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Date: December 20, 2017

To: Valentin Preobrazhenskiy of LAT Foundation Limited (the "Foundation")

From: White Summers Caffee & James, LLP (the "Firm")

Re: Liquid Asset Token ICO

Dear Mr. Preobrazhenskiy,

You have asked us to prepare a legal memorandum that analyzes the technology and functionality of the Liquid Asset Token ("LA Token"), its use on the blockchain asset marketplace known as the "LAT Platform", as well as various aspects of the LA Token Initial Coin Offering ("LAT ICO"), in order to analyze whether LA Token is likely to be considered a regulated security under U.S. Securities laws. Please note that we have not been asked to, and this memorandum does not, analyze whether the underlying tokens that represent tokenized assets on the LAT Platform constitute regulated securities under U.S. Securities laws.

Using the Supreme Court case *SEC v. W.J. Howey*, we have concluded that the LAT ICO likely satisfied only two of the four prongs required for an instrument to be considered a security. First, the LAT ICO is likely an "investment of money", because the Foundation received proceeds from the sale of LA Tokens. Second, while the outcome is dependent on the approach utilized by the finder of fact, the LAT ICO likely satisfies the most commonly used 'horizontal' approach, because the price of the LA Token itself rises and falls uniformly for both LAT ICO purchasers and the Foundation. Third, the LAT ICO likely did not create an "expectation of profits" because of LA Token's purpose in powering the LAT Platform, as opposed to investment. Finally, the value of LA Token is likely not "solely derived from the efforts of others" because the Foundation does not have discretion or oversight in decisions that directly affect the value received by the LA Token purchasers. Based on existing law, the LAT ICO would likely not be deemed a securities offering, because all four prongs were not satisfied.

I. LA TOKEN BACKGROUND AND ICO

From August 22, 2017 to October 10, 2017, the Foundation received $19,600,000 in Ethereum Tokens ("ETH") from investors in exchange for LA Tokens to be used on the Ethereum blockchain.

The functionality of LA Token is detailed in the LA Token Whitepaper (the "LAT Whitepaper") authored by the Foundation. LAToken is a blockchain protocol used on the LAT

Platform for creating and trading asset tokens. The LAT Platform allows asset owners to create and sell cryptographic tokens that represent the equity value of a traditionally illiquid asset, and the buyers purchase such asset tokens using LA Tokens. Examples of assets that can become "tokenized" assets on the LAT Platform are real estate, artwork, stocks, commodities, debt instruments, currency, and cryptocurrency. The LA Token Whitepaper posits that the tokenized representation of assets creates easier liquidity for the asset owner, and the ability for buyers to purchase ownership of high-value assets by purchasing fractional asset tokens using LA Tokens. It is entirely up to the LA Token holders to decide what type and quantity of tokenized assets to purchase.

Prior to forming the Foundation, the Foundation's organizers operated the Foundation's predecessor company, Zalogo, a profitable home equity marketplace. By August 19, 2017, prior to the LAToken ICO, the Foundation had developed the LAToken technology and LAT wallet, and transacted the first tokenized asset on the LAToken Platform.

According to the LAT Whitepaper, several steps are required for an asset to become tokenized, sold to LA Token holders, and liquidated on the LAT Platform. First, the asset owner sells a part or the entirety of an asset to a Foundation-certified custodian, and the transaction terms are memorialized in a self-executing smart contract on the Ethereum blockchain. Next, either the asset owner or custodian issues asset tokens linked to the asset value, and the asset owner sells these tokens to LA Token holders in exchange for LA Tokens. Purchasers of asset tokens have the ability to sell asset tokens on the secondary market, to the extent that a secondary market exists for that type of asset token. Finally, the asset owner can buy back the asset upon the settlement, or the asset will be sold at auction by the custodian.

Owners of real estate assets are required to complete an initial "qualification" step, as well as an appraisal step, prior to engaging with a custodian. Owners of artwork assets are required to complete an initial "application" step, prior to engaging with a custodian. Asset tokens that are linked to the price of publicly traded assets are also available on the LAT Platform. The purchase of publicly traded assets is similar to a forward contract on a stock exchange, and the Foundation buys back these asset tokens on a predetermined settlement date. The LAT Whitepaper also stated that LA Token would be available on "several leading crypto exchanges" after the end of the LAT ICO.

