AIN'T MISBEHAVIN': AN EXAMINATION OF BROADWAY TICKETS AND BLOCKCHAIN TOKENS

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I. INTRODUCTION

Discussing the relevance of federal securities laws to initial coin offerings (ICOs)[1] at the end of 2018, Securities and Exchange Commission (SEC) Chairman Jay Clayton analogized the issuance and sale of blockchain-based cryptographically-protected tokens[2] to the advance sale of tickets to fund a Broadway show production.[3] It is commendable that Chairman Clayton and the SEC Staff continue to engage with the blockchain community in order to provide guidance to the market.[4] In that spirit, this Article aims to distill some of the lessons from Chairman Clayton's Broadway ticket analogy.

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1. "ICO" refers to the type of fundraising in which a company (the sponsor) creates some number of tokens (typically referred to as utility tokens) and sells them to members of the general public to raise funds to develop or expand a blockchain-based protocol or network that uses these tokens. *See* Nathaniel Popper, *An Explanation of Initial Coin Offerings*, N.Y. TIMES (Oct. 27, 2017), https://www.nytimes.com/2017/10/27/technology/what-is-an-initial-coin-offering.html. Frequently, the sponsor states that its intention for the resulting network is for it to be decentralized. Dror Futter, *SEC on ICO's: The Central Thing Is Decentralization*, CROWDFUND INSIDER (June 28, 2018, 6:22 PM), https://www.crowdfundinsider.com/2018/06/135344-sec-on-icos-the-central-thing-is-decentralization/. Nevertheless, at the time the funds are raised, the sponsor almost always has control of the fundraising and the subsequent use of the proceeds of the token sales—through various means, the sponsor may also retain direct or effective control over the network as well. *See* Alex Lielacher, *ICOs Version 2.0 — What Are DAICOs and Will They Revolutionize the ICO*, BRAVE NEW COIN (May 29, 2018, 12:54 PM), https://bravenewcoin.com/insights/icos-version-2-0-what-are-daicos-and-will-they-revolutionize-the-ico.

2. This article uses the terms "tokens" or "cryptographic tokens" to refer to instances of computer code maintained on a blockchain-based ledger that are encrypted using cryptography, with each token typically representing a specific value or amount on the relevant ledger.

3. *See infra* note 13. Chairman Clayton made clear in each case that his public statements on these matters do not represent official SEC policy, consistent with the position regarding public statements made by the Staff of the SEC. *Id.*; Jay Clayton, *Statement Regarding SEC Staff Views*, U.S. SEC. & EXCH. COMM'N (Sept. 13, 2018), https://www.sec.gov/news/public-statement/statement-clayton-091318.

4. *See* William Hinman & Valerie Szczepanik, *Statement on "Framework for 'Investment Contract' Analysis of Digital Assets,"* U.S. SEC. & EXCH. COMM'N (Apr. 3, 2019), https://www.sec.gov/news/public-statement/statement-framework-investment-contract-analysis-digital-assets. On April 3, 2019, the Staff of the SEC, as part of a continuing effort to assist those seeking to comply with the U.S. federal securities laws, published a framework (the "Token Framework") for analyzing whether a digital asset is offered and sold as an investment contract, and therefore is a security. The SEC Staff explained that the Token Framework is not intended to be an exhaustive overview of the law, but rather an analytical tool to help market participants assess whether the federal securities laws apply to the offer, sale, or resale of a particular digital asset. *Id.* That same day, the SEC's Division of Corporation Finance (the "Division") issued a response to a

One of the most fundamental issues impacting the development of blockchain-based platforms is the appropriate legal and regulatory treatment of two intertwined concepts: the fundraising through the means of an ICO, and the tokens sold to those participating in the fundraising (whether held by those initial purchasers or re-sold by them to third parties).[5] When testifying before Congress in February 2018, Chairman Clayton stated, "Every ICO I've seen is a security"[6]—throwing this issue into a very harsh spotlight. However, despite a vast number of commentaries on the proper securities law treatment of ICOs,[7] very few

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no-action request from TurnKey Jet, Inc. (the "TKJ Letter"), indicating that the Division would not recommend enforcement action to the SEC if the digital asset described in the request is offered or sold without registration under the U.S. federal securities laws. *See* TurnKey Jet, Inc., SEC No-Action Letter, 2019 WL 1471132 (Apr. 3, 2019). Although both the Framework and the TKJ Letter are helpful additions to the body of thought issued by the SEC and their Staff on the topic of ICOs, digital assets, and securities law compliance, neither of these directly address the issues discussed in this Article.

5. *See* Popper, *supra* note 1.

6. *See* Stan Higgins, *SEC Chief Clayton: 'Every ICO I've Seen Is a Security'*, COINDESK (Feb. 7, 2018, 1:12 AM), https://www.coindesk.com/sec-chief-clayton-every-ico-ive-seen-security?amp.

7. *See, e.g.*, Shlomit Azgad-Tromer, *Crypto Securities: On the Risks of Investments in Blockchain-Based Assets and the Dilemmas of Securities Regulation*, 68 AM. U. L. REV. 69 (2018) (analyzing the justifications for regulation to blockchain-based investments); William Magnuson, *Financial Regulation in the Bitcoin Era*, 23 STAN. J.L. BUS. & FIN. 159 (2018) (arguing that traditional forms of regulation are ineffective to regulate blockchain-based investing); Michael Mendelson, *From Initial Coin Offerings to Security Tokens: A U.S. Federal Securities Law Analysis*, 22 STAN. TECH. L. REV. 52 (2019) (discussing how to plan an ICO); Darren J. Sandler, *Citrus Groves in the Cloud: Is Cryptocurrency Cloud Mining a Security?*, 34 SANTA CLARA HIGH TECH. L.J. 250 (2018) (analyzing the circuits' differing approaches to cloud mining technology); Nate Crosser, Comment, *Initial Coin Offerings as Investment Contracts: Are Blockchain Utility Tokens Securities?*, 67 U. KAN. L. REV. 379 (2018) (citing SEC v. W.J. Howey Co., 328 U.S. 293 (1946)) (applying the test developed in *Howey* to utility tokens); Marco Dell'Erba, Note, *Initial Coin Offerings: The Response of Regulatory Authorities*, 14 N.Y.U. J.L. & BUS. 1107 (2018) (describing the failures of regulators in responding to ICOs); Nareg Essaghoolian, Comment, *Initial Coin Offerings: Emerging Technology's Fundraising Innovation*, 66 UCLA L. REV. 294 (2019) (citing *Howey*, 328 U.S. 293) (applying the *Howey* test to ICOs); Joseph D. Moran, Comment, *The Impact of Regulatory Measures Imposed on Initial Coin Offerings in the United States Market Economy*, 26 CATH. U.J.L. & TECH. 7 (2018) (comparing different ways in which tokens are offered in ICOs and the accompanying regulation); Ori Oren, Note, *ICO's, DAO's, and the SEC: A Partnership Solution*, 2018 COLUM. BUS. L. REV. 617 (2018) (suggesting that the securities laws apply differently to decentralized autonomous organization as to ICOs); Jay Preston, Note, *Initial Coin Offerings: Innovation, Democratization and the SEC*, 16 DUKE L. & TECH. REV. 318 (2018) (suggesting how securities law may be updated to encompass ICOs); Nathan J. Sherman, Note, *A Behavioral Economics Approach to Regulating Initial Coin Offerings*, 107 GEO. L.J. ONLINE 17 (2018) (analyzing the psychological behavior of investors to justify regulation); Ximeng

of these have examined closely the critical distinction between the treatment of the fundraising, on the one hand, and the tokens, on the other. Fortunately, Chairman Clayton's own Broadway ticket analogy provides an ideal environment to take a closer look at this question.

To do so, this Article briefly provides background on the relevant aspects of securities law, following with an examination of the ticket analogy. For as long as there have been bridges to sell, unscrupulous promoters have been packaging up investment schemes as standard commercial purchase-and-sale agreements. As I will discuss in more detail below, in many cases the form of these agreements is ignored (most commonly when something goes wrong, and the promoter absconds with the purchase money or the promised goods or services never materialize in the way expected). In these cases, the schemes are often recharacterized by courts as disguised securities offerings that were subject to compliance with the federal securities laws.[8] In most of these cases, it is generally straightforward to distinguish the investment scheme from the asset, good, or service which is its object.[9] However, tokens sold in ICOs pose more challenging analytic questions and have caused ongoing consternation, even to some of the most seasoned regulators.[10] In the concluding sections, this Article shows that, through the lens of the Broadway ticket analogy, the relationship between ICOs and their resultant tokens can be better understood.[11] Finally, the Article suggests that commodities law may be a better framework to regulate cryptographic tokens in many cases.[12]

II. CHAIRMAN CLAYTON'S BROADWAY TICKET ANALOGY

A. The Flexibility of the Application of the Securities Acts

Speaking at the *Consensus: Invest* conference, held in New York City, on November 27, 2018,[13] Chairman Clayton began his discussion

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Tang, *Seventy Years After Howey: An Overview of the SEC's Developing Jurisdiction over Digital Assets*, ABA BUS. L. TODAY (Oct. 12, 2018), https://businesslawtoday.org/2018/10/seventy-years-howey-overview-secs-developing-jurisdiction-digital-assets/ (explaining why ICOs generally implicate securities law and suggesting alternatives).

8. *See infra* Section III.B.

9. *See infra* Section III.B.

10. *See infra* Section IV.D.

11. *See infra* Part IV.

12. *See infra* Part V.

13. Zack Seward, *SEC Chairman Jay Clayton's Full Consensus: Invest Interview*, COINDESK (Nov. 28, 2018, 10:13 PM), https://www.coindesk.com/sec-jay-clayton-consensus-invest-video.

of the Broadway ticket analogy by noting that the drafters of the Securities Act of 1933 (the Securities Act)[14] were "very smart people."[15] According to Chairman Clayton, the drafters realized that having a static definition of the term "security" (limited to "a piece of paper that you give to someone in exchange for an interest in a corporation") would result in far too narrow a regulatory framework.[16] Chairman Clayton noted that such a rigid definition could easily be circumvented.[17] In fact, the principles-based definition of the term "security,"[18] adopted by Congress underpins the entirety of U.S. securities law. It has allowed the SEC to prosecute a wide range of fraudulent investment schemes over the years, resulting in the return of funds to duped investors and preventing further harm by wrongdoers.[19] Despite the inevitable interpretive challenges such an approach entails, the principles-based regulatory framework has been a key factor in the adaptability and dynamism of securities regulation and the global preeminence of the United States' capital markets.[20]

One way in which this flexibility was built into the Securities Act and its companion law adopted a year later, the Exchange Act,[21] (the Exchange Act and, together with the Securities Act, the Securities Acts) was by defining the term "security" to include—among the well-understood terms[22] and some additional very particular terms[23]—a catch-all term: "investment contract."[24] The term "investment contract" was not otherwise defined in the Securities Acts and, unlike other terms included within the definition of security, it lacked a self-evident meaning.[25]

It was not until 1946 that a clear understanding of the term "investment contract," in the context of the Securities Acts was first

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14. Securities Act of 1933, 15 U.S.C. §§ 77a–77aa (2018).

15. *See* Seward, *supra* note 13.

16. *Id.*

17. *Id.*

18. *See* Securities Act of 1933, 15 U.S.C. § 77b(a)(1) (defining security).

19. *See* SEC v. W.J. Howey Co., 328 U.S. 293 (1946); *see also* Reves v. Ernst & Young, 494 U.S. 56 (1990).

20. *See* Seward, *supra* note 13.

21. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78mm (2018).

22. *See* Securities Act of 1933, 15 U.S.C. § 77b(a)(1) (using terms such as "note," "stock," and "debenture.").

23. *See id.* (using terms such as "collateral trust certificate" and "fractional undivided interest in oil, gas or other mineral rights.").

24. *See id.* The definition of the term "security" in the Securities Act also contains the phrase "any interest or instrument commonly known as a 'security.'" This part of the definition is less frequently cited in the types of circumstances that concern us here.

25. *See id.*

developed.[26] The U.S. Supreme Court issued an opinion in a case, known as *SEC v. W.J. Howey Co.*,[27] that arose from a convoluted scheme that nominally involved the purchase and sale of land containing orange groves located in Florida, accompanied by the possibility of the land purchaser also entering into a servicing agreement for the groves from an entity affiliated with the seller.[28] In articulating the now well-known *Howey* test,[29] the Court noted that states had commonly used the term "investment contract" in their blue sky laws prior to the adoption of the Securities Acts; the Court incorporated the general interpretive principles applied by state courts to this term.[30]

Subsequent cases made clear that an ostensible purchase-and-sale or other commercial arrangement may be documented in any number of writings or agreements (as was the case in the particular facts of *Howey*), but may still be found to be the type of scheme considered to be an "investment contract."[31] Likewise, the absence of any formal agreements or writings among the parties to a commercial arrangement would not preclude purely oral or lightly-documented arrangements from being considered investment contracts if the requisite *Howey* factors were met.[32]

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26. *See* SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946).

