absent participation or ownership rights – if the issuer promises or implies that tokens will rise in value and can be sold for profits on secondary markets, especially on trading platforms. This expectation of profits is oftentimes the crucial point to tip the scale under the *Howey* Test and can be put in relation to the *contractual* approach taken in the U.S. that relies on the existence of an “investment contract”: For construction of what exactly the issuer offers potential investors, one will have to consider – not only in the capital market context – what the issuer stated or implied before the conclusion of the contract, also in marketing campaigns or promotional materials.<sup>204</sup> This seems to be in

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<sup>203</sup> See, e.g., Bundesanstalt für Finanzdienstleistungsaufsicht, *Merkblatt zu ICOs*, [https://www.bafin.de/SharedDocs/Downloads/EN/Merkblatt/WA/dl\\_wa\\_merkblatt\\_ICOs\\_en.html](https://www.bafin.de/SharedDocs/Downloads/EN/Merkblatt/WA/dl_wa_merkblatt_ICOs_en.html) (last visited Sept. 10, 2020); Finanzmarktaufsichtsbehörde, *ICOs*, <https://www.fma.gv.at/en/contact-point-fintech-sandbox/fintech-navigator/initial-coin-offerings/> (last visited Sept. 10, 2020); Securities Exchange Commission, *Spotlight on Initial Coin Offerings (ICOs)*, <https://www.sec.gov/ICO> and <https://www.sec.gov/finhub> (last visited Sept. 10, 2020).

<sup>204</sup> Cf., e.g., *Blockvest*, 2018 U.S. Dist. LEXIS 200773 at 17 citing *Warfield v. Alaniz*, 569 F.3d 1015, 1021 (9th Cir. 2009) (“At the outset, we note that, while the subjective intent of the purchasers may have some bearing on the issue of whether they entered into investment contracts, we must focus our inquiry on what the purchasers were offered or promised”) and *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 334, 352-353 (1943) (“The test [for

line with the principle that one must look at the (objective) perspective of the investor,<sup>205</sup> as this person would most likely take the issuer's promises as commonly understood into account for her investment decision. Thus, it seems that not only the explicitly stated contents of the contract but also surrounding circumstances play an important role under the *Howey* test. The question is then, of course, whether the existence of a security is, in this respect,<sup>206</sup> solely built on the issuer's statements. Consider the various decisions of the SEC mentioned above: What would have been the results if the issuer had never promised an increase in value or had never marketed the tokens as being tradable on the secondary market? It seems that large parts of the Commission's grounds for deeming the tokens securities were in fact connected to such statements. This can also be applied to "pure" payment tokens and cryptocurrencies: If the issuer does not promise anything but the delivery of the token that can then be used as a means of exchange, the securities laws do not apply and there does not seem to be a good reason why they should. However, this also means that, to a certain extent, the issuer can influence the application of the securities laws by carefully choosing the language in the statements prior to the ICO.

The definition of "transferable securities" in the MiFID II expressly sets forth different elements in detail and does not, unlike the *Howey* test, refer to elements such as a "reasonable expectation of profit" derived from the "managerial efforts" of others. This is sometimes called a "black letter approach" that was implemented to ensure a uniform application of the definition.<sup>207</sup> Against this background, one might ask whether the MiFID II's definition can be aligned with

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determining whether an instrument is a security]... is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducement held out to the prospect").

<sup>205</sup> Cf., e.g., *Telegram*, 2020 U.S. Dist. LEXIS 53846 at 44 ("Consumptive uses for Grams were not features that could reasonably be expected to appeal to the Initial Purchasers targeted by Telegram").

<sup>206</sup> The *Blockvest* court cited the mentioned authorities in connection with the first prong of the *Howey* test ("investment of money"); however, it seems that an equivalent analysis is carried out with regard to the expectations of profit, see *Telegram*, 2020 U.S. Dist. LEXIS 53846 at 43 ("Telegram's offering materials targeted buyers who possessed investment intent. Promotional materials emphasizing opportunities for potential profit can demonstrate that purchasers possessed the required expectation of profits") (referring to *Forman*, 421 U.S. at 853-854; *Edwards*, 540 U.S. 389 at 392).