The LAT Whitepaper indicated that the Foundation will charge fees to engage with the LAT Platform. For asset tokenization, the Foundation will charge asset owners 0.01% of the asset tokens' sale price. For trading asset tokens, the Foundation will charge ~0.001% of the asset token sale price.

Proceeds from the LAT ICO would be used for asset owners' and cryptoholders' engagement on the LAT Platform (40%), token module development (10%), proof-of-assets servicing deployment (excluding value of frozen tokens), artificial intelligence underwriting development (5%), LAT fund for market making and providing liquidity (20%), a team bonus pool (10% capped at $1 million), and administrative expenses (5%). The Foundation also states that it is responsible for securing partnerships with firms that provide blockchain security, gold and other safe haven assets, and real estate assets.

II. DEFINITION OF SECURITIES UNDER U.S. FEDERAL SECURITIES LAWS

In order to analyze the LAT ICO under federal securities laws, we begin with the definition of "security" contained in Section 2(a)(1) of the Securities Act of 1933 ("Securities Act"),[1] which defines a security as:

> "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 ... investment contract ... 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."

All securities offered and sold in the United States must be registered with the U.S. Securities and Exchange Commission ("SEC") or must qualify for an exemption from registration requirements.[2]

The foundational Supreme Court case for determining whether an instrument meets the definition of security is *SEC v. W.J. Howey*, 328 U.S. 293 (1946). The Supreme Court has reaffirmed the *Howey* analysis more recently in *SEC v. Edwards*, 540 U.S. 398 (2004). *Howey* focuses specifically on the term "investment contract" within the definition of security, noting that it has been used to classify those instruments that are of a "more variable character" that may not fit neatly into other categories and that may be considered a form of "contract, transaction, or scheme whereby an investor lays out money in a way intended to secure income or profit from its employment."[3]

Not every contract or agreement is an "investment contract". Rather, the Supreme Court has developed a four-prong test to determine whether an agreement constitutes an investment contract and therefore a security. The Court articulated the test as follows: A contract constitutes an investment contract that meets the definition of security if there is (i) an investment of money; (ii) in a common enterprise; (iii) with an expectation of profits; (iv) solely from the efforts of others (e.g., a promoter or third party), "regardless of whether the shares in the enterprise are evidenced by formal certificates or by nominal interest in the physical assets used by the enterprise."[4] In order to be considered a security, all four prongs must be satisfied.

III. INVESTIGATIVE REPORT ON DAO TOKEN OFFERING AND *HOWEY* TEST

On July 25, 2017 the SEC issued a Section 21(a) investigative report, Release No. 81207 (the "DAO Report"), which provides a framework for understanding which Ethereum-based offerings, including initial coin offerings, fall within the SEC's authority to regulate as securities.[5]

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[1] Securities Act of 1933, §2(a)(1), 15 U.S.C. §77(b)(1).
[2] Id at 77(d).
[3] W. J. Howey, 328 U.S. at 298-99.
[4] Id
[5] SEC, *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO*, Exchange Act Release No. 81207 (July 25, 2017), *available at* https://www.sec.gov/litigation/investreport/34-81207.pdf (the "DAO Report").

The DAO Report applied the *Howey* test to digital tokens offered and sold by a virtual organization known as The Decentralized Autonomous Organization (the "DAO"), which was created by German corporation Slock.it UG ("Slock.it"). The DAO Report concluded that the tokens sold by the DAO were in fact securities.

The DAO raised capital by selling digital tokens (the "DAO Tokens") to investors, and then used the capital to fund projects intended to generate profits. Investors contributed Ethereum Classic tokens ("ETC")[6] in exchange for DAO Tokens, which granted the investors holding DAO Tokens certain voting and ownership rights. The DAO website and whitepaper (the "Promotional Materials") stated that the DAO would earn profits using the ETC contributed by investors to fund projects, which would in turn provide the investors holding DAO Tokens a return on their investment.