27. *Id.*

28. *See id.* at 295.

29. *Id.* at 301. The "*Howey* test" determines whether or not a particular arrangement constitutes an "investment contract" and looks to whether there is (1) an investment of money (2) in a common enterprise (3) with a reasonable expectation of profits (4) to be derived from the entrepreneurial or managerial efforts of others. *Id.*

30. *Id.* at 298. The *Howey* opinion noted a long history of the term investment contract used in the context of states' securities laws:

> The term investment contract is undefined by the Securities Act or by relevant legislative reports. But the term was common in many state blue sky laws in existence prior to the adoption of the federal statute and, although the term was also undefined by the state laws, it had been broadly construed by state courts so as to afford the investing public a full measure of protection. Form was disregarded for substance and emphasis was placed upon economic reality. An investment contract thus came to mean a contract or scheme for the placing of capital or laying out of money in a way intended to secure income or profit from its employment. This definition was uniformly applied by state courts to a variety of situations where individuals were led to invest money in a common enterprise with the expectation that they would earn a profit solely through the efforts of the promoter or of someone other than themselves.

Id. (internal citations and quotations omitted).

31. *See infra* Section III.A.

32. *See, e.g.*, Anderson v. Francis I. Du Pont & Co., 291 F. Supp. 705 (D. Minn. 1968) (holding that oral agreements between plaintiff and defendant under which plaintiff delivered funds to defendant, based on defendant's promise to invest money in commodities with guaranteed profits, constituted investment contracts); SEC v. Addison,

Although this open-ended approach may aid the efforts of plaintiffs seeking redress and the SEC's ability to bring effective enforcement actions, it also has been difficult for private parties to determine *ex ante* whether a court would consider a particular commercial arrangement an investment contract—thus, a sale of a security.[33] In fact, long before cryptographic tokens were a gleam in the eye of Satoshi Nakamoto,[34] scholars (along with courts adjudicating claims involving private parties) grappled with the deliberately broad and open-ended definition of "security"—without reaching any widely accepted conclusions.[35]

B. The Broadway Ticket Analogy

In light of the above, it should come as no surprise that providing clear guidance to market participants on how to apply the *Howey* test to a typical ICO has proved particularly challenging for the SEC—despite its numerous attempts to do so.[36] At an event entitled *Times Talks*, held in

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194 F. Supp. 709 (N.D. Tex. 1961) (holding oral agreements between defendants' workers and defendants, under which workers were urged to contribute money to defendants based on defendants' representations the workers would thereby participate and share in revenues from defendants' mining and other operations, were investment contracts); State v. Johnson, 652 N.W.2d 642 (Wis. 2002) (holding defendant had offered to sell securities despite defendant's argument that "there can be no violation of securities law if all of the representations are made orally and there is no written security prepared.").

33. *See* Securities Act of 1933, 15 U.S.C. § 77*l*(a)(1) (2018). This distinction is critical when commercial arrangements turn sour. If a purchaser of a good or service is later able to successfully show that her arrangement with the seller actually amounted to an unregistered offering of securities, the purchaser will have a statutory right of rescission without the need to show an intent to defraud or the breach of any contractual arrangement. *Id.*

34. For more on Satoshi Nakamoto, the author(s) of the Bitcoin white paper, see L. S., *Who Is Satoshi Nakamoto?*, THE ECONOMIST (Nov. 2, 2015), https://www.economist.com/the-economist-explains/2015/11/02/who-is-satoshi-nakamoto.

35. *See, e.g.*, Ronald J. Coffey, *The Economic Realities of a "Security": Is There a More Meaningful Formula*, 18 CASE W. RES. L. REV. 367 (1967); Scott T. FitzGibbon, *What is a Security?—A Redefinition Based on Eligibility to Participate in the Financial Markets*, 64 MINN. L. REV. 893 (1980); Michael P. Malloy, *The Definition of Security: Marine Bank v. Weaver*, 24 B.C. L. Rev. 1053 (1983).

36. *See, e.g.*, U.S. SEC. & EXCH. COMM'N, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Release No. 81207, 2017 WL 7184670 (July 25, 2017); U.S. SEC. & EXCH. COMM'N, Investor Bulletin: Initial Coin Offerings, (July 25, 2017), https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_coinofferings; Public Statement, Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n, Statement on Cryptocurrencies and Initial Coin Offerings (Dec. 11, 2017), https://www.sec.gov/news/public-statement/statement-clayton-2018-12-11;

New York City on November 29, 2018 (only a few days after the *Consensus: Invest*[37] conference), Chairman Clayton revisited his discussion of ICOs.[38] Clayton noted that:

> If you are going out broadly, and you're saying to people you don't know, 'give me your money and I'll give you a stock certificate, or I'll give you an investment contract, or I'll give you a warehouse receipt, or I'll give you a token, and I don't really know you but I'll give you that' and you're expecting to

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Virtual Currencies: The Roles of the SEC and the CFTC before the S. Comm. on Banking, Hous., & Urban Affairs (2018) (statement of Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n), https://www.sec.gov/news/testimony/testimony-virtual-currencies-oversight-role-us-securities-and-exchange-commission ("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."); U.S. SEC. & EXCH. COMM'N, *The SEC Has an Opportunity You Won't Want to Miss: Act Now!* (May 17, 2018), https://www.sec.gov/news/press-release/2018-88 (announcing satirical launch of "Howey Coin"); William Hinman, SEC Director of the Division of Corporation Finance, Digital Asset Transactions: When Howey Met Gary (Plastic), Remarks at the Yahoo Finance All Market Summit: Crypto (June 14, 2018), in U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/news/speech/speech-hinman-061418; *Oversight of the U.S. Securities and Exchange Commission Before the H.R. Comm. on Fin. Servs.* (2018) (statement of Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n), https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission ("If you are attempting to fund a project—whether it be opening a new manufacturing plant or creating an application on a distributed network—by inviting others to invest in the enterprise based on the expectation that they will profit from other people's efforts, the same laws and standards apply: register the securities offering or use an exemption from registration. Issuing a token rather than a share certificate does not change that approach."); U.S. SEC. & EXCH. COMM'N, Div. of Corp. Fin., Div. of Inv. Mgmt. & Div. of Trading & Mkts., Statement on Digital Asset Securities Issuance and Trading (Nov. 16, 2018), https://www.sec.gov/news/public-statement/digital-asset-securites-issuuance-and-trading; *Oversight of the U.S. Securities and Exchange Commission Before the S. Comm. On Banking, Hous. And Urban Affairs.* (2018) (statement of Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n), https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission-0; Hester Peirce, Comm'r, U.S. Sec. & Exch. Comm'n, Regulation: A View from Inside the Machine (Feb. 8, 2019), https://www.sec.gov/news/speech/peirce-regulation-view-inside-machine; Hinman & Szczepanik, *supra* note 4; TurnKey Jet, Inc., SEC No-Action Letter, 2019 WL 1471132 (Apr. 3, 2019).

37. *See* Seward, *supra* note 13.

38. *S.E.C. Chairman Jay Clayton & Andrew Ross Sorkin*, TIMES TALKS (Nov. 28, 2018), https://www.timestalks.com/talks/timestalksdealbook-andrew-ross-sorkin-and-s-e-c-chairman-jon-clayton/.

> get some kind of return from that based on my efforts—that's a security.[39]

And why does this type of arrangement require special regulation? Because, according to Clayton, "that distant relationship and that money changing hands—it's ripe for fraud."[40]

In his public remarks at both events, Chairman Clayton used the analogy of fundraising for a Broadway production to illustrate the flexibility of the statutory definition of "security" in the United States.[41] As put forward by Chairman Clayton, one can better understand when the federal securities laws are implicated in the offer and sale of tokens in a typical ICO by thinking of a Broadway producer seeking funding for a new show.[42] In Clayton's analogy, one can presume that the producer has the basic idea for a show and its component features (*i.e.*, has published a white paper), but has not yet written the book or the score for the show (*i.e.,* has not yet developed the related coding for the network), or hired the actors and support staff or secured the venue (*i.e.*, implemented the nodes and other elements of an operational network). In fact, to bring the analogy closer to the typical ICO, all the producer may have at this stage is an idea (*e.g.*, it is going to be a new musical called *Ain't Misbehavin'* based on the classic songs of Fats Waller) and a basic pitch (*e.g.*, "This is the perfect time to revisit the golden days of the Harlem Renaissance!").

In the Chairman's analogy, to raise money to develop the new production, his hypothetical producer initially contacts 15 people to invest in the show, stating something like, "Your interest in this play is going to be a suite of tickets."[43] For purposes of a more fleshed out discussion, let's presume that the tickets are for various dates in the

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39. *Id.*

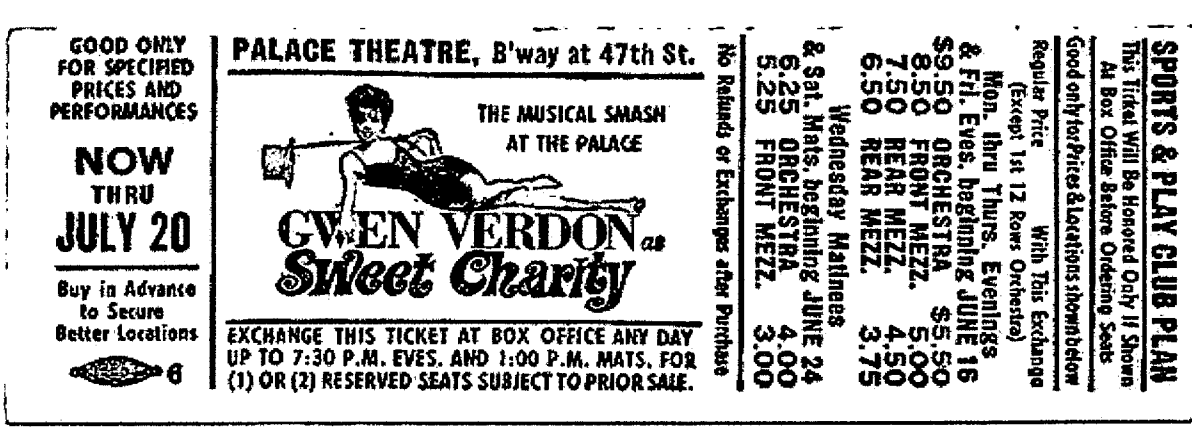
40. *See, e.g.*, Ana Alexandre, *New Study Says 80 Percent of ICOs Conducted in 2017 Were Scams*, COIN TELEGRAPH (July 13, 2018), https://cointelegraph.com/news/new-study-says-80-percent-of-icos-conducted-in-2017-were-scams. The ICO market has indeed been ripe for fraud. The wide pool of market participants seeking to capitalize on what appeared to be other-worldly gains being recorded by bitcoin and other digital assets between 2016 and 2018, combined with the ease by which a scammer could create a new blockchain token and website on which to market it, allowed countless fraudulent token schemes to flourish. For a discussion of the SEC's enforcement efforts in this area, *see* U.S. SEC. & EXCH. COMM'N, ANNUAL REPORT DIV. OF ENF'T (2018), https://www.sec.gov/files/enforcement-annual-report-2018.pdf.

41. *See* Seward, *supra* note 13; *SEC Chairman Jay Clayton*, *supra* note 38.

42. *See* Seward, *supra* note 13; *SEC Chairman Jay Clayton*, *supra* note 38. Here, this Article endeavors to follow Chairman Clayton's analogy in all salient details, while adding facts and comparisons to ICO issuances to his analogy for color and clarity.

43. *See SEC Chairman Jay Clayton*, *supra* note 38.

future and were sold to the 15 investors at a deeply discounted price.[44] If 10,000 tickets were sold at $10 each, this would provide a total fundraising of $100,000 to the producer. Also, let's imagine that these are old-school tickets printed on heavy cardstock of the type illustrated below[45] and are available to be physically delivered to the purchasers (if desired) at the time of sale.



On the face of it, this arrangement could be considered a simple sale of goods transaction involving physical tickets to a Broadway show. However, let's also assume that, prior to their purchase decision, the 15 purchasers in the Chairman's analogy are told about the prospects for the producer's show, for its potential popularity, and that the economic benefits to the purchasers of the deeply discounted price are emphasized during the producer's sales pitch. The producer may even offer a separate service contract, pursuant to which the producer will hold onto the physical tickets on behalf of the purchasers and manage the resales of the

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44. *See* Alex Lielacher, *ICO Presale Best Practices: What Every Investor Should Know*, BITCOIN MKT. J. (Dec. 21, 2017, 8:00 AM), https://www.bitcoinmarketjournal.com/ico-presale-best-practices/. Many ICO pre-sale rounds in 2017 and 2018 had discounts at or approaching 90%, so this would not be unusual. More importantly, the fact that these arrangements involve the delayed delivery of a good, such as Broadway tickets or cryptographic tokens (depending on how documented), may well result in the arrangement being treated as a forward or future and subject to regulation under the Dodd Frank Wall Street Reform and Consumer Protection Act. *See* Dodd Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010). This is a very fact-dependent analysis and outside the scope of this article.

