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# SEC Deems Nine Tokens Securities

## U.S. TECH LAW UPDATE<sup>1</sup>

August 26, 2022

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### I. Introduction

On July 21, 2022, the United States Securities and Exchange Commission (the “SEC”) alleged that nine digital assets constituted securities in its first insider trading claim involving cryptocurrencies, *SEC v. Ishan Wahi, Nikhil Wahi, and Sameer Ramani* (the “Complaint”).<sup>2</sup> In the Complaint, the SEC charges a former Coinbase manager and two others with perpetrating a scheme to trade at least 25 digital assets ahead of Coinbase announcing that those assets would be listed on its trading platform.<sup>3</sup> Each of Coinbase’s announcements prompted a spike in the digital assets’ value, resulting in profits totaling more than \$1.1 million for the defendants.<sup>4</sup> The SEC established its jurisdiction by declaring that nine of the involved digital assets are securities: AMP, RLY, DDX, XYO, RGT, LCX, POWR, DFX, and KROM (the “Nine Complaint Tokens” or “Complaint Tokens”).<sup>5</sup> This is the first time the SEC characterized digital assets as securities in a legal action that did not include the issuers of those digital assets as parties to the legal action.

Also on July 21, 2022, the United States Department of Justice (the “DOJ”) unsealed an indictment for Ishan Wahi, Nikhil Wahi, and Sameer Ramani in the same matter (the “Indictment”).<sup>6</sup> Parallel to the Complaint’s civil charges, the DOJ criminally charged the three named individuals with wire fraud conspiracy and wire fraud for participating in a scheme to trade 25 digital assets that were listed or were under consideration for listing on Coinbase.<sup>7</sup> However, the DOJ named only six digital assets, four of which were not named by the SEC in the Complaint: XYO, POWR, TRIBE, ALCX, GALA, and ENS.<sup>8</sup> The SEC has not indicated why TRIBE, ALCX, GALA, and ENS (the “Four Indictment Tokens,” or “Indictment Tokens”) are not named in the Complaint, and neither the SEC nor the DOJ have clarified why only 13 digital assets of 25 were named between the two actions.

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<sup>2</sup> Complaint, *SEC v. Ishan Wahi, Nikhil Wahi, and Sameer Ramani* (W.D. Wash., 2022).

<sup>3</sup> *Id.* at Paragraph 1.

<sup>4</sup> *Id.* at Paragraphs 1, 25.

<sup>5</sup> *Id.* at Paragraphs 11, 24, 39-85.

<sup>6</sup> Indictment, *US v. Ishan Wahi, Nikhil Wahi, and Sameer Ramani* (S.D. N.Y., 2022).

<sup>7</sup> *Id.* at Paragraphs 1-3.

<sup>8</sup> *Id.* at Paragraph 13.



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Although the SEC released guidance in April 2019 that provided a framework for determining whether a digital asset is a security,<sup>9</sup> and a string of enforcement actions do provide additional examples of the SEC’s actual implementation of this framework,<sup>10</sup> the Complaint and the Indictment nonetheless provide valuable insights into the SEC’s current approach on this question of critical importance to the cryptocurrency industry. The Complaint and the Indictment provide 13 specific digital asset examples, nine that the SEC named as securities and four that it did not. This legal update identifies key characteristics that the SEC highlighted in the Complaint in support of its determination that the Nine Complaint Tokens are securities. We then apply those characteristics to infer why the SEC withheld that determination with respect to the Four Indictment Tokens. In the table at the end of this article, we identify which of the SEC highlighted characteristics are present or absent for each of the named 13 digital assets.

### a. Fungible Tokens

The assets identified by the SEC and the DOJ are all fungible tokens. Fungible tokens belong to a class of non-tangible, interchangeable virtual assets that are created, traded, and stored on blockchain technology, which assets we refer to herein collectively as “digital assets.”<sup>11</sup> Blockchains are decentralized, distributed digital ledgers of verified digital asset transactions,<sup>12</sup> upon which a variety of applications and projects are built. These projects often issue fungible tokens to raise money for the projects as “security tokens,” to use within the projects as “utility tokens,” or to grant communities governing rights over the projects as “governance tokens.”<sup>13</sup> Often, the same fungible token serves multiple purposes over the course of a project’s development.

Fungible tokens can often be exchanged for fiat currency or other digital assets on secondary trading platforms (collectively, the “secondary market”) separate from the project for which they were minted.<sup>14</sup> The trading values of fungible tokens associated with projects are often quite volatile in the secondary market, with much of that volatility driven by the underlying projects’ development or promotional activities.<sup>15</sup>

### b. Consequences of the SEC’s Determination

Congress established the SEC to regulate the securities industry after fraud and speculation, both of which currently plague the digital assets market, catalyzed the stock market crash of 1929.<sup>16</sup> In a press release covering the Complaint, Carolyn M. Welshans, Acting Chief of the SEC’s Crypto Assets and Cyber Unit, affirmed the SEC’s *raison d’être*: “[W]hether in equities, options, crypto assets, or other securities, we will vindicate our mission by identifying and

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<sup>9</sup> See SEC, [Framework for “Investment Contract” Analysis of Digital Assets](#) (last modified April 3, 2019).

<sup>10</sup> See Cornerstone Research, [SEC Cryptocurrency Enforcement: 2021 Update](#) (January 19, 2022), a report that tracks litigation actions and administrative proceedings brought by the SEC against digital assets market participants from July 2013 through 2021.