The projects would be proposed by the holders of the DAO Tokens, vetted by "curators" (which were all chosen by Slock.it) and voted upon by the holders of the DAO Tokens. The SEC emphasized that the Promotional Materials disseminated by Slock.it touted that DAO Token holders would receive "rewards," which the promotional materials and White Paper defined as, "any [ETC] received by a DAO [Entity] generated from projects the DAO [Entity] funded." DAO Token holders would then vote to either use the rewards to fund new projects or to distribute the ETC to DAO Token holders. In addition, DAO Token holders could monetize their investments in DAO Tokens by re-selling DAO Tokens on a number of web-based platforms that supported secondary trading in the DAO Tokens.

The SEC concluded that federal securities laws "apply to those who offer and sell securities in the U.S., regardless of whether the issuing entity is a traditional company or a decentralized autonomous organization, regardless whether those securities are purchased using U.S. dollars or virtual currencies, and regardless of whether they are distributed in certificated form or through distributed ledger technologies."[7] The SEC did not take the position that digital currencies, cryptocurrencies or blockchain tokens, or interests in such digital currencies, cryptocurrencies or blockchain tokens, are securities in and of themselves.

IV. ANALYSIS OF LA TOKENS UNDER THE *HOWEY* TEST

The *Howey* test has not yet been directly applied by the courts to any digital currency, cryptocurrency or Blockchain token. To determine whether LA Tokens are securities, under the guidance of the DAO Report, we examine each of the *Howey* factors in relation to the SEC's analysis of the DAO Tokens.

a. Investment of Money

[6] Known as "Ether" at the time of the DAO Report, Ethereum Classic tokens are tokens derived from the original Ethereum blockchain. After the DAO Report, a fork of the Ethereum blockchain created a new, separate class of tokens that carried on the name "Ether".
[7] *Id.* at 18.

Under *Howey* and subsequent case law, an investment of money may include not only the provision of capital, assets, and cash, but also goods, services, or a promissory note.[8] Investors in DAO Tokens used ETC to make their investments. The SEC found that an investment of ETC is the type of contribution of value that can create an investment contract under *Howey*.[9]

Given (a) the SEC's broad interpretation of a money investment, (b) the SEC's finding that investment of digital currency constitutes an investment of money, and (c) that the Foundation raised $19,600,000 in proceeds from the sale of LA Tokens in ETH as of October 10, 2017, the sale of LA Tokens in LAT ICO would likely constitute an investment of money. Therefore, the LAT ICO most likely passes the first prong of the *Howey* test.

b. Common Enterprise

To be a security, the investment of money must be "in a common enterprise." Different courts use different tests to analyze whether a common enterprise exists, because the Supreme Court has not yet ruled on a definitive and singular approach.

Under the horizontal approach, a common enterprise is deemed to exist where multiple buyers pool funds into an investment and the profits of each investor correlate with those of the other buyers such that the fortunes of all investors in such enterprise rise and fall together.[10] Whether funds are pooled appears to be the key inquiry, thus, in cases where there is no sharing of profits or pooling of funds, a common enterprise may not be deemed to exist.

Conversely, the vertical approach looks at whether the profits of the buyer are tied to the promoter such that the fortunes of buyers and sellers rise and fall together. More precisely, a finder of fact would deem vertical commonality to exist when either (a) the value of the instrument purchased by the buyer rises and falls based on the success of the seller or other third party (narrow vertical commonality), or (b) the value of the instrument purchased by the buyer is reliant on the effort of the seller (broad vertical commonality)[11].

The DAO Report did not specifically analyze the common enterprise prong. However, the SEC did assert that "investors who purchased DAO Tokens were investing in a common enterprise,"[12] presumably based on the fact that the DAO raised ETC from multiple investors who had a common interest in the success of the DAO.

The LAT ICO is likely considered investment in a common enterprise under the horizontal approach because each investor received the same class of LA Token, which exists on the same blockchain, in the LAT ICO. Therefore, each investor's pro-rata ownership of the total LA Tokens in circulation will increase and decrease proportionately with other investors' LA Token holdings, depending on LA Token trade activity on free market exchanges.

