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# A Glimpse into the Future of Token Offerings with First SEC-Approved Public Token Offering?

On June 11, 2019, Blockstack Token LLC (Blockstack) launched a \$28 million offering of its Stacks (STX) Token as the first public token offering approved by the U.S. Securities and Exchange Commission (SEC). Blockstack provides a platform for developers to build and distribute digital rights and privacy applications powered by blockchain technology. As the first of its kind, this public token offering could shape the future of both the primary and secondary market of securities for decades to come. Below, we discuss the SEC's guidance on digital tokens to date, and examine the SEC's reasoning for giving its stamp of approval to this novel type of offering.

## SEC Guidance and the *Howey* Test

Two key pillars of federal securities law and the role of the SEC are to facilitate capital formation and to protect investors. With the introduction of digital assets, including digital "coins" or "tokens," companies have been keen on this seemingly revolutionary way to raise capital without falling under the watchful eye of the SEC. However, the SEC has taken far from a laissez-faire approach and has released significant guidance on the applicability of federal securities laws to Initial Coin Offerings (ICOs) and the sale of digital tokens. SEC Chairman Jay Clayton's statement available [here](#) and Director of the Division of Corporate Finance William Hinman's presentation available [here](#) provided traction which led to the highly anticipated guidance that digital assets will be reviewed under federal securities laws as any other type of investment which may be a "security." The SEC guidance is available [here](#).

The SEC's guidance on the applicability of federal securities laws to the offering of digital assets followed the framework applied to investments for over seven decades. Federal securities laws are applicable if an offering involves a "security." While federal securities laws provide an extensive

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list of items classified as a “security,” one of such items is the broad term “investment contract.” In *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), the Court articulated the so-called “*Howey* test” to determine if an investment is considered an “investment contract” and therefore a “security.” The elements of the *Howey* test are: (i) an investment of value, (ii) in a common enterprise, (iii) with an expectation of profit, (iv) that are derived from the efforts of others. If all four elements are met, then such investment would be classified as an investment contract, and thus triggering federal securities laws compliance obligations in order to be sold. The SEC’s guidance contemplates ICOs and whether such offerings involve securities under federal securities laws. The guidance breaks down each element of the *Howey* test and how such element would apply to digital assets.

When the guidance was published, the Division of Corporation Finance timely released a No Action Letter that stated it would not recommend enforcement against TurnKey Jet, Inc. for its use of digital tokens to facilitate the purchase of private jet flights. One of several considerations under the *Howey* test for why the SEC would not recommend enforcement was due to the key facts that the tokens were specifically used for the purchase of private jet flights and buyers would be unlikely to resell them for a financial gain. Shortly after, Blockstack sought regulatory approval to raise up to \$50 million through the sale of tokens under the Tier 2 of Regulation A (Regulation A+) registration exemption.

#### Regulation A+ Registration Exemption

Relying on the recently released SEC guidance, Blockstack indicated in its Offering Circular that it expected its STX Token would be treated as securities under both federal and state securities laws. The Offering Circular states two main considerations under the *Howey* test for why the STX Token is likely to be treated as a security. First, purchasers will reasonably expect Blockstack to carry out essential managerial or entrepreneurial efforts in deriving value in the STX Token. This consideration is anchored on the factors “with an expectation of profits” and “derived from the efforts of others.” Second, Blockstack largely controls the governance of the Blockstack network. This consideration is anchored on the factors “in a common enterprise” and “derived from the efforts of others.”

Under federal securities laws, if offering securities, a company must register such securities with the SEC unless the offering falls under an exemption. Regulation A+ is a registration exemption for public offerings that, partially due to the size of the offering allowed, has more involved disclosure and reporting requirements than other exemptions. However, Regulation A+ provides a platform for smaller issuers to offer securities to nonaccredited investors. Other registration exemptions provide limitations on offerings to nonaccredited investors and/or significantly lower maximum offering amounts. On June 10, 2019, Blockstack announced that the SEC granted the company qualification under Regulation A+. On June 11, 2019, Blockstack launched the \$28 million offering of its STX Token. According to Blockstack, STX Tokens can be used to register digital assets or register and execute smart contracts.

While STX tokens are novel as they are the first SEC-approved token available for purchase, the cost has been steep. The filed Form 1-A, as amended, states that the anticipated legal fees for this Regulation A+ offering are \$1.5 million. However, Blockstack’s special counsel estimated the fee would likely reach \$2 million, which for smaller issuers is often not a practical alternative to registration. In light of the recently released SEC guidance, as other companies approach capital formation using digital assets, legal fees are likely to reduce over time as the practice becomes more regular. Thus, Blockstack’s offering will likely pave the way for similar, future token offerings.

As set forth in the various No-Action Letters and SEC statements, the STX Tokens are meant to be purchased and used by those using the Blockstack network (STX Tokens are the “fuel” that is burnt as used). Due to registration, however, the STX Tokens distributed in the offering *will not* be restricted securities under federal securities law, and Blockstack anticipates that upon issuance and release from their time lock (see Form 1-A), these tokens will be usable without restriction for commercial purposes on the Blockstack network and *freely tradeable* on a registered exchange or alternative trading system for purposes of federal securities laws. Purchasers, therefore, may see a rise in the value of their initial investment in STX Tokens in the secondary market and need not use them on the Blockstack network. A major caveat, however, is that there are currently no national securities exchanges or exchanges that have been approved by the Financial Industry Regulatory Authority (“FINRA”) or registered under Form ATS with the SEC to support the trading of STX Tokens on the secondary market.

Until a secondary market develops and the cost of a “simple” Regulation A+ offering for digital “coins” / “tokens” come down, we generally recommend a “wait and see” approach. If you have any questions regarding the SEC’s application of the *Howey* Test to digital assets and alternatives to registration of digital assets, please contact any member of Michael Best’s Securities and Capital Markets or Blockchain, Digital Currencies & Smart Contracts teams.

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