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

<sup>12</sup> See Alex Pruden and Sonal Chokshi, [Crypto Glossary: Cryptocurrencies and Blockchain](#), ANDREESSEN HOROWITZ (accessed August 19, 2022); see also Cryptopedia Glossary, [Blockchain](#), GEMINI (accessed August 19, 2022).

<sup>13</sup> Cryptopedia, [Digital Assets: Cryptocurrencies vs. Tokens](#), Gemini (May 17, 2021); see also Pruden and Chokshi, [Crypto Glossary: Cryptocurrencies and Blockchain](#).

<sup>14</sup> See Robert Stevens, [What is Tokenomics and Why Is It Important?](#) COINDESK (April 11, 2022).

<sup>15</sup> *Id.*

<sup>16</sup> Wex Definitions, [Securities law history](#), LEGAL INFORMATION INSTITUTE (accessed August 19, 2022); see also [Rekt News](#), a decentralized autonomous organization that tracks instances of digital assets fraud.



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combatting insider trading in securities wherever we see it.”<sup>17</sup> Acting Chief Welshhans’s statement highlights an important limitation to the SEC’s authority: for the SEC to exert jurisdiction over the digital assets included in the Complaint, those digital assets must be securities. The SEC concluded that they are, but others disagree, and the nature of the proceeding may bar key stakeholders from presenting that dissent in court.

The SEC typically identifies a digital asset as a security through enforcement actions or litigation in which the issuer of the digital asset is a party, which provides the issuer with a forum in which to challenge the SEC’s characterization of their digital asset.<sup>18</sup> However, here, the SEC identified digital assets as securities in a filing to which the issuers of those digital assets are not parties, which means the issuers may not have the opportunity to formally dispute the SEC’s characterizations. As nonparties, issuers have primarily two options for asserting their interests before the court:

- 1) the issuers may attempt to join as parties to the claim but must first convince the court of their eligibility in a motion to intervene,<sup>19</sup> or
- 2) at the court’s discretion, the issuers may be permitted to file amicus curiae briefs to offer the court supplemental information, which the court may heed or ignore at its discretion.<sup>20</sup>

Neither path ensures that the issuers will be able to present their views because both require the issuers to successfully justify their presence in the claim prior to presenting any defense contradicting the SEC’s characterizations of their digital assets as securities.

Both regulators and digital assets platforms have expressed discomfort with the implications of the SEC’s approach. Commodity Futures Trading Commission (“CFTC”) Commissioner Caroline Pham called the Complaint a “striking example of ‘regulation by enforcement’” that “could have broad implications beyond this single case, underscoring how critical and urgent it is that regulators work together.”<sup>21</sup> Commissioner Pham further advised, “Major questions are best addressed through a transparent process that engages the public to develop appropriate policy with expert input.... Regulatory clarity comes from being out in the open, not in the dark.”<sup>22</sup> Coinbase also vocalized dissent, denying that the nine named digital assets are securities and expressing that “the SEC charges are an unfortunate distraction from [the DOJ’s] appropriate law enforcement action.”<sup>23</sup> To date none of the issuers have commented publicly on the Complaint. In addition, most of the projects have modest market capitalizations and thus the issuers may not

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<sup>17</sup> SEC Press Release, [SEC Charges Former Coinbase Manager, Two Others in Crypto Asset Insider Trading Action](#) (July 21, 2022).

<sup>18</sup> See Cornerstone Research, [SEC Cryptocurrency Enforcement: 2021 Update](#) (January 19, 2022).

<sup>19</sup> Federal Rules of Civil Procedure, [Rule 24. Intervention](#), LEGAL INFORMATION INSTITUTE (accessed August 19, 2022); see also Wex Definitions, [intervene](#), LEGAL INFORMATION INSTITUTE (last updated June 2020).

<sup>20</sup> See Federal Rules of Appellate Procedure, [Rule 29. Brief of an Amicus Curiae](#), LEGAL INFORMATION INSTITUTE (accessed August 19, 2022); see also D.D.C. Local Civil Rule 7(o), [Brief of an Amicus Curiae](#); see also Gibson Dunn, [Proposal for Federal Rule of Civil Procedure on District Court Amicus Briefs](#), addressed to the Committee on Rules of Practice and Procedure in the Administrative Office of the United States Courts (March 17, 2021).

<sup>21</sup> Commissioner Caroline D. Pham, [Statement of Commissioner Caroline D. Pham on SEC v. Wahi](#), TWITTER (July 21, 2022).

<sup>22</sup> *Id.*

<sup>23</sup> Brian Armstrong, [An update on our asset listing processes](#), COINBASE (updated July 21, 2022).



have the resources to challenge the SEC’s characterization of their tokens even if the court granted them the opportunity to do so.<sup>24</sup>

## II. Applying the Howey Test

The SEC and federal courts analyze whether unique instruments like digital assets are securities by applying the Howey test.<sup>25</sup> The Supreme Court of the United States established the Howey test in *SEC v. W. J. Howey Co.* when it held that securities called investment contracts exist where parties agree to invest money in a common enterprise with the reasonable expectation of profits derived from the efforts of others.<sup>26</sup> In applying the Howey test to digital assets, the SEC breaks the test into three prongs, all of which must be present for a digital asset to be deemed a security: (a) an investment of money, (b) in a common enterprise, (c) with the reasonable expectation of profits derived from the efforts of others. The third prong is further broken into two elements: (i) reasonable expectation of profits, (ii) derived from the efforts of others.<sup>27</sup>

In reviewing the Complaint, documentation published by the individual projects, and previous guidance from the SEC, we identified several characteristics that appeared most relevant to the SEC’s determination that the Nine Complaint Tokens constitute securities. In comparing those characteristics to the characteristics of the Four Indictment Tokens, we can infer the circumstances under which the SEC believes project management and development teams issuing fungible tokens (hereafter, “Issuers”) are issuing securities. Below we discuss each element of the Howey test, noting the key characteristics that the SEC highlighted in the Complaint in support of its determination that the Nine Complaint Tokens are securities. We also note the absence of some of those key characteristics from the Four Indictment Tokens. As noted above, the table at the end of this article illustrates which of the SEC highlighted characteristics are present or absent for each of the named 13 digital assets.