45. Image credit: Brian Cummings, *"The Musical Smash at the Palace" Gwen Verdon starring in Sweet Charity, 1966*, THE VERDON FOSSE LEGACY LLC (Aug. 18, 2012), http://verdonfosse.com/gwen-verdon-starring-in-sweet-charity-at-the-palace-theatre/.

tickets on their behalf, then distributing to the accounts of the purchasers the net profits from such sales.

Following the sales pitch, each purchaser is offered far more tickets than the purchaser could reasonably be expected to use for herself and those she knows.[46] Since the retail price of tickets to a successful Broadway show can easily exceed $100, the initial sale price of $10 per ticket would represent a very steep discount on the expected market price of the tickets once the show is launched. As a result of this arrangement, ticket purchasers would have a "reasonable expectation of profit" (although not a typical investment profit resulting from dividends on, or a sale of an equity interest, in the company producing the show, but rather simply from the ability to dispose of the tickets in the secondary market if the show turns out to be successful). Induced primarily by this prospect of profits, these individuals decide to purchase the tickets to finance the producer's vision.[47] To keep things simple, also presume that no written documentation is made between the producer and the ticket purchasers, since none is mentioned by Chairman Clayton.[48]

Based on his more lightly-sketched facts, Chairman Clayton argued that this arrangement constitutes a sale of "interests" in the Broadway production because the right to receive a suite of tickets in the manner described above effectively constitutes an offering of securities, and thus is subject to compliance with the Securities Acts.[49]

The author of this Article agrees with that conclusion. Looking at the analogy more closely, the purported commercial sale of show tickets now looks a bit different. The producer has almost certainly created an *investment scheme* meeting all of the prongs of the *Howey* test, and thus (wittingly or otherwise) has engaged in a securities offering.[50] Breaking things down, there is: (1) an investment of money (the purchasers pay the producer for the tickets with U.S. dollars); (2) in a common enterprise (although there are three separate judicial interpretations of this prong,[51] the common interest of the producer and the purchasers in the success of the show would likely be sufficient to satisfy any interpretation of this

46. *See* Seward, *supra* note 13; *SEC Chairman Jay Clayton*, *supra* note 38.

47. *See* Seward, *supra* note 13; *SEC Chairman Jay Clayton*, *supra* note 38.

48. *See* Seward, *supra* note 13; *SEC Chairman Jay Clayton*, *supra* note 38; *see also* cases cited *supra* note 32.

49. *See* Seward, *supra* note 13; *SEC Chairman Jay Clayton*, *supra* note 38.

50. *See supra* note 29 and accompanying text.

51. *Compare* Deckebach v. La Vida Charters, Inc., 867 F.2d 278 (6th Cir. 1989) (adopting horizontal commonality requirement), *with* McGill v. Am. Land & Exploration Co., 776 F.2d 923 (10th Cir. 1985) (adopting vertical commonality requirement), *and* Hocking v. Dubois, 839 F.2d 560 (9th Cir. 1988) (requiring either horizontal or vertical commonality).

standard); (3) with a reasonable expectation of profit on the part of the purchasers (rather than hoping to attend the same show thousands of times, the purchasers are motivated by an expectation of profits from the resale of the tickets); (4) primarily from the efforts of others (the hoped-for profits will come as a result of the efforts of the producer and those she hired to develop and launch the show and, perhaps, to re-sell the tickets in the secondary market on behalf of the purchaser).[52]

Presumably focused on the characterization of the tokens sold in an ICO, Chairman Clayton elaborated on his analogy: "You're giving them tickets in exchange for their interest in the play," and those tickets, he states with a dramatic pause, "are securities."[53] Here is where things get interesting.

One of the most vexing aspects of the securities law analysis of an ICO is the recognition that, although token purchasers may rely initially on a sponsor or initial developer of the network, the network is often expected at some point to no longer be controlled by that entity and instead to become decentralized.[54] Presumably, in an attempt to keep the Broadway ticket analogy in line with the typical ICO structure, Chairman Clayton continued:

> [The investors] are taking those tickets back, waiting for the profits; it's like taking ten per cent of the play . . . The play gets done; it's up and running; [the producer is] long gone; everybody gets their tickets distributed; and all you can exchange the tickets for is going to see the play—that's decentralized.[55]

In his remarks at the *Times Talks* event, Chairman Clayton added, "[w]hen an asset has become so distributed, so disaggregated, so out of the control of one person, the securities laws no longer apply and it looks like a currency."[56] More recently, SEC Commissioner Hester Peirce also

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52. *See supra* note 29 and accompanying text.

53. *See* Seward, *supra* note 13;

54. *See* Hinman, *supra* note 36; *see also infra* Section III.C.

55. *See* Seward, *supra* note 13;

56. *See SEC Chairman Jay Clayton*, *supra* note 38. As discussed in more detail below, the concept of decentralization in the context of a securities law analysis following *Howey* can be viewed as a red herring. In fact, the relationship between the sponsor and the purchasers can be much better understood through the lens of the third factor of the *Howey* test—whether the sponsor is continuing to provide "essential managerial efforts" to the project. *See infra* Part IV. Commissioner Peirce elaborates on this point:

> In the realm of securities regulation, we often talk of the need for disclosure as a means of addressing information asymmetries between the issuers and the investors. The "efforts of others" prong of *Howey* aims at the heart of this

highlighted the challenges which decentralized platforms create for applying traditional analytic frameworks, stating "while the application of the *Howey* test seems generally to make sense in this space, we need to tread carefully. Token offerings do not always map perfectly onto traditional securities offerings."[57]

C. Distinguishing Between an Investment Scheme and Its Object

By putting forward the Broadway ticket analogy, Chairman Clayton provided an instructive framework to explore a critical distinction in the securities law analysis of many typical ICOs: the difference between an investment scheme, subject to regulation as an investment contract; and the underlying asset that is itself the object of that scheme.[58] The former includes a purported standard commercial transaction with an apparent seller and purchaser of a good or service that in fact has all the hallmarks of an investment scheme (comparable in our analogy to the arrangements relating to the sale of a batch of tickets by the Broadway show's producer).[59] The latter refers to an asset or service that, in most cases, but for the totality of the arrangements surrounding the sale, would not otherwise be considered "securities."[60] In our analogy, but for the way in which the show tickets are marketed to the 15 purchasers, these tickets would have no inherent security-like characteristics and would not otherwise be considered "securities."[61]

Unfortunately, things do not always work out the way they are planned. In our analogy, the producer may simply abscond with the

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> problem. If the investors are not in control of the enterprise, that is, if they lack material information about the operation of the organization, they will need to obtain that information from those who are in control in order to make an informed investment decision.

See Peirce, *supra* note 36.

57. *See* Peirce, *supra* note 36.

58. This Article takes particular interest in those projects having a *bona fide* intention of becoming decentralized at some point in the future. That is, projects started by an individual, group of individuals, or company, which I refer to as the "catalyst entrepreneur[,]" seeking to develop a decentralized protocol or network using blockchain technology. *See* Futter, *supra* note 1. Because such projects almost always begin with a single company or small group of founders who initially develop and control the network, but who seek over time to transition the control and operation of the network to its participants through a process of decentralization, I refer to these as "decentralizing" projects. For more on decentralization, see Vitalik Buterin, *The Meaning of Decentralization*, MEDIUM (Feb. 6, 2017), https://medium.com/@VitalikButerin/the-meaning-of-decentralization-a0c92b76a274.

59. *See SEC Chairman Jay Clayton*, *supra* note 38.

60. *Id.*

61. *Id.*

$100,000 raised and never even attempt to put on the show (in ICO terms, an exit scam[62]). Alternatively, the producer may take much longer than expected to mount the show, leaving the ticket purchasers effectively prevented from realizing their hoped-for profits because there is no secondary market for tickets to a yet-to-be-produced show. Another possibility is that the show may get produced, but simply be unsuccessful in its initial format, with few takers for the tickets and very low resale prices. In each of these cases, the ticket purchasers will, quite understandably, be at best disappointed and perhaps even litigious, asserting that facts undisclosed at the time the tickets were offered to them were the driving reasons for the purchasers' losses and that, had these facts only been made clear at the time, they never would have parted with their money. When things go wrong in this way, the parties almost inevitably wind up in court.

When a court determines that an aggrieved purchaser of an asset, who lost money as a result of the purchase, was actually induced to purchase the asset primarily through a reasonable expectation of profit through the seller's efforts in producing or developing the product or service (rather than by the purchaser's own anticipated use and consumption of the product or service), courts are likely to find that the purported purchase-and-sale arrangement was in fact an investment contract.[63] More particularly, when the purchase-and-sale transaction meets all four prongs of the *Howey* test (regardless of how it may be documented), that transaction will be treated as subject to the Securities Acts—at least when the scheme is conducted on an interstate basis.[64] That much at least should be clear at this point. However, the objects of these schemes (*i.e.*, the product or service nominally being purchased as

62. *See* Shobhit Seth, *What's a Cryptocurrency Exit Scam? How do you Spot one?*, INVESTOPEDIA (Mar. 23, 2018), https://www.investopedia.com/tech/whats-cryptocurrency-exit-scam-how-spot-one/.

63. As noted, courts and the SEC have long recognized that sales of assets that have the potential to increase in value may not involve an investment contract, even when third parties play an ongoing role, so long as the primary purpose of the purchase is to "use and consume" the underlying asset that was the subject of the sale contract. United Hous. Found., Inc. v. Forman, 421 U.S. 837, 848 (1975). In *Forman*, the Supreme Court found that the purchase of property or services did not constitute an investment contract pursuant to the *Howey* test, holding that "when a purchaser is motivated by a desire to use or consume the item purchased . . . the securities laws do not apply." *Id.* at 852–53; *see also* LA Fan Club, Inc. Membership Program, SEC No-Action Letter, 2017 WL 2806908 (June 28, 2017); Erica Enders Racing, LLC, SEC No-Action Letter, 2006 WL 3391363 (Nov. 21, 2006).

64. *See supra* Section II.B.

part of the scheme) can vary significantly and are often not themselves "securities."[65]

Why is this distinction between an investment scheme and its object so important? Because for a decentralizing blockchain platform to succeed, its cardinal priority is to develop a critical mass of users and thus capture the value created by positive network effects.[66] If a decentralizing blockchain-based platform wishes to have any reasonable chance for success, as many potential users as possible must be able to employ the tokens for their intended purpose.[67]

Accordingly, when (1) tokens are offered for sale in a manner in which the purchasers are acquiring more of the tokens than they could have reasonably expected to use themselves and would have a reasonable expectation of profit from the purchase; and (2) the sale takes place at a time when the platform to which the tokens relate is still under construction or is dependent on a catalyst entrepreneur to achieve wide adoption (such that there is a likelihood that the purchaser's reasonable expectation of profits from the purchase will be driven by the efforts of the developer selling the tokens), there is a significant chance that the fundraising scheme itself (*i.e.*, the ICO)—regardless of how that scheme may be documented—will be considered an investment contract and thus a "security," which will mean that it needs to be registered with the

65. Critically, it is the case with most such investment schemes involving the sale and purchase of some asset, good, or service in which the object of the scheme can, at least in theory, be separated from the scheme and otherwise disposed. *See, e.g.*, SEC v. W.J. Howey Co., 328 U.S. 293 (1946). However, since virtually all case law and enforcement actions arise out of unsuccessful investment schemes (that is, where the purchaser lost money and brought a claim), it is difficult to find a case where the underlying object was successfully separated from the other elements of the scheme where it caused the entirety of the circumstances to be considered an investment contract. This should not, however, inhibit the inquiry into this crucial distinction in which the objects can be, and are, separated from their related investment schemes and the impact of such separation.

66. *See* Futter, *supra* note 1; *see also* Buterin, *supra* note 58. An example would be a blockchain platform that provides cloud storage without a central intermediary. Blocks with excess online storage capacity can, from time to time, make this capacity available to others who desire to store computer files online, receiving compensation for the cost of obtaining and maintaining this storage capacity through the receipt of tokens transmitted by users of the platform. Users, in turn, obtain these tokens in markets which allow those with excess tokens (i.e., providers of storage capacity) to find those seeking to pay for storage capacity.

67. *See* Yoav Vilner, *No More Hype: Time to Separate Crypto from Blockchain Technology*, FORBES (Nov. 14, 2018, 8:22 AM), https://www.forbes.com/sites/yoavvilner/2018/11/14/no-more-hype-time-to-separate-crypto-from-blockchain-technology/#69bb49ba171c.