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[8] *See, e.g.*, Uselton v. Comm. Lovelace Motor Freight, Inc., 940 F.2d 564, 574 (10th Cir. 1991) ("[I]n spite of Howey's reference to an 'investment of money,' it is well established that cash is not the only form of contribution or investment that will create an investment contract.")
[9] *DAO Report*, supra note 3, at 11
[10] See, e.g., Curran v. Merrill Lynch, 622 F.2d 216 (6th Cir. 1980).
[11] *See, e.g.*, Glenn W. Turner Enterprises, Inc., 474 F.2d 476, 482 n.7 (9th Cir. 1973).
[12] *DAO Report*, supra note 3, at 11.

It is also possible for a finder of fact to define "fortunes" as the value derived from asset tokens. The concept of asset tokenization within the LAT Platform creates the possibility of varying returns between LA Token holders based on individual participation within the LAT Platform. While LA Token holders begin use on the platform with the same form of LA Token, different LA Token holders can choose to use their LA Tokens to purchase different tokenized assets. For example, LA Token holders that choose to buy part of a specific tokenized real estate property on the LAT Platform will have a different level of reward than those LA Token holders that buy part of a tokenized artwork. Furthermore, the proceeds from the liquidation of the tokens which represent the equity value of the tokenized assets will vary based on the original value of the tokenized asset, the fluctuation in value while holding the tokenized asset, the terms for liquidating the tokens, and the final value once the tokens are repurchased or sold. Nonetheless, there remains a higher likelihood that a finder of fact will focus a horizontal commonality analysis on the LA Token, because that was the token directly purchased in the LAT ICO.

A successful determination of a horizontal common enterprise will depend on whether an analysis of the horizontal approach considers the variation in value of LA Tokens or asset tokens.

The LAT ICO may be considered an investment in common enterprise under narrow vertical commonality, because the Foundation will benefit from the rise and fall in value as LA Token holders. The LAT Whitepaper states that unsold tokens after completion of the LAT ICO would become property of the Foundation. Furthermore, 600,000,000 frozen LA Tokens were to be released daily, in ~0.05% increments, after completion of the LAT ICO, for an estimated five-year period. Therefore, the Foundation will incur the same profit or loss, pro rata, as LA Token purchasers in the LAT ICO, because the Foundation (i) owns and intends to sell LA Tokens after the LAT ICO; (ii) owned LA Tokens that had the same value as the LA Tokens purchased during the LAT ICO, upon completion of the LAT ICO; and (iii) will be able to sell LA Tokens on cryptocurrency exchanges based on the same rates available to the purchasers of LA Token during the LAT ICO.

The Foundation, on the other hand, assert that financial compensation of the Foundation is not exclusively derived from the sale of LA Tokens on exchanges, but also derived from the fees associated with tokenized asset transactions. Specifically, the Foundation charges fees for both asset tokenization and asset token trading. Courts have found that vertical commonality does not exist when profits and losses are not interdependent.[13] The Foundation could potentially argue that its profits are derived from LAT Platform fees, and exclusive from any profit derived from LA Tokens sold on the cryptocurrency exchanges. However, since LA Tokens were the purchased

[13] *See, e.g.*, Walther v. Maricopa Intern. Inv. Corp., 999 F. Supp. 725 (S.D.N.Y. 1998) (finding that "success of [plaintiff's] investments were directly tied to the fortunes of the defendants" and strict vertical commonality therefore existed where defendants "were to be paid only if [plaintiff's] funds made substantial gains," and "[c]onsequently, if [plaintiff's] funds appreciated in value, the defendants were financially compensated," whereas "if [plaintiff's] investment did not perform well, the defendants were not paid" (internal quotation marks omitted)); Kaplan v. Shapiro, 655 F.Supp. 336, 341 (S.D.N.Y. 1987) (Strict vertical commonality exists where there is a "one-to-one relationship between the investor and the investment manager" such that there is "an interdependence of both profits and losses of the investment"); see also Lowenbraun v. L.F. Rothschild, Unterberg, Towbin, 685 F.Supp. 336, 341 (S.D.N.Y. 1988) (noting that "[v]ertical commonality is present when there is interdependence between broker and client for both profits and losses of the investment" and holding that plaintiff had not established vertical commonality because "profits and losses were not interdependent since the broker allegedly profited from the commissions while plaintiffs suffered losses.").

items the LAT ICO, there will likely be a significant focus on the Foundation's profit derived from LA Tokens.