### a. Investment of Money

The first prong of the Howey test is typically satisfied whenever a digital asset is purchased or acquired in exchange for value.<sup>28</sup> That value need not be money. According to the SEC’s DAO Investigation Report, “investment of money” encompasses an investment of *any* value, whether fiat currency, “goods and services,” another digital asset, or some other type of consideration.<sup>29</sup>

Blockchain-based projects often conduct multiple rounds of fungible token sales, which satisfies the investment prong of the Howey test because tokens are generally offered and purchased with other digital assets, which can in turn be purchased with fiat currency.<sup>30</sup> Less

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<sup>24</sup> Turner Wright, [SEC listing 9 tokens as securities in insider trading case ‘could have broad implications’ — CFTC](#), COINTELEGRAPH (July 21, 2022).

<sup>25</sup> SEC, [Framework for “Investment Contract” Analysis of Digital Assets](#) (last modified April 3, 2019).

<sup>26</sup> *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946).

<sup>27</sup> SEC, [Framework for “Investment Contract” Analysis of Digital Assets](#) (last modified April 3, 2019).

<sup>28</sup> *Id.* at Section II(A).

<sup>29</sup> SEC Release No. 81207, [Report of Investigation Pursuant to Section 21\(a\) of the Securities Exchange Act of 1934: the DAO](#), 11 (July 25, 2017); see *Uselton v. Comm. Lovelace Motor Freight, Inc.*, 940 F.2d 564, 574 (10th Cir. 1991).

<sup>30</sup> Cryptopedia, [ICO 101: A beginner’s guide to raising capital using cryptocurrencies](#), COINTELEGRAPH (accessed August 16, 2022).



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obviously, according to the SEC, a project may distribute tokens without a requisite “purchase” and still satisfy the investment prong of the Howey test. Some blockchain-based projects choose to distribute fungible tokens through promotional “airdrops,” in which a project distributes digital assets to hundreds or thousands of different wallet addresses in exchange for recipients completing tasks such as following the project’s account on social media, sharing the project’s social media posts, using a particular platform or wallet, or signing up for updates about the project.<sup>31</sup> Although digital assets in an airdrop may be distributed without the recipients making a purchase, if the airdrop is a promotional event designed to reward the recipients’ participation with fungible tokens, then that airdrop of “free” tokens may still constitute an investment of money under the Howey test.<sup>32</sup>

The Issuers of each of the Nine Complaint Tokens launched those tokens through an initial coin offering (an “ICO”), which refers to the first sale of a fungible token conducted for the purpose of raising funds.<sup>33</sup> ICOs are commonly understood as the digital assets market’s interpretation of an initial public offering (an “IPO”), but they are only similar in that both are methods of raising funds for a project or company.<sup>34</sup> For example, an IPO offers shared ownership of a private company to the public and must adhere to specific requirements.<sup>35</sup> But ICOs are often conducted by early stage startups, do not offer shared ownership, and do not adhere to standardized requirements.<sup>36</sup> Further, the term “ICO” is nebulously applied to public token sales, private token sales to accredited investors, and strategic token sales to select purchasers—any initial token sale for the purpose of raising funds, regardless of purchaser, could be called an ICO.<sup>37</sup> SEC Chair Gary Gensler and his predecessor, former SEC Chair Jay Clayton, have previously expressed that most tokens sold in ICOs constitute securities.<sup>38</sup>

By contrast, only two of the four Issuers of the Four Indictment Tokens launched those tokens through ICOs. The Issuer of TRIBE launched its token on a decentralized exchange with sales to the public,<sup>39</sup> and the Issuer of ALCX released its token in a private offering to a select group of venture capital firms.<sup>40</sup> Gala Games launched the GALA token through rewards players for completing in-game milestones and rewards to operators of Gala Games nodes (meaning a computer that connects to a blockchain network to support the network through validation and relaying transactions).<sup>41</sup>

The Issuer of ENS launched its token by conducting an airdrop, which, as noted above, the SEC might still regard as a securities offering if the airdrop token is provided in exchange for some type of value.<sup>42</sup> Although the ENS token was airdropped to wallets connected to ENS

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<sup>31</sup> Andrey Sergeenkov, [What Is a Crypto Airdrop?](#) COINDESK (January 18, 2022).

<sup>32</sup> SEC Administrative Proceeding File No. 3-18641, [In re Tomahawk Exploration LLC and David Thompson Laurance](#) (August 14, 2018).

<sup>33</sup> Cryptopedia Glossary, [Initial Coin Offering \(ICO\)](#), GEMINI (accessed August 19, 2022).

<sup>34</sup> Glossary, [Initial Coin Offering \(ICO\)](#), BINANCE ACADEMY (accessed August 24, 2022).