SEC.[68] This helps one make sense of Chairman Clayton's statement quoted above that "[e]very ICO I've seen is a security."[69]

However, it is one thing to register a fundraising with the SEC—this is something commonly done.[70] Registration is an arrangement that mandates a minimum level of disclosure and provides a variety of other protections for the persons entering into a contractual relationship with the registrant.[71] It is quite another thing to say that a product or service that is the object of the fundraising *and that would not otherwise be considered a security but for the sale of the object as part of the investment scheme* is itself a "security."[72]

D. The Consequences of Treating Tokens as Securities

If one follows Chairman Clayton's logic as expressed in the Broadway ticket analogy, then it is not just the fundraising (*i.e.,* the investment scheme) that will need to be registered with the SEC, but also its object—the tokens themselves.[73] However, once the position is taken that tokens sold as part of an investment scheme are themselves also

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68. *See* Securities Act of 1933, 15 U.S.C. § 77e (2018). It is critical to note that by no means will all sales of cryptographic tokens involve securities offerings. Many market participants have worked in a variety of forums to help delineate standards and practices that find valid distinctions between sales of tokens in functional and dysfunctional systems. Under these standards, no securities offering occurs in functional systems, whereas dysfunctional systems result in violations of securities laws. *See, e.g.,* THE BROOKLYN PROJECT, https://thebkp.com/ (last visited Jan. 28, 2019). The Staff of the SEC has also stated that they may be able to provide No-Action Letters to certain projects involving the sale or distribution of cryptographic tokens in which no securities offering occurs. *See, e.g.*, Hinman *supra* note 36 (noting that the SEC Staff is "prepared to provide more formal interpretive or no-action guidance about the proper characterization of a digital asset in a proposed use").

69. *See* Higgins, *supra* note 6.

70. *See, e.g.,* Rich Rodman, *Fundraising: Three Things Startups Should Know to be SEC Compliant*, WEWORK, https://www.wework.com/ideas/fundraising-3-things-startups-know-sec-compliant (last visited June 21, 2019).

71. *See* Securities Act of 1933, 15 U.S.C. § 77e (2019).

72. *See* Seward, *supra* note 13; *see also SEC Chairman Jay Clayton, supra* note 38.

73. *See* Seward, *supra* note 13; *SEC Chairman Jay Clayton, supra* note 38. The SEC Staff also seems to have taken this position. *See, e.g.*, Carriereq, Inc., Securities Act Release No. 10575, 2018 WL 6017664 (Nov. 16, 2018), https://www.sec.gov/litigation/admin/2018/33-10575.pdf; Paragon Coin, Inc., Securities Act Release No. 10574, 2018 WL 6017663 (Nov. 16, 2018), https://www.sec.gov/litigation/admin/2018/33-10574.pdf (finding that the tokens sold in ICOs were securities required to be registered under Securities Act § 12(g)). Note that an alternative to registration of the tokens is to qualify the tokens for exemption from registration under Regulation A, but this still would involve treating the tokens as securities. *See* Regulation A Rule 251, 17 C.F.R. § 230.251 (2018).

securities, then all subsequent dealing in those tokens will also become securities transactions, creating a significant amount of friction with all future transfers of, or dealings in, those tokens. To begin, parties otherwise engaging in what would appear to be standard commercial transactions involving the tokens (including users, exchanges, and even the platform itself) would likely be considered broker-dealers and must meet a variety of complex regulatory requirements relevant only to persons in the business of dealing with assets that are traditionally recognized as securities.[74]

In addition, there are several other fundamental concerns that follow from categorizing the tokens used in connection with a decentralizing blockchain platform as securities. For example, a platform user acquiring a significant number of tokens may inadvertently be considered an investment company that is subject to regulation under the Investment Company Act of 1940,[75] as amended.[76] There are also special tax,[77] accounting,[78] regulatory capital,[79] and commercial law[80] provisions that

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74. "Broker" is defined in § 3(a)(4)(A) of the Exchange Act as "any person engaged in the business of effecting transactions in securities for the account of others." 15 U.S.C. § 78c(a)(4)(A) (2019). "Dealer" is defined in § 3(a)(5)(A) of the Exchange Act as "any person engaged in the business of buying and selling for his own account, through a broker or otherwise." 15 U.S.C. § 78c(a)(5)(A). Among other things, broker-dealers are subject to net capital requirements, are subject to SEC examinations, must maintain anti-money laundering programs and must comply with a wide variety of other requirements. *See Guide to Broker-Dealer Registration*, U.S. SEC. AND EXCH. COMM'N (Apr. 2008), https://www.sec.gov/reportspubs/investor-publications/divisionsmarketregbdguidehtm.html.

75. 15 U.S.C. §§ 80a-1–64 (2018).

76. Investment company is defined by Section 3 of the Investment Company Act of 1940 as:

> [A]ny issuer which (A) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities; (B) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or (C) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

15 U.S.C. § 80a-3.

77. *See, e.g., Topic Number 429 – Traders in Securities (Information for Form 1040 Filers)*, I.R.S. (Feb. 22, 2019), https://www.irs.gov/taxtopics/tc429.

78. *See, e.g.*, ERNST & YOUNG, LLP, FINANCIAL REPORTING DEVELOPMENTS—CERTAIN INVESTMENTS IN DEBT AND EQUITY SECURITIES (2018), https://www.ey.com/ul/en/accountinglink/frd-bb0961-certain-investments-in-debt-and-equity-securities.

79. *See, e.g.*, Steven T. Mnuchin & Craig S. Phillips, *A Financial System that Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation*, DEP'T OF THE

apply to dealing in securities that would differ from provisions applicable to software and other types of intangible assets. Individuals and commercial parties who seek to use tokens would likely want to understand the implications of all these different frameworks before even considering using the tokens; this would very likely prove a significant disincentive to the day-to-day use of the related blockchain platform for which the tokens are intended.

Perhaps most importantly, if tokens relating to a particular blockchain platform are explicitly treated as securities in the United States, it may be more difficult, as a practical matter, for either the seller or any purchasers to take the position that the tokens are not securities under the regulatory frameworks applicable in other jurisdictions. This means that access to the tokens will be limited to a much smaller group of users globally: those who have a securities account and the means (and interest) to purchase a product that is also a security. Ultimately, the likely result of treating tokens as securities is that the related blockchain platform fails to achieve wide adoption, ironically defeating the purpose of developing a decentralized project in the first place.

All of the above noted, however, the fact that it may be inconvenient or impractical to treat tokens as securities is not really the issue—that is a policy debate that can theoretically be resolved through changes in legislation.[81] The critical question is more straightforward: Is this a correct understanding of federal securities law as it stands today?

III. LESSONS FROM CHAIRMAN CLAYTON'S BROADWAY TICKET ANALOGY

A. Federal Securities Regulation in the United States Clearly Extends to Investment Schemes Presented as Standard Commercial Purchase-and-Sale Arrangements

If there had previously been any doubt, Chairman Clayton's Broadway ticket analogy makes it patently clear[82] that the SEC will not allow parties' ostensible treatment of a transaction as a standard commercial arrangement to interfere with its enforcement efforts when

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TREAS., (July 2018), https://home.treasury.gov/sites/default/files/2018-07/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financi....pdf.

80. *See, e.g.*, CARL S. BJERRE & SANDRA M. ROCKS, THE ABCS OF THE UCC ARTICLE 8: INVESTMENT SECURITIES (2d ed. 2015).

81. *See, e.g.*, Token Taxonomy Act of 2019, H.R. 2144, 116th Cong. (2019), https://www.govtrack.us/congress/bills/116/hr2144.

82. *See* Seward, *supra* note 13; *SEC Chairman Jay Clayton*, *supra* note 38.

the SEC believes that a violation of the Securities Acts has occurred.[83] This position was echoed more recently in the SEC's Token Framework.[84] When the SEC made its first pronouncement relating to blockchain-based token sales in its July 2017 Report on The DAO, it recognized that even when new technologies were involved, investment schemes may still be present.[85] Chairman Clayton reiterated this theme at *Consensus: Invest*.[86] Regardless of the technology in which a possible investment scheme presents itself, Chairman Clayton noted:

> Look at it from the investor's perspective. What is in it for the person purchasing the token? Are they doing this in the same way that they would invest in a new company that was issuing stock or are they doing it as somebody who purely wants to use it?[87]

An investment contract or scheme that triggers the application of the Securities Acts can involve a wide range of underlying assets as the relevant object.[88] This is due to the unending ingenuity of entrepreneurs

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83. The violation may be as basic as a failure to register the offer with the SEC where registration is required. Securities Act of 1933, 15 U.S.C. §§ 77e & 77*l*(a)(1) (2018). In addition, the violation may also involve the sponsor having made misleading or false statements in connection with the sale (or omitting to disclose material information that would be required to make the previously-made statements not misleading). Securities Act of 1933, 15 U.S.C. § 77k (2018).

84. Hinman & Szczepanik, *supra* note 4.

85. "The automation of certain functions through this technology, 'smart contracts,' or computer code, does not remove conduct from the purview of the U.S. federal securities laws." Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Release No. 81207, 2017 WL 7184670, at *2 (July 25, 2017) (citing SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943)). The Supreme Court in *C.M. Joiner Leasing Corp.* reasoned:

> [T]he reach of the [Securities] Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts,' or as 'any interest or instrument commonly known as a 'security.'

C.M. Joiner Leasing Corp., 320 U.S. at 351; *see also* Reves v. Ernst & Young, 494 U.S. 56, 61 (1990) ("Congress' purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called.").

86. *See* Seward, *supra* note 13.

87. *Id.*

88. *See, e.g.*, Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 756 F.2d 230 (2d Cir. 1985); SEC v. Glen-Arden Commodities, Inc., 368 F. Supp. 1386, 1390 (E.D.N.Y. 1974), *aff'd sub nom.* Glen-Arden Commodities, Inc. v. Costantino, 493 F.2d 1027 (2d Cir. 1974).

(honest or otherwise) and the seemingly unquenchable desire of investors to find the next get-rich-quick scheme.[89] In fact, any asset, whether tangible (physical) or intangible, may theoretically be used to create an investment opportunity, so long as there is some prospect of the appreciation of the price of that object in the future.[90]

Since *Howey*, when a possible investment scheme occurred, the SEC and the courts have focused closely on the nature of the underlying commercial arrangements, enforcing violations of the Securities Acts whenever the factors enumerated in *Howey* are present.[91] For example, the investment scheme at issue in *Howey* itself involved multiple agreements: a land sale contract for orange groves paired with a separate service contract for the harvesting and sale of the oranges.[92] Although taken at face value these appeared to be relatively standard commercial contracts, when examined together with all of the facts and circumstances of the case, the Supreme Court found an investment scheme to be present and applied the Securities Acts to find that violations occurred.[93]

In another influential decision considering the reach of securities regulation relative to investment schemes, the Eastern District of New York issued a permanent injunction halting the sale of warehouse receipts—a standard commercial document used in trade—for Scotch whiskey based on a finding that the offer of such receipts constituted an unregistered offering of "securities."[94] The warehouse receipts ostensibly evidenced the ownership of casks of whiskey stored in bonded warehouses in Scotland; however, the court concluded that there was sufficient evidence to establish that the warehouse receipts were part of

89. *See* Kevin Peachy, *Bitcoin: Crypto Investors 'Think They Can Get Rich Quick'*, BBC (Mar. 7, 2019), https://www.bbc.com/news/business-47483068.

90. Recall that the prospect of price appreciation of an asset may entice prospective investors, but the other elements of the *Howey* test will also need to be present for there to be a securities transaction (*i.e.*, appreciation of the asset is not sufficient). *See supra* note 29 and accompanying text; SEC v. W.J. Howey Co., 328 U.S. 293, 295 (1946). Some sort of common enterprise and the expectation of profit stemming primarily from the managerial efforts of a third party are also necessary. *Howey*, 328 U.S. at 295. Thus, contracts involving the sale of coins, bottles of wine, or artworks generally do not involve investment contracts even through the purchaser may be primarily motived in the purchase by the opportunity to profit.

91. *Compare* SEC v. Edwards, 540 U.S. 389 (2004), *and* SEC v. Int'l Loan Network, Inc., 968 F.2d 1304 (D.C. Cir. 1992), *with* United Hous. Found., Inc. v. Forman, 421 U.S. 837 (1975).

92. *Howey*, 328 U.S. at 295.

93. *Id.* at 301.

94. SEC v. Glen-Arden Commodities, Inc., 368 F. Supp. 1386, 1390 (E.D.N.Y. 1974), *aff'd sub nom.* Glen-Arden Commodities, Inc. v. Costantino, 493 F.2d 1027 (2d Cir. 1974).

an investment package, the public offering of which triggered the registration obligations under the Securities Act.[95]

An example frequently cited by the SEC is a case known as *Gary Plastic*.[96] A well-known brokerage firm resold large-denomination commercial bank certificates of deposit (CDs) to high-net-worth individuals.[97] The brokerage firm took efforts to select banks with competitive yields on their CDs and provided their customers with a guarantee that they would repurchase them—allowing their customers to potentially profit from capital appreciation.[98] The brokerage firm regularly monitored each bank issuing CDs and investors relied on the brokerage firm's expertise in that regard.[99] Although under a prior Supreme Court ruling, CDs are not themselves treated as "securities,"[100] the *Gary Plastic* court found that a standard bank CD—when issued and sold pursuant to the brokerage firm's program—were indeed "securities" for purposes of the Securities Act.[101]

Living animals also proved to be popular objects of investment schemes; the SEC brought several cases against the operators of schemes involving the sale of interests in beavers which were raised for their

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95. The District Court in *Glen-Arden Commodities* noted that:

> Faced with the evidence in this case the defendants' contention that they were merely selling gallons of raw unblended whisky that could be consumed, sold or dealt with as a purchaser saw fit is untenable. The sale of the warehouse receipts must be viewed in their totality; substance and not form is controlling. Unquestionably, the warehouse receipts were merely a means by which the defendants transacted their business. *Their true product was an investment package.* Ownership, right of possession or the right to consume were in reality of little import to the purchasers of the receipts.