<sup>207</sup> Maume & Fromberger, *supra* at 572-573.

the *Howey* test. As already mentioned, convergence can generally be assumed for currency and investment tokens. The situation with regard to utility tokens is more complicated, however. While “pure” utility tokens would – similar to the legal situation quo in the E.U. – most likely not be considered as securities in the U.S.,<sup>208</sup> the cases outlined above suggest that the SEC will only reluctantly assume a token that conveys “pure” utility.<sup>209</sup> Here, one gets the impression that also the presence of an “ancillary” investment component triggers the application of the securities laws.<sup>210</sup> While transferability does not automatically mean that a token is a security,<sup>211</sup> one can assume that a utility token that is not transferrable by its technical nature would not be considered as a security because the investment component would blur.<sup>212</sup> The same result can be expected under the MiFID II that expressly provides for the transferability requirement.<sup>213</sup> The skeptical attitude vis-à-vis utility tokens under U.S. securities laws is summarized by *Rodrigues*, stating that “consumptive tokens are suboptimal digital assets which their promoters stripped of key investor protections like voting rights, in a futile effort to avoid regulation”.<sup>214</sup> Besides the issue of transferability, the ESMA Report 2019 appears to suggest that E.U. securities regulators take a more lenient approach to utility tokens than their U.S. counterpart. As will be discussed shortly, this is in fact well in line with the securities definition of the MiFID II. While the definition does not make an explicit mention to this effect, already the

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<sup>208</sup> See, e.g., Rohr & Wright, *supra*, at 488-502; Houman B. Shadab, *Regulation of Blockchain Token Sales in the United States*, in *Regulating Blockchain* (Philipp Hacker, Ioannis Lianos, Georgio Dimitropoulos & Stefan Eich eds., 2019) 249, 250, 253.

<sup>209</sup> Cf. the statement made by Securities and Exchange Commission chairman Clayton stated in hearing before the U.S. Senate (“I believe every ICO I’ve seen is a security”), see Stan Higgins, *SEC Chief Clayton: ‘Every ICO I’ve Seen Is a Security’*, <https://www.coindesk.com/sec-chief-clayton-every-ico-ive-seen-security> (last visited Sept. 10, 2020).

<sup>210</sup> Cf. Hacker & Thomale, *supra* at 682 (“The tiniest shred of security component infects the complete token”).

<sup>211</sup> Rohr & Wright, *supra*, at 496.

<sup>212</sup> Rodrigues, *supra* at 151; see, however, Maume & Fromberger, *supra* at 571 (“By focusing on the tradability of tokens on the secondary capital market, the E.U. framework completely differs from the investment-based approach taken by the others jurisdictions discussed above”) and 574 (“This is a significant difference from the *Howey* test under U.S. securities regulation, which does not relate to transferability at all”).

<sup>213</sup> Hacker & Thomale, *supra* at 664. One could argue, of course, that the token would still be transferrable by passing on the private key to the acquirer. However, it is questionable whether this would meet the statutory requirements of a security, given that this way of “selling” a token does not seem to be suited for large-scale trading; furthermore, the person selling the token will usually retain knowledge of the private key.

<sup>214</sup> Rodrigues, *supra* at 144; see also *id.* at 152.



notion of a public “offer” contained in the Prospectus Regulation<sup>215</sup> presupposes that the investor will conclude a contract to acquire the securities that one might label as a kind of “investment contract”. However, that does not mean that these contracts are assessed in the way an “investment contract” under the *Howey* test would. It should be noted that according to the SEC’s application of the test, the expectation of profits can be derived either from a “claim” against the company (*e.g.*, payment of dividends) or from circumstances associated to the investment contract; an example would be that the company expresses plans to work towards an increase in value of the tokens that can be realized by trading on the secondary market. However, there is a clear difference between these two types of expectations: The expectations as regards the rights conveyed by a contract (or membership) should be distinguished from the expectations as regards a token’s potential appreciation of value over time, at least from the perspective of the European rules on securities. To this effect, *Hacker & Thomale* convincingly argue that utility tokens generally “do not qualify as securities since they lack the decisive profit occasion of shares, the participation in future cash flows and in liquidation/sales proceeds of the company”; an exception can be made where the “appreciation in value aspects (as well as voting rights) are so prominent in the structure and business case of the token ecosystem that they eclipse the lack of cash flows”.<sup>216</sup> A substance-over-form approach is also advocated by the ROFIEG.<sup>217</sup> As a side note, excluding a utility token from these laws does not mean that purchasers are totally unprotected, as other areas of law – that are most likely better suited to

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<sup>215</sup> Prospectus Regulation art. 1(1).