<sup>35</sup> See [The Entrepreneur’s Roadmap: From Concept to IPO](#), 197-215, NEW YORK STOCK EXCHANGE (May 2017).

<sup>36</sup> See Annika Feign, [What is an ICO?](#) COINDESK (March 9, 2022).

<sup>37</sup> Oddup, [Delving Into ICO Private Sales, Pre-Sales, And Crowdsales](#), MEDIUM (June 9, 2019).

<sup>38</sup> Chair Gary Gensler, [Prepared Remarks of Gary Gensler on Crypto Markets](#), address before the Penn Law Capital Markets Association Annual Conference in Philadelphia, PA (April 4, 2022).

<sup>39</sup> Fei Labs, [The TRIBE Token Distribution](#), Medium (February 9, 2021).

<sup>40</sup> Kevin Reynolds, [DeFi Lending Protocol Alchemix Raises \\$4.9M in Round Led by CMS](#), Alameda, CoinDesk (March 14, 2021).

<sup>41</sup> Dean Takahasi, [John Oswald interview: How Gala Games fuels blockchain game hits with fewer players](#), VENTUREBEAT (April 9, 2022).

<sup>42</sup> Jordan Finneseth, [Early Ethereum Name Service \(ENS\) adopters rewarded with a hefty five-figure airdrop](#), COINTELEGRAPH (November 10, 2021); see also SEC Administrative Proceeding File No. 3-18641, [In re Tomahawk Exploration LLC and David Thompson Laurance](#) (August 14, 2018).



domains with a distribution based on how long recipients owned an ENS domain, the airdrop was “retroactive.”<sup>43</sup> That is, the airdrop was not advertised or announced to encourage users to perform an action or provide value to the project, instead the project created the airdrop to distribute governing rights to users who had already engaged with the project without the promise of that incentive.<sup>44</sup>

## b. Common Enterprise

Federal courts require that there be either horizontal commonality or vertical commonality in a project to satisfy the second prong of the Howey test, common enterprise.<sup>45</sup> Horizontal commonality exists where each individual investor’s fortunes are tied to the fortunes of other investors by the pooling of assets, often combined with the *pro-rata* distribution of profits.<sup>46</sup> Vertical commonality, which focuses on the relationship between an asset’s promoter<sup>47</sup> and the asset’s investors, exists in two variants: broad vertical commonality and strict vertical commonality. To establish broad vertical commonality, the fortunes of the investors need be linked only to the *efforts* of the promoter.<sup>48</sup> To establish strict vertical commonality, the fortunes of the investors must be tied to the *fortunes* of the promoter.<sup>49</sup>

The SEC asserts that investments in digital assets nearly always constitute investments in a common enterprise because the fortunes of digital asset purchasers are linked either to each other, thus establishing horizontal commonality, or to the success of the promoter’s efforts, thus establishing broad vertical commonality.<sup>50</sup>

In its analysis of the Nine Complaint Tokens, the SEC frequently implies the existence of horizontal commonality by noting that purchaser funds are pooled together and used to develop a project that is not yet functional at the time of the ICO or to enhance development of a functional project. This same characteristic also supports the SEC’s analysis of a project’s reliance on the efforts of others in satisfying a portion of the third prong of the Howey test.

- 1) The SEC alleged that each Issuer of the Nine Complaint Tokens uses funds raised during its ICO to finance the underlying network, product, or exchange (the “Project”), thus linking purchasers to each other by pooling the purchasers’ funds into treasuries dedicated to development and maintenance of the Project.<sup>51</sup>
- 2) The SEC highlighted that three Projects (AMP, DDX, and POWR) are only functional if purchasers deposit their Complaint Tokens in liquidity pools, indicating another route to establish horizontal commonality.<sup>52</sup> For example, DDX will feature an “insurance fund”

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<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

<sup>45</sup> *Revak v. SEC Realty Corp.*, 18 F.3d 81, 87-88 (2d Cir. 1994); SEC, [Framework for “Investment Contract” Analysis of Digital Assets](#), n. 10.

<sup>46</sup> *Id.*

<sup>47</sup> “Promoter” is broadly defined in the Securities Act of 1933 as (i) any person who directly or indirectly takes initiative in founding and organizing the business or enterprise of a securities issuer, or (ii) any person who, in connection with the founding and organizing of the enterprise of a securities issuer, directly or indirectly receives in consideration of services 10% or more of any class of securities of the issuer, or 10% or more of the proceeds from the sale of those securities. *See* Securities Act of 1933, Rule 405, 17 C.F.R. § 230.405.

<sup>48</sup> *Long v. Shultz Cattle Co., Inc.*, 881 F.2d 129, 140-41 (5th Cir. 1989).

<sup>49</sup> *Brodv. Bache & Co., Inc.*, 595 F.2d 459, 461 (9th Cir. 1978).

<sup>50</sup> SEC, [Framework for “Investment Contract” Analysis of Digital Assets](#), n. 11.

<sup>51</sup> Complaint, [SEC v. Ishan Wahi, Nikhil Wahi, and Sameer Ramani](#) (W.D. Wash., 2022).

<sup>52</sup> *Id.* at Paragraphs 103, 126, 172.