Glen-Arden Commodities, 368 F. Supp. at 1390 (emphasis added). The Second Circuit added, "Here the customer, unlike the commodity buyer, while purchasing actual tangible property, was upon the representations of appellants buying in addition services absolutely necessary to the turning of the promised profit. In short, *it was a 'package deal.'*" *Costantino*, 493 F.2d at 1035 (emphasis added).

96. Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 756 F.2d 230 (2d Cir. 1985).

97. *Id.* at 234.

98. *Id.* at 234–35.

99. *Id.* at 235.

100. Marine Bank v. Weaver, 455 U.S. 551 (1982) (holding that a certificate of deposit is not an investment contract because the Federal Deposit Insurance Corporation eliminates nearly all risk of loss).

101. *Gary Plastic*, 756 F.2d at 242. Because the *Gary Plastic* decision arose from an appeal from a lower court summary judgment finding, the court remanded the case to determine whether deceptive statements (i.e. failing to disclsoure issues of materal fact required under the federal secruties laws) were made by the brokerage firm in connection with the sale. *Id.*

pelts.[102] Another interesting (albeit pre-*Howey*) case involved a scheme in which pairs of silver foxes were sold to retail purchasers.[103] Particularly noteworthy was a scheme in which the purported investors actually took possession of chinchillas sold to them, then raised and bred the animals, but relied on the promoter to buy back the chinchillas' offspring and sell them to new investors at inflated prices, creating a furry pyramid scheme.[104]

B. Examining the Distinction Between Investment Schemes and Their Objects

As shown above, the federal securities laws may apply to almost any scheme or commercial arrangement involving interstate commerce, so long as the money raised was part of a formal or informal set of contracts which altogether constitute an investment package—as the term was used in *Glen-Arden Commodities*[105]—that meets the various factors set out in *Howey*.[106] However, in all the above cases, the investment package (*i.e.*, the set of oral or written agreements between the seller and the purchaser) is clearly distinguishable from the object of the scheme itself (*i.e.*, the real estate, commodity, or other tangible or intangible asset(s) used to motivate the purchase and, hence, investment).[107]

How then should we look at assets like blockchain tokens that, but for being part of an investment scheme, would not otherwise be considered themselves "securities"? That is, assets that do not have

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102. Press Release, SEC, News Digest, Issue No. 66-200 (Oct. 19, 1966), https://www.sec.gov/news/digest/1966/dig101966.pdf.

103. SEC v. Payne, 35 F. Supp. 873 (S.D.N.Y. 1940). Interestingly, in *Payne*, the sellers went to great lengths to document their transaction as a sale. *Id.* at 875. The court in *Payne* noted:

> [O]n their face, and judged according to form, [the documents prepared by the seller] appear to be contracts of sale; true the purchaser is given title and the right to possession of the animal or animals mentioned in the contracts; true there are other indicia of ownership, such as marking of the animals for each individual purchaser, the recording in the proper office of the bill of sale in the name of the purchaser and the payment of personal tax on each animal.

Id. at 878. Nevertheless, taking the various transactions and all the surrounding circumstances together, the court concluded that these transactions were investments and not actual and bona fide sales. *Id.* at 879.

104. *See generally* Miller v. Central Chinchilla Group Inc., 494 F.2d 414 (8th Cir. 1974).

105. SEC v. Glen-Arden Commodities, Inc., 368 F. Supp. 1386, 1390 (E.D.N.Y. 1974), *aff'd sub nom.* Glen Arden Commodities, Inc. v. Costantino, 493 F.2d 1027 (2d Cir. 1974).

106. *See supra* Section III.A.

107. *See supra* Section III.A.

characteristics of either equity (voting rights, entitlement to dividends, a share of revenues, or liquidation proceeds) or indebtedness (representing a promise to pay and/or a right to receive payments of interest). At least when it comes to blockchain tokens, the SEC Staff has floated a potential answer: digital assets previously sold as a security can be reevaluated at the time of later offers or sales.[108] Put another way, the Token Framework suggests that a digital asset in the form of a blockchain token, which is sold in connection with an investment scheme, may at some point transform its character and later be considered a non-security.[109] The Token Framework helpfully lays out factors that the SEC Staff asserts may be relevant in making this determination, focusing in particular on the presence and role of what the SEC Staff refers to as active participants (a promoter, a sponsor, or other third party/affiliated group of third parties who provide the essential managerial efforts that affect the success of what the Token Framework refers to as the enterprise).[110] But does this position hold up under scrutiny?

A closer look at the fact pattern in *Glen-Arden Commodities* may help us shed light on this question.[111] In *Glen-Arden Commodities*, the defendants' contention that they were merely selling gallons of raw unblended whiskey that could be consumed, sold, or dealt with as the purchaser saw fit was rejected by the District Court as untenable.[112] In fact, in a June 2018 speech William Hinman, Director of the Division of Corporation Finance, referred to the SEC's guidance on investment schemes involving aging whiskey as his favorite example of how securities regulations apply to ICOs.[113]

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108. *See* Hinman & Szczepanik, *supra* note 4.

109. *Id.*

110. *Id.*

111. *See generally* SEC v. Glen-Arden Commodities, Inc., 368 F. Supp. 1386 (E.D.N.Y. 1974), *aff'd sub nom.* Glen Arden Commodities, Inc. v. Costantino, 493 F.2d 1027 (2d Cir. 1974).

112. *Id.* at 1390. In a related decision, the Second Circuit noted:

> It seems that at least up until July 6, 1967, the SEC took the position that certain ownership interests in *whiskey* similar to those that respondents allege that they sell were not securities. See letter dated July 6, 1967, from Arthur F. Mathews, Chief, Branch of Criminal Reference and Special Proceedings, Division of Trading and Markets, SEC (by Peter J. Adolph, attorney) to Allen E. Bachman, Executive Vice-President, National Better Business Bureau, Inc. On the other hand, Securities Act Release No. 5018 (Nov. 4, 1969) indicates that it is also the Securities and Exchange Commission's position that *whiskey warehouse receipts* may indeed be securities within the meaning of the federal securities laws.

SEC v. Brigadoon Scotch Distrib. Co., 480 F.2d 1047, 1052 (2d Cir. 1973), *cert. denied*, 415 U.S. 915 (1974).

113. *See* Hinman, *supra* note 36.

Promoters sold the receipts to U.S. investors to finance the aging and blending processes of Scotch whiskey.[114] The whiskey was real—and a clear "consumptive use."[115] But W.J. Howey Co. were not selling oranges and the warehouse receipt promoters were not selling whiskey for consumption.[116] They were selling investments, and the purchasers were expecting a return from the promoters' efforts.[117]

But, what if the facts in *Glen-Arden Commodities* had been different (and more closely aligned with those of a successful ICO)? What if a purchaser of warehouse receipts had later entered into a separate agreement assigning just her share of the whiskey represented by the warehouse receipts to an unaffiliated liquor distributor? Even if the original purchaser was not herself in the liquor business and had acquired warehouse receipts for far more whiskey than she could reasonably consume (as would typically be the case of an initial purchaser purchasing tokens in a token sale), would this change the warehouse receipts (much less the physical whiskey)—now in the hands of the liquor distributor—into "securities"? Does the answer change if one notes that the value of the aging whiskey (the object of this investment scheme) will undoubtedly be dependent on the essential managerial efforts of the active participant responsible for the whiskey maturation process (monitoring the whiskey barrels, temperature, and distillery conditions; and periodically changing barrels).[118]

Common sense answers "no." Whiskey is, after all, only a liquid—though one with exquisite utility, in Director Hinman's terms, and a subsequent purchaser in the business of liquor distribution would be buying the whiskey represented by the warehouse receipts with a *bona fide* commercial purpose.[119] Further, the distributor would eventually be able to determine how the whiskey will be bottled and marketed.[120] Yet it would be exactly the same whiskey, represented by exactly the same warehouse receipts, when in the hands of both the initial investor and the distributor that purchased the warehouse receipts from the investor.

Viewed in this light, does it make sense that the warehouse receipts could change from "securities" to "documents of title" when transferred

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114. *Glen-Arden Commodities, Inc.*, 368 F. Supp. at 1390.

115. *See* Hinman, *supra* note 36.

116. *Glen-Arden Commodities, Inc.*, 368 F. Supp. at 1390.

117. *Id.*

118. *See* Whisky.com: Maturation in Casks, https://www.whisky.com/information/knowlodge/production/details/maturation-in-casks.html (last visited June 16, 2019).

119. *Id.*

120. *See Glen-Arden Commodities, Inc.*, 368 F. Supp. at 1389 (observing that the warehouse receipts evidence ownership).

to a third party? And should the analysis of the legal character of the warehouse receipts in the hands of a transferee be a wholly subjective one?[121] What if the original purchaser had transferred one portion of the warehouse receipts to the liquor distributor and another portion to her sister (not in the liquor business), in exchange for forgiveness of debt? Would the sister's warehouse receipts still be "securities" when those belonging to the liquor distributor would not?[122] And how would a subsequent transferee from these two parties be able to make this determination?

With these questions in mind, let's reconsider *Gary Plastic*.[123] The court in that case concluded that the brokerage firm created investment contracts with its customers because of its attendant undertakings and the manner in which the firm identified, sold, and managed the CDs.[124] The court so held, despite the fact that the objects of the scheme, CDs, are clearly excepted from the definition of "security" under prior case law.[125]

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121. *See* Landreth Timber Co. v. Landreth, 471 U.S. 681 (1985) (considering whether a subjective test should be applied when the security in question was 100% of the shares of stock in a business being sold). The following observations from the Supreme Court in *Landreth* are very relevant:

> More importantly, however, if applied to this case, the sale of business doctrine would also have to be applied to cases in which less than 100% of a company's stock was sold. This inevitably would lead to difficult questions of line-drawing. The Acts' coverage would in every case depend not only on the percentage of stock transferred, but also on such factors as the number of purchasers and what provisions for voting and veto rights were agreed upon by the parties. As we explain more fully in *Gould v. Refenacht, post* at 471 U. S. 704-706, decided today as a companion to this case, coverage by the Acts would in most cases be unknown and unknowable to the parties at the time the stock was sold. These uncertainties attending the applicability of the Acts would hardly be in the best interests of either party to a transaction. *Cf. Marine Bank v. Weaver,* 455 U.S. at 455 U. S. 559, n. 9 (rejecting the argument that the certificate of deposit at issue there was transformed, chameleon-like, into a "security" once it was pledged).

Landreth, 471 U.S. at 696.

122. Note that the focus here is only on the transfer of the underlying object. When—as in *Howey* and virtually all previously identified cases—the relevant investment contracts are comprised of multiple undertakings and the purchaser assigns the object, including all rights and benefits offered by the seller to induce the purchase, to a third party; this assignment would not separate the object from the investment scheme. *See Glen-Arden Commodities, Inc.*, 368 F. Supp. at 1390. Instead, it would simply substitute one investor in the scheme for another. This is relevant to the inquiry because neither Broadway tickets nor blockchain tokens, alone, carry any additional undertakings or promises by the seller.

123. Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 756 F.2d 230 (2d Cir. 1985).

124. *Id.* at 240–41.

125. *Id.* at 241–42.

However, even given the court's holding, there is nothing in *Gary Plastic* to suggest that if a customer assigned *just the CD*—not any other contractual rights against the firm—to a third party, that the assigned CD would be considered an investment contract. The other rights and services provided by the brokerage firm made the CDs in *Gary Plastic* securities.[126] Once separated from those rights and services, the CDs are plainly just bank-issued obligations, not securities under *Marine Bank.*[127]

Thus, the focus is on the *separability* of the object from the initial investment scheme. When an initial investor transfers an object that would not otherwise be considered a "security" (*e.g.*, whiskey, animals, CDs) in a way that disassociates the object from the promoter's scheme, securities laws should recognize the object in the hands of the transferee only as what it is, not a "security." But what if the separation of the investment scheme and its object is not as straightforward as simply undertaking a *bona fide* commercial sale?