<sup>216</sup> *Hacker & Thomale, supra* at 683-684. It is not entirely clear whether *Maume & Fromberger* reach the same results; *see Maume & Fromberger, supra* at 577 (“Therefore, if the possible return on investment can only stem from an increased value of the tokens in the secondary market, the respective token is not an investment token and *a priori* cannot be considered a “transferable security””), however, *see also id.* at 578 (voting rights might be enough to fulfill the definition) and 585 (“the only major difference [between EU and US law] is the classification of investment tokens that are not transferable due to a lockup”).

<sup>217</sup> ROFIEG, *supra* at 56.

deal with these specific issues – can step in to provide protection; an example would be consumer protection law.<sup>218</sup>

Interestingly, the Crypto-Currency Act of 2020 alludes to the treatment of a good or service in the market, stating that the term “crypto-commodity” only refers to goods and services that, inter alia, “the markets treat with no regard as to who produced the goods or services”.<sup>219</sup> This can be likely taken to mean that if the markets determine the value of a token irrespective of the issuer, the token is a commodity rather than security.<sup>220</sup> While there are certainly grey areas inherent to this definition, it potentially provides a helpful guidance to delineate the different types of tokens for the purposes of U.S. capital market law.

### **7.3. Was It, Is It, or Will It be a Security?**

A further problem in the application of the securities laws to crypto-assets relates to the relevant point in time for the legal analysis. In the context of payment tokens – that are usually considered to fall outside the scope of the securities laws – commentators highlight that the qualification of tokens as securities can in fact change over time. For instance, according to the SEC’s standards, Ether could have likely been regarded as a security initially, but is nowadays no longer considered to be subject to the securities laws.<sup>221</sup> A related argument – however, “in reverse”, as the common enterprise and the managerial efforts of others prongs were concerned – was raised, for instance, in the *Telegram* case: There, Telegram argued that the “Grams” should be evaluated at the launch of the TON Blockchain. However, the court differed and

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<sup>218</sup> Hacker & Thomale, *supra* at 683. Enforcement problems are certainly possible but can also be observed in connection with the securities laws. *See*, however, ROFIEG, *supra* at 58.

<sup>219</sup> Crypto-Currency Act of 2020 § 2(1)(B).

<sup>220</sup> For definition of „crypto-security”, *see id.* § 2(3).

<sup>221</sup> *See, e.g.*, Shadab, *supra* at 253-255; Park & Park, *supra* at 103, 124 (also mentioning *Balestra v. ATBCOIN LLC*, 380 F. Supp. 3d 340 (S. D. N. Y. 2019), 2019 U.S. Dist. LEXIS 55972, a case that involved a company that wanted to develop a blockchain to overcome, inter alia, inefficiencies within other cryptocurrencies, *see id.* at 346-347), 130-131 (arguing that Ether could in fact still be regarded as a security). Similar tendencies have been observed in connection with commodities, *see, e.g.*, Blakemore, *supra* at 224, 231-234 (arguing that the commodity definition – much like the securities definition – can change over time, so that certain assets might become or cease to be commodities). According to Blakemore, this was the case with Bitcoin that was not a commodity at least in its early days; furthermore he argues that the expression “in the future dealt in” in the Commodity Exchange Act’s definition was phrased from the point in time of the act’s adoption).

analyzed the transactions at the time they were made.<sup>222</sup> The issue of the change of a token's nature over time adds another layer of uncertainty to the *Howey* analysis. In general, by this way of application, a wide variety of ICOs seem to fall within the scope of the securities laws at least at the time of the ICO.