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in which purchasers pool tokens to use when transactions made on the underlying network fail.<sup>53</sup>

- 3) Finally, the SEC implied that strict vertical commonality exists with respect to six Projects (AMP, RLY, DDX, LCX, DFX, KROM) when it noted in the Complaint that the Issuers retain some or most of their Complaint Token’s supply, linking the Issuers’ fortunes to the purchasers’ fortunes.<sup>54</sup>

By contrast, the three of the Four Indictment Tokens did not pool funds raised through an ICO to finance ongoing development of the Project, although many do establish strict vertical commonality through the allocation of tokens to the Issuer.

- 1) Of the Four Indictment Tokens, only ALCX established horizontal commonality by pooling purchasers’ funds raised during an ICO to finance Project development.<sup>55</sup>
- 2) Of the Four Indictment Tokens, only ALCX has functionality dependent on purchasers pooling their funds.<sup>56</sup>
- 3) Three of the Four Indictment Tokens do, however, share strict vertical commonality because Issuers of those tokens do retain some of their Indictment Token’s supply.<sup>57</sup>

c. Reasonable Expectation of Profits Derived from the Efforts of Others

The SEC indicated in its prior guidance that it believes the first two prongs of the Howey test are normally satisfied by most digital assets, and thus the main issue is whether a purchaser has a reasonable expectation of profits derived from the efforts of others.<sup>58</sup> This prong is met when a promoter or other third party provides essential managerial efforts that affect the success of the enterprise, and the purchaser is aware of and expects to profit from those efforts. The SEC focuses on the “economic reality” of the transaction, and thus on the “character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect.”<sup>59</sup> There are two elements, (i) reasonable expectation of profits, (ii) derived from the efforts of others, each with characteristics relevant to identifying when a digital asset is a security.<sup>60</sup>

i. *Reasonable Expectation of Profits*

Purchasers of a digital asset must have a reasonable expectation of profits for the digital asset to constitute a security under the Howey test.<sup>61</sup> “Profits” can include an increase in the digital

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<sup>53</sup> *Id.* at Paragraph 129.

<sup>54</sup> *Id.* at Paragraphs 105, 114, 127, 152, 164, 188, 200.

<sup>55</sup> Alchemix Finance White Paper, [ALCX Emissions Schedule](#).

<sup>56</sup> Alchemix Finance White Paper, [Staking Pools](#); see also ENS White Paper, [Introduction](#); see also Gala Games, [About](#); see also Fei Protocol White Paper, [A Decentralized, Fair, Liquid, and Scalable Stablecoin Platform](#).

<sup>57</sup> See Fei Labs, [The TRIBE Token Distribution](#), Medium (February 9, 2021); Alchemix Finance White Paper, [Token Distribution](#); ENS, [SENS Token Allocation](#).

<sup>58</sup> SEC, [Framework for “Investment Contract” Analysis of Digital Assets](#), Section II(C).

<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

<sup>61</sup> *Id.* at Section II(C)(2).



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asset's trading price, or participation in earnings from the Project underlying the digital asset.<sup>62</sup> Price appreciation resulting solely from external market forces (such as general inflationary trends or the economy) impacting the supply and demand for the underlying digital asset is generally not considered "profit" under the Howey test.<sup>63</sup> As a result, if a project raises funds through a token sale and then uses those funds to further development of the project, which results in an increase the trading price of the token, then those tokens might be securities. Additionally, a token may be a security if the token gives its purchasers rights to share in the underlying project's income or profits.<sup>64</sup>

Expectations can be engendered by the project's marketing, including marketing that uses language indicating purchasers are investors, that expresses intent to develop the project or token using proceeds from the token's sale, that the token is readily transferable, and that there is an available market for trading the token.<sup>65</sup> Thus, language used to market a token is a key determining factor as to whether that token is a security because the marketing language can engender an expectation of profits among prospective purchasers of the token. In the Complaint the SEC cited six characteristics common to each of the Nine Complaint Token that supported its conclusion that purchasers have a reasonable expectation of profits, two of which emphasize the importance of a Project's marketing language.

- 1) Token Supply Caps. The SEC indicated that five of the Nine Complaint Tokens exist in limited supply to support the value of the tokens through scarcity, meaning the Issuer will not create or release any more tokens after a ceiling number of tokens has been issued, a number which is set by the Issuer ("Supply Caps").<sup>66</sup>
- 2) Token Buybacks. Related to Supply Caps, the SEC noted that five Issuers of the Nine Complaint Tokens engage or have engaged in periodic "burnings" and "buybacks" of tokens in which Issuers either destroy tokens or buy tokens back from holders of those tokens on the open market.<sup>67</sup> These actions also help support the Complaint Tokens' trading price by reducing the supply of the tokens, similar to a public company share buyback.
- 3) Marketing Profit Potential. The SEC notes that when marketing the Nine Complaint Tokens each Issuer advertised the Complaint Tokens' profitability to potential purchasers, including through social media posts, through documents explaining the Projects, in blog posts, and on the Projects' websites.<sup>68</sup> The profitability promised by Issuers was often speculative. For example, the Issuer of DFX tweeted that purchasing DFX would help Purchasers "beat inflation" on the presumption that DFX would continue to rise despite macroeconomic conditions, which ultimately proved false.<sup>69</sup> Some Issuers even used language referring to purchasers as "investors" and the Projects

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<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *Id.*

<sup>66</sup> Complaint, [SEC v. Ishan Wahi, Nikhil Wahi, and Sameer Ramani](#), Paragraphs 99, 137, 153, 165, 175.

<sup>67</sup> *Id.* at Paragraphs 106, 140, 153, 162, 203.

<sup>68</sup> *Id.* at Paragraphs 106, 115, 128, 140, 153, 165, 173, 190, 202.