C. The Conundrum of Transferability and the Concept of "Mutability"

The two examples discussed above are, of course, hypothetical. It is quite unlikely that the purchasers of warehouse receipts in *Glen-Arden* would have attempted to assign their warehouse receipts to liquor distributors.[128] It seems similarly unlikely that the customers of the brokerage firm in *Gary Plastic* would have endeavored to assign their certificates of deposit separately from their relationship with the brokerage firm.[129] Investors rarely, if ever, transfer such objects to third parties. In the over seventy years since *Howey*, there appears to have been no cases addressing the transferability of the object of an investment scheme. Consequently, few courts have wrestled with the critical distinction between the investment package and the property, commodity, or any other assets that are the objects of the investment scheme.[130] In the primary cases deciding whether otherwise seemingly standard commercial arrangements are investment contracts, the parties were still in direct privity (*i.e.*, the aggrieved purchaser had not transferred their interest in the object of the scheme to a third party).[131]

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126. *Id.*

127. Marine Bank v. Weaver, 455 U.S. 551 (1982).

128. *See generally* SEC v. Glen-Arden Commodities, Inc., 368 F. Supp. 1386 (E.D.N.Y. 1974), *aff'd sub nom.* Glen Arden Commodities, Inc. v. Costantino, 493 F.2d 1027 (2d Cir. 1974).

129. *See generally Gary Plastic*, 756 F.2d 230.

130. *Glen-Arden Commodities, Inc.*, 368 F. Supp. at 1390.

131. *See supra* Section III.B.

What distinguishes investment contracts in which blockchain platform sponsors sell tokens in an ICO from the other investment schemes discussed above is: (1) the general absence of clear contractual documentation setting out the terms of the investment package offered to purchasers,[132] (2) the ease of transferability of the object of these schemes—the tokens themselves—through various exchanges, and (3) the way in which the tokens' value depends on the managerial efforts of the sponsor even after the transfer of the tokens by the initial purchaser.[133] Such managerial efforts typically include promotion of the platform to achieve the expected network effects and taking a leadership role in the continued development and maintenance of the platform codebase while an open source community is still forming.[134]

These distinctions make Chairman Clayton's Broadway ticket analogy so instructive. As noted above, let's assume in the Broadway ticket example: (1) an absence of any formal documentation between the producer raising funds and the ticket purchasers (perhaps just a handshake, physical or virtual); (2) the easy transferability on StubHub, or other established third-party ticket marketplaces of the objects of the scheme, of the tickets themselves; and (3) the dependence of the tickets' value on the managerial efforts of the producer after the transfer of the tickets to a *bona fide* third party, including keeping the show up and running, making changes to cast and crew, and promoting the show. In both the case of the Broadway tickets and the ICO tokens, separability of

132. Many token sales used very simple clickwrap purchase agreements—likely not prepared by lawyers and which do not clearly set out the rights and responsibilities of the parties. *See, e.g.,* Sultan v. Coinbase, Inc., 354 F. Supp. 3d 156 (E.D.N.Y. 2019) (observing Coinbase's use of clickwrap agreements). However, the lack of written contractual documentation has not inhibited courts from finding an investment contract. *See supra* note 32. Absence of clear documentation, in the case of a token sale, should not detract from the critical requirement that there must be some form of agreement between the seller and purchaser, creating executory obligations. *See* SEC v. W.J. Howey Co., 328 U.S. 293, 298–99 (1946) (finding a combination of a land-sale agreement and a service contract sufficient to create an investment contract). For example, an agreement to deliver tokens to the purchaser at a certain future date or even an undertaking (express or implied) to continue developing the relevant software code and promote the utility of the relevant blockchain-based platform would likely suffice. However, a cryptographic token does not itself represent any sort of agreement. *See* Hinman, *supra* note 36. A token that is part of a blockchain-based platform is simply computer code that may be used as part of the platform to store files, run programs, or perform other tasks. *Id.* Unlike an agreement, which terminates following default or full performance by the parties, a blockchain token will continue to exist independent of any particular individual or legal entity, so long as the minimum number of nodes are running the relevant blockchain protocol code. *See* Buterin, *supra* note 58.

133. *See* Hinman, *supra* note 36.

134. *Id.*

the objects from the underlying investment scheme is not particularly clear.

Unfortunately, at least in the case of cryptographic tokens, these factors have made it tempting to conclude that the tokens themselves are also securities.[135] As a result, making a clear distinction between the investment scheme and its object becomes critical—hence, the helpfulness of the Broadway ticket analogy.

One thing essential to any security is an issuer.[136] In the case of a security resulting from the creation of an investment contract, the issuer is the counterparty to the various contractual arrangements with the investor.[137] That party would have the obligation, under Section 5 of the Securities Act, to register the security if it were offered publicly.[138] However, no security continues to exist following the demise of its issuer.[139] This challenge was noted directly by Director Hinman in his *When Howey Met Gary (Plastic)* speech: "As a network becomes truly decentralized, the ability to identify an issuer or promoter to make the requisite disclosures becomes difficult, and less meaningful."[140]

On the other hand, commodities and other property created by the sponsor of an investment scheme, such as the oranges grown, beavers or foxes raised, or whiskey aged, will continue to exist even if the enterprise that produced them ceases to exist.[141] Likewise, tokens that are a part of a decentralized blockchain platform can continue to exist and have economic value even if the catalyst entrepreneur that originally developed the platform and sold the tokens dissolves.[142] Yet, Chairman Clayton and others at the SEC have repeatedly asserted that the tokens

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135. Even Commissioner Peirce seems to embrace this idea in her forward-looking February 2019 speech:

> A group of people get together to build something and they need to find investors to fund their efforts so they sell securities, sometimes called tokens. The SEC applies existing securities laws to these securities offerings, which means that they must be conducted in accordance with the securities laws or under an exemption. When the tokens are not being sold as investment contracts, however, they are not securities at all.

See Peirce, *supra* note 36.

136. *See* Securities Act of 1933, 15 U.S.C. § 77b(a)(4) (2018).

137. *Id.*

138. *See* Securities Act of 1933, 15 U.S.C. § 77e(a) (requiring the filing of a registration statement in connection with any sale of security). *But see* 15 U.S.C. § 77d(a)(2) (exempting a transaction not involving a public offering); Regulation D Rule 504 & 506, 17 C.F.R. §§ 230.504 & 230.506 (2018) (providing limited exemptions for private offerings based on dollar amount and investor status).

139. *See* Hinman, *supra* note 36.

140. *Id.*

141. *See id.*

142. *See* Buterin, *supra* note 58.

sold in an ICO are themselves securities.[143] So, is the possible "mutability" of an asset from a security to a non-security, as discussed above, the solution to this conundrum?

According to the Token Framework, a token's "mutability" would be driven largely by the role and level of engagement of an active participant (a stand-in for the *Howey* test's "essential managerial efforts of others" prong)[144] as well as, one assumes, the degree to which the relevant platform has become decentralized, as discussed in the earlier speech by Director Hinman.[145] When speaking about transactions involving Ether, the native token of the Ethereum network, Director Hinman noted that "putting aside the fundraising that accompanied the creation of Ether, based on my understanding of the present state of Ether, the Ethereum network and its decentralized structure, current offers and sales of Ether are not securities transactions."[146]

The "mutability" approach may initially seem to have some merit as a results-oriented solution for the conundrum noted above. Put simply, this position could be summarized as: cryptographic tokens sold in a typical ICO are securities until they are not.[147] But is this solution to the dilemma[148] supported by current case law? Also, how would this work in the real world, if applied to ongoing transactions? Chairman Clayton's Broadway ticket analogy provides an ideal opportunity to analyze this concept of asset mutability.[149]

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143. *See* Higgins, *supra* note 6; *see also supra* note 36.

144. *See* Hinman & Szczepanik, *supra* note 4. Factors cited in the Token Framework include: whether or not the efforts of an active participant, including any successive active participant, continue to be important to the value of an investment in the digital asset; whether the network on which the digital asset is to function operates in such a manner that purchasers would no longer reasonably expect an active participant to carry out essential managerial or entrepreneurial efforts; and whether the efforts of an active participant are no longer affecting the enterprise's success. Interestingly, the Token Framework does not explain what enterprise means in the context of a decentralizing blockchain-based platform.

145. Hinman, *supra* note 36.

146. *Id.*

147. *See* Hinman & Szczepanik, *supra* note 4.

148. *See supra* Section III.B.

149. *See infra* Section IV.

IV. BROADWAY SHOW TICKETS—A CLOSER LOOK

A. Fundraising Through the Sale of Broadway Tickets Can Involve a Securities Offering

With the above legal analysis in mind, let's return to the Broadway ticket analogy and further develop Chairman Clayton's facts in a way that brings them more closely in line with those of a typical ICO.[150] As before, suppose that our producer raises $100,000 in seed money to fund the development of the production from 15 purchasers in exchange for 50% of the 10,000 total tickets to be issued in what will be a strictly limited-run engagement. Following a time-honored sales tradition, the producer is hoping that, by limiting the supply of the tickets, she can create a hurry-up-and-buy environment for the tickets she is selling.[151]

The forced scarcity resulting from the producer's decision to make her show a limited-run event can be a factor to consider in determining whether the tickets being sold are the object of an investment scheme.[152] By deliberately limiting the supply of a product, a party undertaking a fundraising effort may successfully incentivize purchasers to buy the product.[153] Purchasers have an expectation that scarcity and increased demand will result in appreciation in value, thus, potential profit for those initial 15 ticket purchasers who get in on the ground floor.[154]

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150. *See* Seward, *supra* note 13.

151. *See, e.g.*, AFP, *iPhone Launch Generates Crowds, Queues Worldwide*, DAILY MAIL (Sept. 16, 2016, 5:29 PM), https://www.dailymail.co.uk/wires/afp/article-3792366/Apples-iPhone-7-launches-sold-models-leave-disappointed.html (discussing allegations that Apple was "deliberately limiting supply" of iPhone 7 during launch).

152. Laura Gritz, *Teaching a New Dog Old Tricks: Why the Howey Test Is Still the SEC's Best Friend When Examining Initial Coin Offerings*, 19 N.C.J.L. & TECH. ON. 193, 206–07 (2018). Forced scarcity is also a factor in many ICOs. It should be noted, however, that in developing a decentralizing blockchain-based platform, fixing the number of tokens at the launch of the project is often a key element of the relevant mechanism design. *Id.*; *see also* Alex Evans, *A Crash Course in Mechanism Design for Cryptoeconomic Applications*, MEDIUM (Oct. 17, 2017), https://medium.com/blockchannel/a-crash-course-in-mechanism-design-for-cryptoeconomic-applications-a9f06ab6a976. Although some blockchain platforms may devolve governance decisions—such as the number of tokens at issue—to token holders, most platforms seek to fix the number of tokens at the start, so that all participants in the ecosystem know how the economics of the system will operate in advance. *See* Sandler, *supra* note 7, at 257. Because most decentralizing blockchain platforms are open source, participants unhappy with the current set-up of the platform can launch their own version by "forking" the code. *See* Magnuson, *supra* note 7, at 172 (discussing the forking that occurred with bitcoin).

153. *See* Gritz, *supra* note 152, at 206–07.

154. *Id.*

Continuing to develop the analogy, assume that the tickets entitle the holder only to attend a specific performance of the show on a future date and that the ticket holders acquire no other rights or interest in the production itself. The producer might retain the unsold 50% of the tickets to sell at a later date, to cover ongoing promotion costs, and to generate profit for herself. Similarly, purchasers of tokens in a typical ICO receive only future utility on the upcoming blockchain network and generally acquire no interest of any type in the company selling the tokens.[155] Platform sponsors would generally retain a significant percent of the tokens generated, often in the range of 50%, to sell at a later date to cover costs and generate profit.

The alignment of economic interests between the seller, who retains a significant portion of the tickets/tokens, and the purchasers is a factor that could be cited as supporting a common enterprise for purposes of a *Howey* analysis of the relevant investment scheme.[156] The purchasers may also take comfort due to the skin-in-the-game retained by the seller.[157] This may give purchasers more confidence as to the seller's incentive to drive price appreciation of the asset in question.

As discussed earlier, when the Broadway producer induced the purchases of tickets in quantities greater than what the purchaser could reasonably use or consume[158] and when these purchases were solicited through promises or suggestions of profit from the later sale of the tickets, the producer has likely created an investment scheme similar to that found in *Howey*, *Glen-Arden*, or *Gary Plastic*.[159] There was an *investment of money* by the 15 initial purchasers in a *common enterprise* between the producer and the ticket purchasers, and there was a *reasonable expectation of profit* on the part of the purchasers *primarily as a result of the managerial efforts of the producer*.[160] If the fundraising was not conducted by the producer as a valid private placement[161] or some other exemption did not apply, then the producer would be at significant risk of an enforcement action from the SEC or from state-level securities regulators with jurisdiction.[162]

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155. *Id.* at 198–99.

156. *See* SEC v. Edwards, 540 U.S. 389, 393–94 (2004) (reaffirming the requirement of a common enterprise but not resolving the circuit split).

157. *Id.* at 397 (discussing the efforts of others requirement).

158. *See* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 852–53 (1975).

159. *See supra* Section III.B.

160. *See supra* note 29.

161. *See* Regulation D, Rule 501, 17 C.F.R. § 230.501 (2018).