It is uncertain whether similar principles govern the definition of “transferable security” in the MiFID II. For instance, “negotiability” does not require the tokens to be traded on an exchange; rather, the definition also captures tokens that, based on their characteristics, could be traded in the future.<sup>223</sup> However, if one applies the test outlined above, focusing on the right of token holders to participate in the profits of the company, it is not always apparent how the legal position conveyed, without a new agreement between the parties, should change overtime, thereby altering the assessment under the definition of the MiFID II. The only avenue that comes to mind for the token to become or cease to be a security would then relate to the rare cases where the appreciation-of-value component either becomes clearly dominant or loses its central position. Furthermore, since transferability is a central element under E.U. securities laws, lockups that are either installed or removed can have a bearing on the assessment under the MiFID II.<sup>224</sup>

## **8. Remarks on the Future Regulation of Crypto-Assets**

This section reflects on different regulatory paths towards the regulation of crypto-assets. Also, it hints at possible future developments and considers different legislative options.

### **8.1. The Promises and Pitfalls of a “Black-Letter Approach”**

As indicated above, it is necessary to distinguish between different types of crypto-assets, as not all of these assets imply the same characteristics and the same risks; while crypto-assets like Bitcoin might be better assessed under the law of payment services, investment tokens are better

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<sup>222</sup> *Telegram*, 2020 U.S. Dist. LEXIS 53846 at 28-29, 59-60.

<sup>223</sup> Maume & Fromberger, *supra* at 579.

<sup>224</sup> Hacker & Thomale, *supra* at 663-664.

dealt with under the securities laws. For this purpose, regulation and potential future legislation specifically applying to crypto-assets will have to deal with the difficult task of defining different subtypes of crypto-assets;<sup>225</sup> this is exemplified, for instance, by the legislative proposals in the U.S. However, definitions can be a double-edged sword: While they might seem clear at time of drafting, some changes in the technological development or practical use might lead to significant uncertainties. Again, the problem is that law-making can only react slowly to these kinds of changes, especially if the regulatory efforts extend beyond the border of one single jurisdiction. The issue is especially apparent with regard to several hybrid forms of tokens. Here, it can be unclear whether tokens are covered by a regulatory framework; furthermore, it is conceivable that, based on ill-drafted definitions, several authorities (*e.g.*, in the banking, securities or commodity trading area), based on their respective mandates, claim jurisdiction for the same crypto-assets.<sup>226</sup> However, there is no easy answer to this problem. For the purposes of the securities laws, a functional approach<sup>227</sup> appears to be the best solution to allow for a flexible application of the regulatory standards to new forms of token. What is more, there is, *a priori*, no reason to treat crypto-assets that are securities different from other securities only because of their technical background. Likewise, if the dangers arising from an ICO are similar to the dangers from the issuance of other securities, then, *prima facie*, there is no case for expanding existing exceptions. However, the argument might go that innovation in the financial markets should be promoted rather than stifled by the full set of requirements set forth by the securities laws.<sup>228</sup>

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<sup>225</sup> See, *e.g.*, ROFIEG, *supra* at 52 (Recommendation 7).

<sup>226</sup> Cf. Rohr & Wright, *supra*, at 516.

<sup>227</sup> See, *e.g.*, Hacker & Thomale, *supra* at 659 (“[O]nly such a functional view can provide answers in the analysis of radically novel investment facilities, such as ICOs, which defy traditional categories”).

<sup>228</sup> The Token Taxonomy Act of 2019 was mainly directed at excluding crypto-assets from the definitions several laws, *see above* at 6.2. *See on exceptions to the security laws, e.g.*, Hacker & Thomale, *supra* at 687-689. A frequently discussed regulatory model are “regulatory sandboxes”, *see* ROFIEG, *supra* at 69-72 (Recommendation 14). On the application of U.S. Regulation A+ in the context of crypto-assets *see* Peter J. Henning, *A Taxonomy of Cryptocurrency Enforcement Actions*, 14 *Brook. J. Corp. Fin. & Com. L.* 227, 250-254 (2020).