It should be noted that, if a finder of fact defines "value" as the profit or loss derived from performance of the asset tokens, then the required "success of the seller or other third party" would likely not be found.

A successful determination of a narrow vertical common enterprise will depend on whether the finder of fact considers profits and losses of the LA Token owned by the Foundation as the "value" received by the Foundation.

Finally, the LAT ICO may be considered investment in a common enterprise under the broad vertical commonality approach because of the relationship between the Foundation's work and the value LA Token purchasers receive due to increase in LA Token value. The Whitepaper indicates that a portion of the LAT ICO proceeds would go towards supporting and developing the LAT Platform. The Foundation's use of the LAT ICO proceeds to recruit asset owners, enter more cryptocurrency exchanges, and secure more partnership deals can potentially attract more purchases of LA Token, and thus increase the token's value. Furthermore, the Foundation's daily daily introduction of new LA Token's into the market may affect LA Token value. The finder of fact will likely consider the degree of connection between the Foundation's active promotion of the LAT Platform and the LA Token purchasers' reliance on the Foundation's work to increase the value of LA Token. For example, some courts may require that the fortunes of all LA Token holders must be "inextricably tied" to specific, identifiable actions of the Foundation.[14] Other courts may consider LA Token investors' entrustment of funds to the Foundation sufficient to find broad vertical commonality.[15]

Alternatively, a finder of fact may consider that the value of a LA Token holder's coin is based on the purchases of asset tokens. In this case, the asset value would be determined by the asset's respective market, and independent of the Foundation's actions or performance.

A successful determination of a broad vertical common enterprise would depend on the degree of connection, as required by the finder of fact, required to show that the value of LA Token is reliant on the Foundation's efforts.

The LAT ICO may be determined to have passed the second prong of the *Howey* test, depending on whether the horizontal or vertical approach is used for commonality, and depending on how the respective approaches are applied.

c. Expectation of Profits

[14] *See* 474 F.2d 476, 482-83 (9th Cir. 1973) ("[a] common enterprise is one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties […] requisite commonality is evidenced by the fact that the fortunes of all investors are inextricably tied to the efficacy of the Koscot meetings and guidelines on recruiting prospects and consummating a sale.")
[15] *See* Berman v. Bache, Halsey, Stuart, Shields, Inc., 467 F.Supp. 311, 319 (S.D. Ohio 1979) ("a finding of a common enterprise based solely upon the fact of entrustment by a single principal of money to an agent effectively excises the common enterprise requirement of Howey").

The third prong of the *Howey* test considers whether buyers who purchased an instrument reasonably expected to earn profits from the enterprise. For tokens, this can refer to any type of return or income earned as a result of being a token holder. However, subsequent case law interpreting *Howey* has clarified that the expectation of profit from the mere existence of a secondary market is insufficient to satisfy this prong.[16] There is no expectation of profit where a purchaser is motivated primarily by the desire to use or consume the item purchased.[17]

The SEC found that the Promotional Materials publicized by the DAO creators informed investors that the DAO was a for-profit entity whose objective was to finance projects in exchange for a return on investment. The very purpose of the DAO was to produce profit via investments in contractor projects proposed by the token holders, and to share such profit among its token holders, once the projects had been approved by the DAO curators and voted upon by the token holders. Since the functional value of a DAO Token was to provide token holders with the prospect of profits, the SEC reasoned that the DAO's investors would have been motivated by a reasonable expectation of profits.[18] The DAO Report stated that "expectation of profits" is not necessarily limited to distributions of cash or appreciation of equity interests, and that such expectation includes the types of rewards that The DAO promised to provide, such as participation in contractor projects.