162. In this case, the sales would likely be subject to a right of rescission on the part of the purchaser, pursuant to § 12(a)(1) of the Securities Act, but that is a matter for future publication. 15 U.S.C. § 77*l*(a)(1) (2018). In addition, a purchaser believing that the sale

In her own defense, the producer may attempt to claim that the tickets had "utility" because they could be used to attend a show. Though a correct observation in itself, such a claim would carry almost no weight on the fundamental issue: whether the producer had undertaken an unregistered sale of securities. Based on the above, there is a high likelihood that the producer's *fundraising* would be considered an investment scheme that meets the elements of the *Howey* test.[163] Likewise, protestations by sponsors of ICOs that the tokens they sold have "utility" similarly miss the point. The focus of securities regulators on the purported sale of a software product, like cryptographic tokens, is simply a more technologically savvy version of the investment schemes discussed in the cases above.[164]

B. Broadway Tickets Are Not Securities

Does the conclusion that the producer's fundraising scheme likely constitutes an investment contract and, thus, a securities offering mean that the Broadway tickets are themselves securities? If there is case law to support the proposition that an investment scheme's underlying asset, good, or service (that does not itself have the characteristics of a security)[165] should be considered a "security" when separated from any contractual obligations or undertakings of the scheme's sponsor, the SEC has not yet cited it in any enforcement actions. Relevant case law usually has taken care to identify the package of rights and promises that induce a purchaser's investment and implies that—separate from these promises and representations—the underlying object would not otherwise be considered a "security."

In our interpretation of Clayton's analogy above, the Broadway tickets which were sold are printed on paper and entitle the holder to nothing more or less than the ability to attend a performance of the show.[166] The tickets do not pay any interest or dividends to the holder, nor do they entitle the holder to share in the profits of the production, nor do they grant the ability to vote, nor do they allow the holder to express an opinion on how the show should be managed, nor do they say what expenses should be incurred in promoting the show, nor do they arrange

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was made by means of materially misleading oral statements or written documents will have a private right of action against the seller. *See* 17 C.F.R. § 240.10b-5 (2018); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 750 (1975).

163. *See supra* Section IV.A.; *see also* Sultan v. Coinbase, Inc., 354 F. Supp. 3d 156 (E.D.N.Y. 2019).

164. *See* Hinman, *supra* note 36.

165. *See* supra note 29.

166. *See supra* Section II.B.

which actors play which roles—even though all these elements could reasonably impact the success of the show, and therefore, the value of the tickets in the secondary market.[167] Further, the tickets alone benefit from no other contractual rights or promises from the producer or any other third party.

The transferability of the Broadway show tickets by purchasers is unrestricted, and the initial 15 ticket purchasers are free to resell the tickets on the online ticket exchange of their choosing. Purchasers of those tickets in the secondary market will likely have no idea who the seller was or what the circumstances of the seller's acquisition of the tickets were.[168] As a result, the value of the tickets in the secondary market will continue to depend, for some time, on the managerial efforts of the producer (who would likely be considered an active participant under the Token Framework).[169] Should one expect a "ticket purchaser" in the secondary market to be considered engaged in a securities transaction?

The Staff of the SEC addressed a remarkably similar question when providing relief in *Ticket Reserve, Inc.*[170] The Staff agreed with the conclusions of the incoming letter, which stated that, "Neither a seat ticket nor a right to acquire it is a security. It is not inherently an investment medium. Rather, it is a good, a commodity purchased for use or consumption, that is, to attend the baseball or football game or go to the concert."[171] Even if the tickets to the proposed Broadway show are resold by the initial purchaser at a time prior to the show's launch, this could not reasonably change the nature of the tickets into securities.[172]

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167. Generalizing about cryptographic tokens can be a dangerous business. It should be noted that some blockchain platforms feature on-chain governance through which token holders do have voting rights relating to the platform. *Not so Fast—Risks Related to the Use of a "SAFT" for Token Sales*, CARDOZO BLOCKCHAIN PROJECT 1 (Nov. 21, 2017), https://cardozo.yu.edu/sites/default/files/Cardozo%20Blockchain%20Project%20-%20Not%20So%20Fast%20-%20SAFT%20Response_final.pdf. This Article does not pursue the implications of that variation.

168. *See, e.g.*, Luke Lancaster, *StubHub Is Changing How You Buy Tickets in Australia*, CNET (Jan. 9, 2017, 8:28 PM), https://www.cnet.com/news/stubhub-is-changing-how-you-buy-tickets-in-australia/ (observing that the ticket resale platform StubHub allows seller anonymity).

169. *See* Hinman & Szczepanik, *supra* note 4.

170. Ticket Reserve, Inc., SEC No-Action Letter, 2003 WL 22195093 (Sept. 11, 2003). In addition to ticket re-sale platforms, there are a wide variety of other public marketplaces for everything from baseball cards to high-end handbags, and we are not aware of any regulatory suggestion that these marketplaces qualify as a national exchange or that they comply with a relevant exemption from such requirement.

171. *Id.* at *4.

172. It is important to distinguish resales that create a new investment scheme from the situation analyzed here. It is certainly possible for a purchaser of a large quantity of

Despite Chairman Clayton's public admonitions to the contrary during his remarks at *Consensus: Invest* and *Times Talks*,[173] the reasoning underlying the *Ticket Reserve, Inc.* no-action letter and a common-sense examination of the way Broadway tickets are treated demand a different conclusion. Even when the promise of future tickets is used to induce investment in a commercial venture like a Broadway show, provided that the tickets are disposed of in a *bona fide* sale to a third party, they should not be treated as securities.

C. Cryptographic Tokens Are Similar in Many Ways to Broadway Tickets

If Broadway tickets used to induce investors to enter an investment scheme with the producer are not securities, what about the cryptographic tokens sold in an ICO? In many ways, the Broadway ticket analogy is very similar to the typical ICO.

Like Broadway tickets, most tokens sold in ICOs do not pay any interest or dividend to the holder.[174] In addition, most tokens sold in ICOs do not entitle the holder to any share of the profits of the entity that developed the blockchain platform and sold the tokens, nor do they provide holders with the ability to vote, or express an opinion on how the platform should be managed or promoted, or on what changes should be made to the underlying codebase of the platform—managerial decisions that, like in the Broadway ticket analogy, could reasonably be expected to impact the success of the platform and the value of the tokens.[175]

Like Broadway tickets, the transferability of cryptographic tokens is generally unrestricted—purchasers are free to resell the tickets on the crypto exchange of their choice.[176] Purchasers of tokens in the secondary market will have no idea about the identity of the seller or the circumstances of the seller's acquisition of the tokens.[177] Furthermore, many blockchain platforms are dependent on the sponsor to attract a user base and complete or maintain the code development.[178] Therefore, the

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tickets in the Broadway show analogy to redistribute them in a secondary or derivative investment scheme in such a way that the *Howey* factors are met. *See supra* note 29 and accompanying text; SEC v. W.J. Howey Co., 328 U.S. 293, 298–99 (1946).

173. *See* Seward, *supra* note 13; *SEC Chairman Jay Clayton*, *supra* note 38.

174. *See* Gritz, *supra* note 152, at 198–99.

175. *See* CARDOZO BLOCKCHAIN PROJECT, *supra* note 167, at 2.

176. *See* Gritz, *supra* note 152, at 210.

177. *See, e.g.*, Carlos Manzano, *Racing to Regulation: A Comparative Analysis of Virtual Currency Regulation in Alaska and the Proposed Alaska Money Services Act*, 35 ALASKA L. REV. 239, 243 (2018) (discussing anonymity of bitcoin transactions).

178. *See* Hinman, *supra* note 36.

value of tokens in the secondary market will continue to depend, for some time after the sale, on the managerial efforts of the platform sponsor.[179]

However, the analogy is not perfect. Tickets to a Broadway show are generally used once and then disposed of—their value has a clear expiry date. In contrast, cryptographic tokens are simply digital code that can exist in perpetuity (or at least as long as their platform is maintained).[180] The same token can be sold and resold an unlimited number of times, changing in value as demand for the platform to which the token relates waxes and wanes.[181] But does this difference change the analysis? The final Part of this Article expands the Broadway ticket analogy to examine this question more closely.

D. The Consequences of Fraudulent or Manipulative Activity

In prior sections, this Article posited that the objects of investment schemes may not themselves be securities.[182] But does this conclusion mean that parties who engage in fraud or manipulative activity with respect to these objects are free from potential liability? Put another way, if the federal securities laws did not to apply to the resale and transfer of these assets, does that mean that enforcement authorities and private parties would have no recourse for harms from activities intended to dupe secondary-market buyers or sellers?

In the case of Broadway tickets, a recent report from the Office of the Attorney General of the State of New York makes clear that there are serious consequences for those who engage in nefarious activities with event tickets.[183] Additionally, given the large number of events that occur in New York State, a specific regulatory framework applicable to event tickets has been in place there for quite some time.[184] These regulations are a recognition that bad actors create unique mischief for event tickets sales, and the state seeks to create a regulatory framework to inhibit potential harm before it can occur.[185] Failure to comply with the

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179. *See id.*

180. *See id.*; *see also* Buterin, *supra* note 58.

181. *See* Hinman, *supra* note 36.

182. *See, e.g., infra* Section IV.C.

183. Eric T. Schneiderman, *Obstructed View: What's Blocking New Yorkers from Getting Tickets*,
Off. N.Y. ATT'Y GEN (2016), http://www.ag.ny.gov/pdfs/Ticket_Sales_Report.pdf.

184. *Id.* at 9; *see also FAQ – Ticket Reseller*, N.Y. ST. DEP'T OF ST. DIV. OF LICENSING SERVS., https://www.dos.ny.gov/licensing/ticketresell/ticket_faq.html (last visited May 30, 2019).

185. *See* Schneiderman, *supra* note 183, at 7–8.

requirements can lead to civil and criminal penalties.[186] Event tickets are not alone; federal and state law enforcement officials have tailored consumer protection regulations in a wide variety of areas in which they have found abuses.[187] While there is a general recognition that regulators should vigorously prevent abusive practices from impacting consumers, one should also recognize that not all such abuse can or should be considered the purview of federal or state-level securities regulators. Equally, the fact that a state securities regulator takes the lead in commencing an enforcement action does not necessarily mean that the underlying transaction involves the sale of a security.[188]

But what about the tokens sold in a typical ICO? Significant federal and state-level consumer-protection laws also apply. At the federal level, the Federal Trade Commission enforces the Federal Trade Commission Act, which prohibits unfair or deceptive acts or practices in or affecting commerce and would likely apply to consumer token purchases.[189] At the state level, attorneys general have broad consumer protection authority that generally prohibits unfair or deceptive acts or practices.[190] Notably, many state consumer protection statutes apply to consumer transactions in merchandise, which is defined to include commodities in many jurisdictions.[191]

Moreover, at the federal level, the Commodities Futures Trading Commission (the CFTC) has asserted jurisdiction over virtual currencies, as "commodities."[192] Many tokens sold in ICOs, even if not considered virtual currencies, could well be determined to meet the general definition of a commodity and thus be subject to CFTC jurisdiction

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186. *Id.* at 9.

187. *See generally Consumer Protection in the States: A 50-State Evaluation of Unfair and Deceptive Practices Laws*, NAT'L CONSUMER L. CTR. (Mar. 2018), http://www.nclc.org/images/pdf/udap/udap-report.pdf.

188. *See* Kevin T. Van Wart, *Preemption and the Commodity Exchange Act*, 58 CHI. KENT L. REV. 657, 698 (1982) (citing a GAO report urging Congress to amend the Commodities Exchange Act "to permit any State securities commission or other State authority to investigate and prosecute *options fraud and other forms of commodity-related fraud* under State blue sky or other antifraud statutes" (emphasis added)).

189. FTC Act, 15 U.S.C. § 45(a) (2018).

190. *See generally* Amy Widman & Prentiss Cox, *State Attorneys General's Use of Concurrent Public Enforcement Authority in Federal Consumer Protection Laws*, 33 CARDOZO L. REV. 53, 58 (2011).

191. *See, e.g.*, DEL. CODE ANN. tit. 6, § 2511(6) (West 2019).

192. *See, e.g., CFTC Backgrounder on Oversight of and Approach to Virtual Currency Futures Markets*, CFTC OFF. PUB. AFF. (Jan. 4, 2018), https://www.cftc.gov/sites/default/files/idc/groups/public/%40customerprotection/documents/file/backgrounder_virtualcurrency01.pdf.

under the Commodity Exchange Act.[193] As shown in the above examination, the mantle of commodities fits much more squarely on cryptographic tokens of the type sold in ICOs than does the mantle of investment contracts or securities. Looking specifically at whether one should characterize bitcoin as a commodity, a commentator identified a five-point test to determine how adaptable a particular good is to organized futures trading—the key factor in determining whether a good is a commodity.[194] In those cases, the CFTC[195] would also regulate the token for anti-fraud and oversees any futures or derivatives markets in which the tokens arise.[196]

E. Examining the Sufficiently Decentralized Standard Proposed by Director Hinman

In light of the above, to the extent that the sufficiently decentralized standard is still applicable following the release of the Token Framework, one may then inquire about the extent to which the decentralized nature of a blockchain platform figures into this analysis.[197] Because the concept of decentralization is not one that had previously been relevant to matters of securities law, there appears to be no case law yet on how it might impact a scheme.[198] Whether a blockchain platform is decentralized should have no independent bearing on how a court would approach the arrangement established by a catalyst entrepreneur to raise money to develop and promote a platform through the sale of tokens.[199] One may well characterize such a typical scheme for ICOs as

193. The Commodities Exchange Act contains a remarkably cumbersome definition of the critical term "commodity" (onions are notably excluded). Commodities Exchange Act, 7 U.S.C. § 1a(9) (2018). At its essence, the definition applies to any goods or services "in which contracts for future delivery are presently or in the future dealt in." *Id.* Given the presence of futures markets for bitcoin today, it is certainly possible that futures markets for other cryptographic tokens could arise soon.