<sup>69</sup> Complaint, [SEC v. Ishan Wahi, Nikhil Wahi, and Sameer Ramani](#), Paragraph 190; see Mike Winters, [Bitcoin was supposed to hedge against inflation—here's why it hasn't worked that way](#), CNBC (July 8, 2022).



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as “investments,” such as the Issuer of RGX, who additionally referred to RGT holders as “shareholders.”<sup>70</sup>

- 4) Marketing Token Exchange Listings. The SEC also notes that Issuers promoted the availability of secondary markets for trading the Nine Complaint Tokens through social media posts, blog posts, and the Projects’ websites.<sup>71</sup> For example, the Issuers of RLY and XYO announce whenever secondary trading platforms list their tokens for the first time, and the Issuer of XYO directs purchasers to an internet site listing all of the secondary trading platforms on which XYO can be resold for profit.<sup>72</sup> The SEC also highlighted instances where Issuers display market prices for Complaint Tokens, such as the Issuer of LCX hosting a webpage that displays LCX’s market price.<sup>73</sup>
- 5) Pool Financial Rewards. The SEC also highlighted that four of the Nine Complaint Tokens advertised financial rewards, and thus opportunities for profit, to purchasers who deposited their tokens in pools.<sup>74</sup> For example, purchasers of AMP who deposit tokens in pools are entitled to receive more AMP tokens as “network rewards” on a pro-rata basis. In other words, the more tokens an AMP purchaser deposits, the more AMP tokens they can expect to receive in return.<sup>75</sup>
- 6) Token Price Volatility. The SEC indicated that the trading prices for each of the Nine Complaint Tokens have experienced substantial volatility.<sup>76</sup> For example, the SEC notes that in November 2021, LXC had a return of approximately 700%,<sup>77</sup> and that by April 2022 KROM experienced an increase of more than 1200%.<sup>78</sup>

Although the Four Indictment Tokens share some characteristics noted above with the Nine Complaint Tokens, none of the relevant Issuers marketed the Four Indictment Tokens as investment opportunities. Further, the execution of some of the same characteristics carry notable differences.

- 1) Token Supply Caps. Three of the Four Indictment Tokens have Supply Caps.<sup>79</sup> ALCX does not have a Supply Cap but does have a strict emissions schedule such that the rate of release for ALCX tokens will gradually decrease over the course of three years.<sup>80</sup> After three years, there will be a flat weekly emission of 2,200 ALCX tokens.<sup>81</sup>
- 2) Token Buybacks. The Issuer of TRIBE engages in periodic buybacks of tokens, but only if TRIBE token holders propose and vote for a buyback.<sup>82</sup> The public materials from the

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<sup>70</sup> Complaint, [SEC v. Ishan Wahi, Nikhil Wahi, and Sameer Ramani](#) at Paragraph 155.

<sup>71</sup> *Id.* at Paragraphs 92, 108, 116, 130, 140, 153, 167, 173, 191 200.

<sup>72</sup> *Id.* at Paragraphs 116, 140.

<sup>73</sup> *Id.* at Paragraph 166.

<sup>74</sup> *Id.* at Paragraph 97, 129, 186, 203.

<sup>75</sup> *Id.* at Paragraph 97.

<sup>76</sup> *Id.* at Paragraphs 111, 120, 134, 144, 160, 180, 196, 203.

<sup>77</sup> *Id.* at Paragraph 162.

<sup>78</sup> *Id.* at Paragraph 203.

<sup>79</sup> See Fei Labs, [The TRIBE Token Distribution](#), Medium (February 9, 2021); [GALA Price Index and Live Chart](#), COINDESK (accessed August 19, 2022); ENS, [SENS Token Allocation](#) (November 2, 2021).

<sup>80</sup> Alchemix Finance White Paper, [ALCX Emissions Schedule](#) (last modified 1yr ago).

<sup>81</sup> *Id.*

<sup>82</sup> See, e.g. [TRIBE Buyback Pilot Program Proposal](#) (August 2021).



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other three Issuers of the Four Indictment Tokens do not disclose intentions to conduct buybacks or burn tokens.

- 3) Marketing Profit Potential. The publicly available materials for the Four Indictment Tokens do not include marketing language emphasizing investment opportunities or profit potential. Instead, the Four Indictment Tokens are marketed for their value in imparting governance rights, in the cases of all Four Indictment Tokens, or their utility, in the cases of ALCX and GALA. The Issuer of ALCX explicitly states in its token distribution materials, “There are no guarantees [ALCX] has any value, whatsoever.”<sup>83</sup>
- 4) Marketing Token Exchange Listings. Three of Issuers of the Four Indictment Token’s do promote the listing of their tokens on secondary trading platforms by tweeting or through blog posts.<sup>84</sup> For example, Gala Games advertises the secondary trading platforms where GALA is available for purchase and sale through blog posts and on a webpage that lists those secondary trading platforms.<sup>85</sup>
- 5) Pool Financial Rewards. Two of the Four Indictment Tokens, TRIBE and ALCX, can be deposited in pools in exchange for additional TRIBE and ALCX tokens.<sup>86</sup> Issuers of both TRIBE and ALCX advertise these pools as opportunities to reward purchasers who contribute to the Projects’ liquidity.<sup>87</sup>
- 6) Token Price Volatility. Except for TRIBE, which experienced only an 8% price increase at its peak,<sup>88</sup> the trading prices for the Indictment Tokens have fluctuated dramatically since each Indictment Tokens’ launch. For example, ALCX launched at a price of approximately USD\$600.00 in February 2021 and peaked at USD\$11,060.63 on May 11, 2021.<sup>89</sup>