In order to meet this prong of the *Howey* test, the expectation of profit need not be the only motivating factor for buyers in order to classify the purchased instrument as a security, but it must be the predominant motivation. The primary purpose of the DAO Token was to provide token holders with the prospect of profits by promising to use the ETC from the token sale to fund projects that would provide DAO Token holders with a return on investment. The primary purpose of the LA Tokens is to provide LA Token holders access to a marketplace for purchasing fractional ownership of assets. The possibility that some buyers may purchase LA Tokens for speculation, and that a secondary market may independently develop, does not challenge the utility purpose of the LA Token on the LAT Platform.

Unlike the DAO's approach, LA Tokens have a distinct utility purpose separate from generating profit, because LA Tokens add new functionality to a pre-existing business platform. Prior to the LAT ICO, the organizers of the Foundation operated the Zalogo Platform, which is a direct predecessor to the LAT Platform. In other words, the LAT Platform blockchain was implemented into the existing platform, and will serve the definitive role of unlocking fractional ownership of existing assets for LA Token holders. LA Token holders are unlikely to have a predominant expectation of profit based on the purchase of the LA Tokens themselves. The purchase of LA Tokens is necessary to participate in the marketplace offered on LAT Platform, which participation would be undertaken with the expectation of profit from the appreciation of the assets being tokenized.

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[16] *See, e.g.*, Noa v. Key Futures, Inc., 638 F.2d 77 (9th Cir.1980); Marco Santori, *Appcoin Law: ICOs the Right Way*, COINDESK (Oct. 15 2016); Note, the existence of a secondary market may be sufficient to satisfy this prong if the seller itself creates.
the secondary market, by for example, guaranteeing repurchase.

[17] *United Housing Foundation, Inc. v. Forman*, 421 U. S. 852-853 (1975).

[18] *DAO Report*, supra note 3, at 11-12.

In addition to the utility of the token, we must also examine whether promotion of the LAT ICO created a predominant expectation of profit. Unlike the Promotional Materials for the DAO, which contained investment language advertising the "rewards" that token holders would receive from profits generated by contractor projects, or the ability to vote for contractor projects, the Foundation did not promise any rewards, voting rights, or ownership other than access to its already-existing LAT Platform in order to interact with other LA Token holders.

For the reasons stated above, the LAT ICO likely does not satisfy the third prong of the *Howey* test.

d. Solely from the Efforts of Others

The fourth prong of the *Howey* test examines whether or not the profits of an instrument are derived solely from the managerial efforts of others. Courts have expanded the term "solely" in this context such that, in addition to the literal meaning, the efforts can *predominately* come from the efforts of others.[19]

In the DAO Report, the SEC determined that the DAO's investors were reliant on the managerial efforts of The DAO "Curators" (which were chosen by Slock.it) because the Curators performed crucial security functions and maintained ultimate control over which proposals could be submitted to, voted on, and funded by the DAO, and because the DAO's investors had limited voting rights.

i. Derived from Managerial Efforts of Others

The SEC found that the DAO organizers, through their conduct and within the Promotional Materials, led investors to believe that success of the DAO depended on the Curators' expertise and broad discretion to (1) choose contractors, (2) determine whether and when to submit contractor proposals for votes, (3) determine the order and frequency of the proposals that were submitted for votes, and (4) determine whether to reduce the investor voting quorum requirement to vote on a proposal by 50%.

Thus, the Curators exercised significant control over the order and frequency of proposals, and could impose their own subjective criteria for whether the proposal should be whitelisted for a vote by DAO Token holders. DAO Token holders' votes were limited to proposals whitelisted by the Curators, and, although any DAO Token holder could put forth a proposal, each proposal would follow the same protocol, which included vetting and control by the current Curators. While DAO Token holders could put forth proposals to replace a Curator, such proposals were subject to control by the current Curators, including whitelisting and approval of the new address to which the tokens would be directed for such a proposal.