The foregoing is not to say that adjustments of the existing laws or their application (*e.g.*, the information contained in the prospectus) cannot provide improvements;<sup>229</sup> however, in principle, it makes sense that regulation treats securities that are associated with the same risks equally. As the interpretation of the securities definitions both in the U.S. and the E.U. provide enough flexibility to deal with the numerous different types of tokens, an adaption is currently not necessary from a *strictly legal point of view*. However, from other perspectives, an adaption might be worth considering. The fact that existing laws can be applied to new technological phenomena does not mean their application to the individual case is smooth. In this light, a regulatory strategy could be to enact a separate crypto-asset act that provides for clear definitions and legal consequences.<sup>230</sup> To be clear, this does not necessarily mean that there currently exists a regulatory gap or the requirements of the law as it stands should be lowered;<sup>231</sup> new legislation could be introduced *even though* crypto-assets and ICOs are already covered by the existing laws as a signal to innovators and entrepreneurs in the crypto scene. The main purpose of such legislation would then be to foster innovation in the jurisdiction by attracting ICOs and FinTech companies. Whether such efforts actually bring about substantial improvements, of course, turns on the way the potential crypto-asset legislation is drafted. In principle, the foregoing also applies to the drafting of exceptions from the definitions. In any event, definitions and exceptions on the E.U. level should either be prescribed in a directive that follows the principle of full harmonization or in a regulation in order to guarantee a common understanding of crypto-assets in the internal market.

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<sup>229</sup> According to ESMA, the necessary information for crypto-assets “would likely include detailed information on the issuer’s venture, its features and rights attached to the crypto-assets being issued the terms and conditions and expected timetable of the offer, the use of the proceeds of the offer and the specific risks related to the underlying technology”, *see* ESMA Advice 2019 at 23.

<sup>230</sup> Liechtenstein, for instance, adopted the Token and Trustworthy Technology Service Providers Act in 2019 to comprehensively address, *inter alia*, the emission of tokens and certain related services. The act can be accessed in German via <https://www.gesetze.li/konso/pdf/2019.301> (last visited Sept. 10, 2020).

<sup>231</sup> The more lenient approach to utility tokens has been referred to as a „genuine comparative advantage of EU vis-à-vis US law”, *see* Hacker & Thomale, *supra* at 684.

## 8.2. ICOs and Trading Platforms

Besides the issuers of tokens, intermediaries play crucial roles on the market for crypto-assets. While tokens can generally be acquired by investors and consumers directly from the issuer in the course of an ICO, trading on the secondary market on exchanges or trading platforms<sup>232</sup> is an important factor in further disseminating the tokens. Secondary market trading has also proven relevant under the SEC's application of the *Howey* test to ICOs as it facilitates the generation of profits by selling the tokens after an increase in value. Thus, exchanges make the access to and the management of crypto-assets easier; in some instances – due to limited knowledge and/or equipment – certain consumer groups would have, if any, only limited access to crypto-assets without trading platforms in the first place. Additionally, these platforms possess experience and expertise in the relevant markets. Thus, in theory, they could serve as a channel to filter out dubious ICOs.<sup>233</sup> In fact, some exchanges only admit crypto-assets for trading after a review.<sup>234</sup> In this way, exchanges have the potential to contribute to the protection of investors and consumers. However, there are also risks attached to platforms, especially because they are often in control of the assets of a large amount of people. The concerns relate to, inter alia, hacking attacks, trading policies, but also counterparty risks vis-à-vis the platform.<sup>235</sup> Consequently, it would be necessary to consider to what extent general consumer protection laws apply to transaction on crypto-exchanges, whether that protection is sufficient, and whether more specific capital-market oriented safeguards should be enacted or made

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<sup>232</sup> There are different types of trading platforms, a detailed description of which goes beyond the scope of this research; ESMA, for instance, distinguishes several types of platforms, “namely i) those that have a central order book and/or match orders under other trading models (ii) those whose activities are similar to those of brokers/dealers and (iii) those that are used to advertise buying and selling interests”, see ESMA Advice 2019 at 24, Appendix 2.

<sup>233</sup> For this specific purpose, several rating websites (that are sometimes of questionable quality) have developed; see for the impact on the success of ICOs as well as a critical assessment of such websites Ofir & Sadeh, *supra* at 586. In at least one case, SEC enforced U.S. laws against an ICO rating firm, see *In ICO Rating.*, Securities Act Release No. 10673, File No. 3-19366 (SEC Aug. 20, 2019).