ii. *Derived from the Efforts of Others*

Satisfaction of this element of the third prong of the Howey test is determined by whether a purchaser relies on a promoter, sponsor, or another party that provides significant managerial efforts affecting the failure or success of the enterprise.<sup>90</sup> This prong is satisfied when a third party (such as an Issuer) is responsible for the development, improvement, operation, or promotion of the Project, especially when the Project is not yet operable for its intended functionality, or not yet operable without efforts from the Issuer.<sup>91</sup> Other relevant characteristics of a security include an Issuer having interests in enhancing the value of the digital asset by retaining or allocating a portion of the digital asset to itself, or having ongoing primacy in making decisions about or exercising judgment concerning the project and the characteristics or

<sup>83</sup> Alchemix Finance White Paper, [Token Distribution](#) (last modified 1yr ago).

<sup>84</sup> See, e.g., Fei Protocol, “[And \\$TRIBE will be listed on @KuCoin!](#)” TWITTER (August 24, 2021); AlchemixFi, “[Alchemix is now on Harvest! \\$ALCX.](#)” TWITTER (July 26, 2022).

<sup>85</sup> See Gala Games, [Get GALA](#); see also Gala Games, [CaCE Files | New Exchange Listings](#), MEDIUM (August 17, 2022).

<sup>86</sup> Joey Santoro, Fei Protocol White Paper, [A Decentralized, Fair, Liquid, and Scalable Stablecoin Platform](#), 15; Alchemix Finance, [Staking Pools](#) (last modified 1yr ago).

<sup>87</sup> *Id.*

<sup>88</sup> [TRIBE Market Statistics](#), COINBASE (accessed August 19, 2022).

<sup>89</sup> [ALCX Market Statistics](#), COINBASE (accessed August 19, 2022).

<sup>90</sup> SEC, [Framework for “Investment Contract” Analysis of Digital Assets](#), Section II(C)(1).

<sup>91</sup> *Id.*



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rights represented by the digital assets.<sup>92</sup> Fully decentralized projects that do not rely on the efforts of a core development or management team, where decision making authority is dispersed among the community and where initial promoters do not retain or allocate to themselves material amounts of digital assets, are less likely to satisfy this element of the Howey test.

The SEC cites five key characteristics in the Complaint in its analysis of whether purchasers rely on the efforts of others to fulfill an expectation of profits.

- 1) Marketing Core Team. The SEC noted that eight of the Nine Complaint Tokens have a core management team, often comprised of developers or executives (sometimes both, such as with KROM), the involvement of which the Issuer advertises through social media, Project documents, blog posts, or the Project's website.<sup>93</sup> The SEC also indicated that many Issuers emphasized the importance of these core management teams to the success of the Projects, and thus to the success of the Complaint Tokens.<sup>94</sup>
- 2) Pre-Functional Projects. The SEC indicated that two of the Nine Complaint Tokens, DDX and RGT, were launched before the underlying Projects were fully operational.<sup>95</sup> Thus, purchasers could not use RGT and DDX for the utility rights promised by the Issuer at the time of purchase because the Issuer had not yet completed the infrastructure on which those tokens would be used.<sup>96</sup>
- 3) Ongoing Development. The SEC noted that although the remaining seven of the Nine Complaint Tokens could be used immediately upon launch of the respective token, the underlying Project required maintenance and further development to realize the Issuers' promises.<sup>97</sup> Thus, according to the SEC, the efforts of the Issuers remained essential to the related Complaint Tokens' value.<sup>98</sup>
- 4) Centralized Authority. The SEC highlighted that in each of the Projects associated with the Nine Complaint Tokens, decision making power rests nearly entirely with the Issuers.<sup>99</sup> Even the purchasers with governance rights bestowed by a Complaint Token, like DFX purchasers, have only nominal governance rights, since they can only make "marginal" improvements to the Project.<sup>100</sup> The SEC also identified centralized teams in three of the Nine Complaint Tokens: RLY, XYO, and RGT.<sup>101</sup>
- 5) Exchange Listing Efforts. The SEC noted that the Issuers of the Nine Complaint Tokens, except for the Issuer of KROM, facilitated a secondary market listing by applying to have their respective tokens listed on a secondary trading platform.<sup>102</sup>

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<sup>92</sup> *Id.*

<sup>93</sup> Complaint, [\*SEC v. Ishan Wahi, Nikhil Wahi, and Sameer Ramani\*](#), Paragraphs 109-110, 118, 142-143, 157, 168, 176-178, 193, 204-205.

<sup>94</sup> *Id.*

<sup>95</sup> *Id.* at Paragraphs 132, 152.

<sup>96</sup> *Id.*

<sup>97</sup> *Id.* at Paragraphs 110, 114, 139, 162, 171, 195, 200.

<sup>98</sup> *Id.*

<sup>99</sup> *Id.* at Paragraphs 109, 118-119, 131, 143, 157, 168, 177, 193, 204.

<sup>100</sup> *Id.* at Paragraph 55.

<sup>101</sup> *Id.* at Paragraphs 31, 39, 44,

<sup>102</sup> *Id.* at 108, 116, 130, 140, 156, 167, 173, 191.