Unlike the DAO, the success of the LAT Platform does not predominantly depend on the managerial efforts and expertise of the Foundation. Rather, use of LA Tokens on the LAT Platform is driven by each LA Token holder's decision to engage with the LAT Platform by buying or selling fractional, tokenized assets. Asset holders set their own criteria and prices for tokenized

[19] *See e.g.*, 474 F.2d 476, 482-83 (9th Cir. 1973); *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473 (5th Cir. 1974) (emphasis added).

assets sold to buyers in exchange for LA Tokens. LA Token holders solely determine what tokenized assets they want to purchase using their LA Tokens. As such, increase in value to the LA Token holders would be derived from token holders' own efforts and stem from participation itself rather than the efforts of the Foundation. Thus, the value of the LAT Platform depends entirely on the number of users utilizing the LAT Platform to create transactions with one another.

It would be worth examining how much discretion the Foundation exercises in the real estate "Qualification Check" and artwork "Application", as this gatekeeping could be likened to the DAO Curator's selection of proposals. It should also be noted that the Foundation's certification of asset appraisers and custodians for valuing and transacting a seller's tokenized assets may be compared to the DAO's Curators. However, the asset appraisers and custodians are ministerial, as they are not responsible for increasing value based on their actions. The asset owners are able to choose these vendors from a list provided by the Foundation, and the terms by which these vendors must act are pre-determined in a self-executing smart contract. The value of asset tokens only increases as a result of changes in the market. LA Token holders are active participants rather than passive investors, and do not rely on the management of the Foundation to increase the value of LA Tokens post-LAT ICO [,other than in their efforts to attract more users to the LAT Platform].

The DAO Report focused on the DAO's managerial efforts that generated profits, which came *after* the token sale.[20] We have been made aware that in November 2017, the SEC has been sending letters to companies that offered for sale and sold utility tokens in the U.S., informing them that any cryptographic tokens that were not functional prior to the initial token sale will not be considered utility tokens by the SEC or exempt from the requirements imposed on securities. Therefore, it is important for the purpose of the LA Token analysis to consider whether LA Token was a "pre-functioning" or "already-functioning" token at the time of the LAT ICO.

In a "pre-functioning" token sale, an expectation of profit is predominantly derived from the efforts of others when entrepreneurial efforts have not taken place prior to the token sale.[21] In an "already-functioning" token sale, an expectation of profit would not be predominantly derived from the efforts of others when (1) the value of the promoter's efforts had already been impounded into the purchase price of the investment, and (2) neither the promoter nor anyone else was expected to make further efforts that would affect the outcome of the investment."[22]

The DAO token was considered a pre-functional token sale because investors relied on the Curators to exercise discretion in choosing contractor projects, and such activity occurred only after the DAO token sale had commenced.[23] Therefore, the DAO Token would not be considered an already-functioning token, because the Curators' efforts could not have been factored into the

[20] *DAO Report*, supra note 3, at 12.
[21] *See* Juan Batiz-Benet, Marco Santori, and Jesse Clayburgh, The SAFT Project: Toward a Compliant Sale Framework, (October 2, 2017), http://www.saftproject.com/static/SAFT-Project-Whitepaper.pdf (citing *SEC v. Edwards*, 540 U.S. 389 (2004).
[22] *SEC v. Life Partners, Inc.*, 87 F.3d 536, 547 (D.C. Cir. 1996).
[23] *DAO Report*, supra note 3, at 5-6 (The DAO code was first uploaded to the Ethereum blockchain on April 29, 2016, and the DAO token sale commenced on April 30, 2016).

token sale price, and there was an expectation for the Curators' actions to increase the investment value by securing contractor jobs that produced profit.

The LA Token would not be considered a pre-functioning token, because LA Token had been deployed and functional prior to the LAT ICO, and because the value of LA Tokens were dependent on each LA Token holder's choice to purchase fractional tokenized assets after the LAT ICO. LA Token will likely be considered an already-functioning token, because (1) the costs of LA Token development was already built into the LAT ICO price, and (2) intervention by the Foundation is generally not required for LA Tokens to function.

ii. Voting Rights

In the DAO Report, the SEC focused on the fact that the DAO Promotional Materials promised DAO Token holders that they could vote on contract proposals, including proposals to the DAO to fund projects and distribute the DAO's anticipated earnings from the projects it funded.[24] Each DAO Token holder's vote, according to the DAO Promotional Materials, are weighed based on the number of DAO Tokens that each DAO Token holder holds. However, the Curators have broad discretion to pre-approve the contractor projects that are submitted to a vote, including those projects that are voter submitted. As a result of this broad discretion, even when DAO Token holders did vote, their voting rights were limited because the DAO voting algorithm inherently disincentivized certain investor voting behaviors.[25] Because of the significant role played by the Curators, the SEC found that DAO Token holders were substantially reliant on the managerial efforts of Slock.it, its co-founders, and the Curators to approve profitable investment opportunities.