<sup>234</sup> See, e.g., Coinbase, *Coinbase Digital Asset Framework*, <https://listing.coinbase.com/policy> (last visited Sept. 10, 2020). However, it is not always clear which steps platforms take, see ESMA Advice 2019 at 12 (“It is unclear whether platforms routinely undertake due diligence of new crypto-assets”).

<sup>235</sup> ESMA Advice 2019 at 14-16, 44 (also highlighting that certain types of decentralized platforms called “DEX” have developed).

applicable.<sup>236</sup> In fact, platforms trading tokens that qualify as securities are possibly already subject to existing securities exchange regulation. Conversely, even though some exchanges might resemble payment service providers in certain respects, it is questionable whether the European rules for payment services can simply be applied to crypto-asset trading platforms.<sup>237</sup> The European Commission actually considered this option in the drafting process of the amendments to the Anti Money Laundering Directive. However, the option was rejected because the requirements under the PSD2 were considered to be too extensive.<sup>238</sup>

As a side note, related problems with regard to consumer protection – on a smaller scale, however – arise in connection with “Crypto-ATMs” which can be used, inter alia, to exchange money for certain crypto-assets.<sup>239</sup> Reportedly, the German BaFin, for instance, has recently begun shutting down several “Crypto-ATMs” in Germany.<sup>240</sup>

### 8.3. Harmonization of the “Commercial Law of Crypto-Assets”?

Up to this point, the discussion has centered on the capital market-related questions of crypto-asset regulation. However, there are numerous other fields of law that need to be applied to crypto-assets and that contain unresolved issues. In this vein, the ROFIEG alludes to the

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<sup>236</sup> Cf., e.g., Anastasia Sotiropoulou & Stéphanie Ligot, *Legal Challenges of Cryptocurrencies: Isn't It Time to Regulate the Intermediaries?*, 16 ECFR 2019, 652, 668-675 (discussing different regulatory options). See also art. 2(g) of the Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC, 2015 O.J. (L141) 73-117, that, as amended, includes “providers engaged in exchange services between virtual currencies and fiat currencies” and “custodian wallet providers” as obliged entities.

<sup>237</sup> See, e.g., Nabilou, *supra*; see also Asress A. Gikay, *Regulating Decentralized Cryptocurrencies under Payment Services Law: Lessons From European Union Law*, 9 J. L., Tech. & Internet, 1 (2018); Sara J. Hughes & Stephen T. Middlebrook, *Advancing a Framework for Regulating Cryptocurrency Payments Intermediaries*, 32 Y. J. Regulation 495 (2015).

<sup>238</sup> European Commission, *Commission Staff Working Document Impact Assessment* 30-31, SWD(2016) 223 final (2016) (“Submitting exchange platforms to PSD2 would automatically bring exchange platforms under 4AMLD (option C) but would also submit them to broader consumer protection rules, licensing requirements and safeguarding requirements. [...] Having recourse to PSD2 would (i) require that VC currency exchange platforms comply with many other provisions of PSD2 (licensing, capital requirements, information, etc.) which they would need more time to conform to, and (ii) would go beyond the current focus of the IA on strengthening the fight against terrorist financing”).

<sup>239</sup> The availability of ATMs at a given location is accessible via <https://coinatmradar.com/>.

<sup>240</sup> Danny Nelson, *German Regulator Seizes Crypto ATMs*, <https://www.coindesk.com/bafin-seizes-shitcoins-club-bitcoin-atms> (last visited Sept. 10, 2020).