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Issuers for the Four Indictment Tokens, however, emphasized community governance, attempted to minimize the Issuers' control over the underlying Projects, and launched the tokens after the Projects obtained at least some level of functionality.

- 1) Marketing Core Team. The Issuers of the Four Indictment Tokens have acknowledged that there is a core development or management team required to maintain the Project, but they have also expressed attempts towards minimizing their involvement rather than emphasizing their involvement.<sup>103</sup> For example, the developers of ALCX are not identified in the Project's documentation or on the Project's website,<sup>104</sup> although they do use pseudonyms to identify themselves as co-founders or developers of ALCX in their social media accounts and in some public statements.<sup>105</sup>
- 2) Pre-Functional Projects. Each of the Four Indictment Tokens had immediately utility or governance capabilities upon launch; and none of the underlying Projects were inaccessible or non-operational to purchasers when the tokens were initially launched.<sup>106</sup>
- 3) Ongoing Development. Each of the Projects underlying the Four Indictment Tokens did continue to be developed and updated after the launch of their respective tokens.<sup>107</sup>
- 4) Centralized Authority. Three of the Issuers of the Four Indictment Tokens delegate significant decision-making power to token purchasers. Purchasers of TRIBE, for example, decide on updates to the underlying Project, mergers with other digital assets projects, and on value-impacting initiatives such as buybacks of circulating TRIBE tokens.<sup>108</sup> ENS token holders can remove and appoint individuals within the teams that act as the Issuer of ENS.<sup>109</sup> The Issuer of GALA retains primary control over the direction of the underlying Project, but purchasers of GALA can vote on whether some games proposed by the Issuer will be funded.<sup>110</sup>
- 5) Exchange Listing Efforts. Among the Issuers of the Four Indictment Tokens, only the Issuer of TRIBE discussed facilitating a secondary market listing for its token, by listing TRIBE on Uniswap, a digital assets exchange that allows issuers to create their own listings rather than relying on the exchange to decide which digital assets to list.<sup>111</sup> Although all Four Indictment Tokens can be exchanged on secondary trading platforms, the public documents for the other Indictment Tokens didn't indicate that the Issuers initiated their respective tokens' listings.

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<sup>103</sup> See, e.g., Nick Johnson, [ENS progress update, mid 2018](#), MEDIUM (June 27, 2018); [Gala Node Ecosystem](#), GALA GAMES (accessed August 19, 2022).

<sup>104</sup> See [Alchemix Website](#).

<sup>105</sup> See [Alchemix Overview & History](#), MESSARI (accessed August 19, 2022).

<sup>106</sup> See Fei Labs, [The TRIBE Token Distribution](#); [Alchemix Overview & History](#); Dean Takahasi, John Oswald interview: How Gala Games fuels blockchain game hits with fewer players; ENS, [ENS Token Allocation](#).

<sup>107</sup> *Id.*

<sup>108</sup> Joey Santoro, Fei Protocol White Paper, [A Decentralized, Fair, Liquid, and Scalable Stablecoin Platform](#), 15.

<sup>109</sup> See, e.g., ENS Documentation, [Removal of Brantly Millegan as Director of the ENS Foundation Proposal](#) (March 1, 2022).

<sup>110</sup> See Dean Takahasi, [John Oswald interview: How Gala Games fuels blockchain game hits with fewer players](#).

<sup>111</sup> See Fei Labs, [The TRIBE Token Distribution](#).



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AMP	RLY	DDX	XYO	RGT	LCX	POWR	DFX	KROM	CHARACTERISTICS	TRIBE	ALCX	GALA	ENS
<u>Investment of Money</u>													
X	X	X	X	X	X	X	X	X	Token launched in an ICO	X	X		
<u>Common Enterprise</u>													
X	X	X	X	X	X	X	X	X	ICO funds used to finance the Project's development, linking purchasers by the pooling of assets		X		
X		X				X			Token's value and the Project's functionality depend on purchasers depositing tokens into a pool, linking purchasers to each other by the pooling of assets		X		
X	X	X		X	X		X	X	Issuer retains a portion of token's supply, linking Issuer's fortunes with purchasers' fortunes	X	X		X
<u>Reasonable Expectation of Profits</u>													
X			X	X	X	X			Token exists in limited supply to support value through scarcity	X		X	X
X			X	X	X			X	Issuer either burns tokens or buys tokens back on the open market to support value through scarcity	X			
X	X	X	X	X	X	X	X	X	Issuer markets token as an investment opportunity				
X	X	X	X	X	X	X	X	X	Issuer promotes the availability of a secondary market for token	X	X	X	
X		X					X	X	Issuer provides or promises financial rewards to purchasers who deposit their tokens in pools	X	X		
X	X	X	X	X	X	X	X	X	Token's trading price has experienced substantial volatility		X	X	X
<u>Derived from the Efforts of Others</u>													



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X	X		X	X	X	X	X	X	Issuer emphasizes the involvement of a central management team with significant influence over the token's success, such as by advertising its management team's expertise and efforts to potential purchasers	X	X	X	X
		X		X					The Project is either inoperable or has limited operability and is thus dependent on the efforts of Issuer and its management team to realize promises to purchasers				
X	X		X		X	X	X	X	The Project is operable, but Issuer performs tasks essential to the Project's ongoing development and maintenance work	X	X	X	X
X	X	X	X	X	X	X	X	X	Issuer retains significant decision-making power; purchasers have marginal or nominal governing power			X	
X	X	X	X	X	X	X	X		Issuer arranges for token to be listed on secondary trading platforms	X	X		