In the LAT Whitepaper, specific voting rights are not afforded to purchasers of asset tokens on the LAT Platform. The terms of purchase for the asset token are in a self-executing smart contract, transparently programmed on the Ethereum blockchain before the asset tokens are available for purchase. Instead of voting, LA Token holders individually browse the LAT Platform to decide what assets to purchase — this opportunity is not determined by management. The LAT Whitepaper states that a qualification requires the asset owner to provide basic information about the real property, indicate the percentage of the asset value to be tokenized, a settlement date, and household finances. Unlike the DAO's discretionary oversight in choosing projects for DAO Token holders to engage with, there is a set of standard criteria for qualifying assets for sale on the LAT Platform.

For the reasons stated above, the LAT ICO likely does not satisfy this fourth prong of the *Howey* test.

V. CONCLUSION

In the United States, the implication of the DAO Report is that depending on the facts and circumstances of an individual token sale, the virtual coins or tokens that are offered or sold may

[24] ID at 4.
[25] Id at 7.

be considered securities, and that if they are considered securities, the offer and sale of these virtual coins or tokens are subject to compliance with federal securities laws.

To avoid being considered an investment contract and thus a security, the LAT ICO needed to avoid only one of the *Howey* prongs. In fact, based on the LAT Whitepaper, the LAT ICO likely avoids both the "reasonable expectation of profits" and the "derived from the efforts of others" prongs. Thus, based on the existing law, the LAT ICO would likely not be deemed a securities offering, and accordingly, and federal securities laws would likely not apply to the initial distribution and subsequent trading of LA Tokens.

VI. DISCLAIMER

A conclusion in this Memorandum that the LAT ICO qualification as a utility token sale does not guarantee that (a) the SEC or a regulatory authority in another jurisdiction will agree with the logic presented herein, (b) that applicable law will not subsequently be interpreted by the courts to lead to a different conclusion, or (c) that the Foundation may rely on such conclusion with respect to a decision not to register LA Tokens.

Please note that laws surrounding cryptocurrency and ICO markets are rapidly evolving. As recently as December 11, 2017, SEC Chairman Jay Clayton released a public statement which cautioned that merely structuring a token to provide some utility does not prevent the token from being a security. [26] Furthermore, the statement urged lawyers and other advisors to refer to the DAO Report, and continue to use the current U.S. securities law as a guide.[27]

Should the Foundation's tokens be determined to be securities by the SEC, or another regulatory authority, the Foundation and the individuals involved in the LAT ICO may be subject to civil or criminal penalties, if the tokens are not properly registered, as applicable. The analysis presented in this Memorandum concluding that LA Token is likely a utility token will not exempt the Foundation from registration requirements in the United States or in any other jurisdiction or excuse the Foundation or the individuals involved in the LAT ICO from liability, if and as applicable.

THIS MEMORANDUM IS NOT A LEGAL OPINION OF THE FIRM. THE FIRM ACCEPTS NO RESPONSIBILITY OR LIABILITY FOR THE ACCURACY OF THE ANALYSIS PRESENTED HEREIN OR FOR ANY ACTIONS OR FAILURES TO ACT OF THE FOUNDATION MADE IN RELIANCE THEREON.

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[26] SEC Chairman Jay Clayton, *Statement on Cryptocurrencies and Initial Coin Offerings*, (December 11, 2017), *available at* https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11 (the "Statement") ("Merely calling a token a "utility" token or structuring it to provide some utility does not prevent the token from being a security. Tokens and offerings that incorporate features and marketing efforts that emphasize the potential for profits based on the entrepreneurial or managerial efforts of others continue to contain the hallmarks of a security under U.S. law.)

[27] Id