harmonization of the “commercial law of crypto-assets”.<sup>241</sup> By this, the ROFIEG means primarily conflicts-of laws rules but also suggests considering harmonizing “the remainder of commercial law, including property, corporate and insolvency law”.<sup>242</sup> While these issues certainly need to be explored, it is a different question whether all of these topics require harmonization across borders. Consider for instance the example of property law, alluded to by the ROFIEG. This domain is generally left to the member states’ national legislation and, as property law is rooted at the heart of each of the different private law jurisdictions in the E.U., a vertical harmonization of the private law status of crypto-assets is likely to lead to great distortions within the different private law systems. Also, the need for harmonization is far less obvious than in capital market law where large investments – that often extend beyond border of one single member state – should be encouraged. After all, the private law nature of fiat money, *i.e.*, euro coins and bank notes, is not harmonized and same applies to the process of transferring these funds. This applies, *e.g.*, to question under which circumstances a good faith acquisition of money is possible. Yet, there doesn’t seem to be a great distortion of the internal market. Why, then, do we need to harmonize the private law status of crypto-assets? The call for harmonization is easy to articulate, however, it seems that harmonization of national laws is not always necessary, let alone beneficial.<sup>243</sup> The status of crypto-assets under property doctrines should, therefore, not be harmonized on the E.U. level. Apart from that, the ROFIEG is certainly right that the conflicts-or-law rules are essential for legal certainty and companies that plan an ICO in the E.U. Furthermore, as large parts of the consumer protection laws are already harmonized on the E.U. level, common rules in this respect appear to be a natural

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<sup>241</sup> ROFIEG, *supra* at 58.

<sup>242</sup> ROFIEG, *supra* at 59.

<sup>243</sup> It should be noted that the ROFIEG acknowledges that commercial is largely regulated by national law, *see* ROFIEG, *supra* at 59 (“Commercial law is to a large extent the Member States’ national autonomous law. A fully-fledged EU-wide legal framework is difficult to establish and probably neither necessary nor desirable”).



extension of the existing legal status quo. This includes potential specific information obligations vis-à-vis consumers when offering or selling crypto-assets.

## **9. Conclusions**

The analysis of the application of the securities laws to crypto-assets has shown that the respective definitions of the U.S. Securities Act's notion of "security" and MiFID II's concept of "transferable securities" are flexible enough to deal with the different kinds of tokens, both in their "pure" and "hybrid" form. With regard to pure investment and payment token, both jurisdictions reach largely similar results, whereas the most important divergence relates to utility tokens and hybrid tokens with an investment component. Under U.S. legal practice, these token types will likely be considered as securities, whereas under E.U. law, it is reasonable to exclude tokens from the definition of "transferable securities" that have a prevailing utility component and do not confer membership or ownership rights.

Against this background, a reform of the respective definition is not strictly necessary; however, a clarification of the legal treatment of the different token types could be an important signal to companies that want to raise capital via an ICO or engage in related activities. The same applies to exemptions from the securities laws which should be drafted to foster innovation and legitimate new business models while at the same time protecting investors and functioning of the capital market.

In any event, clarifying the legal status of crypto-assets that are currently covered by no regulatory framework as well as the operations of crypto-exchanges and trading platforms appears to be a likely future development. Now that crypto-assets have been developing for over 12 years and the hype around ICOs lies around three years behind us, it is time to finally make a decision on a legal framework for the different types of crypto-assets. Indeed, the European Commission is currently working on a proposal for a regulation that is expected to be published soon; at the same time, several U.S. legislative proposals have been published.

However, it should be kept in mind that the numerous questions attached to crypto-assets concern several different areas of law that are not equally suited for harmonization or regulation – neither on the E.U. nor the international level.

### **Postscript**

After the completion and submission of this paper, the European Commission published several proposals for new legislative instruments that form part of the “digital finance package”.<sup>244</sup> With regard to crypto-assets, the Commission proposes a comprehensive regulation on markets in crypto-assets (MiCA) that would apply to “persons that are engaged in the issuance of crypto-assets or provide services related to crypto-assets” (art. 2(1) MiCA); however, crypto-assets that qualify, *inter alia*, as financial instruments, would not be covered by this regulation (art. (2)(2)(a) MiCA) but continue to be subject to existing Union legislation (especially MiFID II; *see* recital 6 MiCA). While this means that the EU securities laws will still apply to tokens that are transferable securities within the meaning of the MiFID II, it seems that the “commercial law of crypto-assets”, as understood above, have not been comprehensively addressed by this proposal. Lastly, it should be mentioned that the Commission has also put forward a proposal for a regulation on a pilot regime for market infrastructures based on distributed ledger technology.

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<sup>244</sup> European Commission, Digital finance package, [https://ec.europa.eu/info/publications/200924-digital-finance-proposals\\_en](https://ec.europa.eu/info/publications/200924-digital-finance-proposals_en) (last visited Nov. 2, 2020).