194. Mitchell Prentis, *Digital Metal: Regulating Bitcoin as a Commodity*, 66 CASE W. RES. L. REV. 609, 630–31 (2015) ("In order to be traded on a futures exchange, a commodity must: 1) be homogenous; 2) be susceptible to standardized grading; 3) have large supply and demand; 4) have an unrestricted market; 5) have uncertain supply and demand; and 6) not be perishable."). Many cryptographic tokens sold in ICOs would meet these criteria.

195. *See* Commodities Exchange Act, 7 U.S.C. § 6c(c)(1) (2018) (modeled on Exchange Act § 10b); 17 C.F.R. § 180.1 (2018) (implementing 7 U.S.C. § 6(c)(1) and modeled on Exchange Act Rule 10b-5.

196. *See, e.g.*, BFXNA Inc., CFTC No. 16-19, 2016 WL 3137612, at *5 (June 2, 2016).

197. *See* Hinman, *supra* note 36.

198. *Id.*

199. *See* SEC v. W.J. Howey Co., 328 U.S. 293, 298–99 (1946).

an investment contract; thus, an offer and sale of securities.[200] However, when the object of the scheme is separated from the scheme and sold to a *bona fide* third party, that object—otherwise considered a digital good or commodity—should not itself be a "security."[201]

It is better to see the decentralization standard proposed by Chairman Clayton and Director Hinman as a productive effort to assist market participants who are attempting to address a separate but related issue: when does the investment scheme, in which initial purchasers of tokens from a sponsor are participating, end or terminate? As a practical matter, more traditional investment schemes effectively terminate only when any contractual relationship between the promoter and the purchaser ends or, if sooner, when the underlying object of the scheme is transferred by its purchaser and the purchaser no longer has any economic exposure to the promoter.[202] In some of the cases we have looked at, investment schemes involved a contractual arrangement to sell something that did not yet exist, such as the whiskey to be blended, aged, and bottled; or beavers to be raised.[203] Once the whiskey or beavers are sold and the sponsor delivers the profits to the investor, the sponsor's efforts are no longer material and the original investment scheme has therefore terminated.

This is in sharp contrast to many tokens sold in ICOs. In these cases, the stated intention of the token-seller, acting as a catalyst entrepreneur, is to build the platform and then get out of the way by disseminating most, if not all, of the tokens and letting a community of token holders and users maintain and develop the platform as an open source project.[204] This arrangement is relatively unique outside the world of blockchain and digital assets. A Broadway producer, whiskey distiller, or beaver rancher are *always* needed to create the underlying value promised to purchasers. One can best see the sufficiently decentralized standard as a response to the question of whether an investment scheme can end prior to the purchaser disposing of the underlying object of the scheme. This also aligns with the more developed concept of active participants found

200. *Id.*

201. Director Hinman acknowledged this in his speech, stating: "Returning to the ICOs I am seeing, strictly speaking, the token – or coin or whatever the digital information packet is called – all by itself is not a security, just as the orange groves in *Howey* were not." *See* Hinman, *supra* note 36.

202. *See, e.g.*, *Good Practices for the Termination of Investment Funds*, The Board of the International Organization of Securities Commissions (Aug. 2016), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD542.pdf.

203. *See, e.g.*, SEC v. Glen-Arden Commodities, Inc., 368 F. Supp. 1386 (E.D.N.Y. 1974), *aff'd sub nom.* Glen-Arden Commodities, Inc. v. Costantino, 493 F.2d 1027 (2d Cir. 1974); Press Release, *supra* note 102.

204. Randolph A. Robinson II, *The New Digital Wild West: Regulating the Explosion of Initial Coin Offerings*, 85 TENN. L. REV. 897, 911–13 (2018).

in the Token Framework. Therefore, one can align Director Hinman's sufficiently decentralized standard to a more well-understood securities law question: whether the promoter of an investment scheme is no longer providing the essential managerial efforts needed for the platform to function.[205]

V. A MODEST PROPOSAL

To conclude this examination of the relationship between investment schemes and their objects, one can expand Chairman Clayton's Broadway ticket analogy a bit further to align it as closely as possible with the typical circumstances surrounding the development of a blockchain-based platform.[206] In particular, imagine a performance ecosystem in which recirculating blockchain-based digital tickets, in the form of tokens, allow a Broadway production to progress into a truly decentralized state, without a single owner or active participant.

Suppose that the Broadway production commences as otherwise described above: the producer solicits 15 investors to purchase 50% of the tickets in her production. Presume that only a certain number of tickets —say 10,000—will ever be created for this production to replicate the forced scarcity of blockchain-based platforms. So far, these presumptions are consistent with the ordinary operation of a Broadway production.

To alter the ordinary scenario, however, imagine that each ticket/token sold allows the holder to attend *any* given nightly performance of the show on a first-come, first-served basis.[207] If the theater in which the production is mounted holds, say 1,000 seats, then for any given evening's performance, the first 1,000 ticketholders to reserve seats for that show will be admitted to attend. Assume now that someone is responsible for collecting token-based tickets presented by theatergoers each evening and before the production was mounted, all those involved in the production agreed that their only compensation for acting, performing music, managing lighting, and such would be measured in an agreed percentage of the total number of tickets collected from a given evening's performance. Of course, some tickets from each night's performance would also be allocated to the company that owns the venue, to pay rent and other overhead costs. Because all those

205. *See* Hinman, *supra* note 36.

206. *See* Seward, *supra* note 13.

207. Lest anyone find themselves dwelling on hypothetical ticketholders waiting in the rain on 45th Street, one can assume that the ticketholders can make advance reservations for particular showings—one reservation per ticket at a time.

involved in the production need money to pay expenses and because tickets are not specific to any particular performance, the production staff can access the ticket reselling site of their choosing and resell their tickets in the market for cash.

In keeping with the analogy to a blockchain platform, suppose also that the show's script and other production details were all made open source by the producer and placed on a public code repository such as Github.[208] In that way, it would be possible for others to mount a production with few, or many, similarities to the original, and to make changes that the new team thought would improve the show, like in a fork.[209] At this point, all the producer would own is 50% of the total ticket supply she retained. Any decisions regarding the future of the production would be taken by the token holder community of prospective attendees, actors, musicians, stagehands, etc. (voting based on the number of tokens they controlled at any time).

Of course, the amount of value a given participant in the production receives for her tickets will depend on the demand by theatergoers to see the production at the time she sells the tickets, and on the total supply of tickets available. In early days of production, the price of the tickets might be relatively low, as theatergoers are determining whether this particular production is something they are interested in attending. If the production becomes popular and demand increases, the price of the tickets would increase as well, thereby rewarding those involved in the production and incentivizing them to continue their efforts. Alternatively, if the production is not well received, the resale price of the tickets may plummet, disincentivizing further participation in the production.

Thus, in such an arrangement, when the production is not owned by anyone, one might wonder if the recirculating tickets are securities? If so, who would be the issuer of these securities? In other words, how would we identify the person or entity, the absence of which would render the tickets worthless? It would certainly not be the original producer who initially sold the tickets, as she is not providing the essential managerial efforts required to keep the production going.[210] If our analogy now imagines using digital tokens maintained on a public blockchain (rather than paper-based tickets), would any conclusions change?

Although, as discussed above, the initial fundraising for such a unique production by the producer, via the sale of advance tickets, might still meet the *Howey* test, and thus involve a sale of securities, another

208. *See* GITHUB, https://github.com/ (last visited June 23, 2019).
209. *See, e.g.*, Magnuson, *supra* note 7, at 172.
210. *See* Peirce, *supra* note 36.

issue remains.[211] Is it appropriate to conclude, as the initial ticket purchasers sell their tickets in a marketplace and others buy the tickets, whether intending to attend the show or speculating that the tickets may be worth more in the future, that these tickets in the form of digital tokens are themselves "securities"? Among other things, such a conclusion would mean that these tickets could not be offered for sale on StubHub or other ticket marketplaces as none of these entities are licensed to be an exchange for securities.[212]

Can this be the correct result? And what of the sufficiently decentralized test? Is the answer to whether these special tickets are "securities" somehow tied to whether, at any particular moment in time, the production is sufficiently decentralized or whether an active participant can be identified?[213] If so, who would be responsible for making this determination, and how would it be communicated to ticketholders? As previously stated, because whether the tickets are considered securities will have a variety of impacts on the ticket-holders: will they need to know the precise moment in time when this transformation occurs. Further, what would happen after the sufficient decentralization has occurred if there is a subsequent aggregation of the tickets by a company, or if another entity leaps in and becomes an active participant with respect to the production? Would that company's acquisition of the tickets or engagement as an active participant at some point transform the tickets back into securities?

Going one step further, this proposal also demonstrates the valuable role that third-party investment in these very special tickets can play. Should investors start buying up tickets while they are trading at relatively low prices in the secondary market; this activity sends market-based price signals to those involved in the community that there is interest in the production.[214] Thus, further engagement and development of the production will be rewarded economically by higher ticket prices.[215] Similarly, one of the elements that makes blockchain-based platforms highly unique is that secondary market prices for tokens can send a clear signal as to anticipated demand for the platform, even if

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211. *See supra* note 29 and accompanying text; SEC v. W.J. Howey Co., 328 U.S. 293, 298–99 (1946).

212. Entities seeking to operate a national securities exchange must register with the SEC and satisfy the lengthy requirements of Exchange Act § 6, 15 U.S.C. § 78f (2018).

213. *See* Hinman, *supra* note 36.

214. *When do Investors Invest?*, FUNDABLE, https://www.fundable.com/learn/resources/guides/investor/when-do-investors-invest (last visited June 24, 2019).

215. *Id.*

those pricing signals come from investors who do not expect to use the tokens themselves.

In some respects, this is no different than the role traders play in many spot commodities markets—buying and selling crude oil, copper, wheat, cotton, and other commodities based on their expectation of subsequent price changes. This type of third-party trading aids in price discovery and provides essential liquidity to those markets, assuring end-users of the availability of the commodity for a price.[216] This is the a role ticket brokers play as well, ensuring that visitors to Manhattan can access the hottest tickets in town, even if theatergoers are obliged to pay a premium for the service of making these tickets available when needed.[217]

Likewise, the secondary market trading of cryptographic tokens that are used as part of a blockchain-based platform gives the investment community a previously unavailable method of making economic gains based exclusively on the growth of the relevant network, rather than on the equity of a company that runs a network that is expanding.[218] The difference is like that between buying shares in a company that grows and harvests wheat and buying the wheat itself with a view toward resale. This ability of investors to take a position on the anticipated success of networks is far from a bug—it is one of the most important features of blockchain technology.[219]

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216. For a thorough and thoughtful analysis of the detrimental effects of purely speculative derivatives, see Timothy E. Lynch, *Coming Up Short: The United States' Second-Best Strategies for Corralling Purely Speculative Derivatives*, 36 CARDOZO L. REV. 545 (2014).

217. *See* Gary Adler, *There are Millions of Seats to Fill. Ticket Brokers Help Fill Them*, TICKET NEWS (Oct. 17, 2017), http://www.ticketnews.com/2017/10/ticket-brokers-benefit-business/.

218. *See* Robinson, *supra* note 204, at 950.

219. One very important observation should be made here. Spot transactions in physical commodities have historically been conducted only by commercial parties and other large, sophisticated players in a wholesale market. Lynn A. Stout, *Derivatives and the Legal Origin of the 2008 Credit Crisis*, 1 HARV. BUS. L. REV. 1, 16 (2011). There are typically very high capital expenditures required to acquire, store, insure, and transport physical commodities. *Id.* at 7–8. With cryptographic tokens, these transaction costs nearly disappear, allowing retail customers and anyone with access to a token exchange to enter the spot market for tokens. Jonathan Rohr & Aaron Wright, *Blockchain-Based Token Sales, Initial Coin Offerings, and the Democratization of Public Capital Markets*, 70 HASTINGS L.J. 463, 484 (2019). For historical reasons, the CFTC has not had supervisory oversight of the spot markets in commodities. Lee Rainers, *Bitcoin Futures: From Self-Certification to Systematic Risk*, 23 N.C. BANKING INST. 61–62 (2019). It may be appropriate to revisit this jurisdictional decision when it comes to intangible commodities, like cryptographic tokens.

Note that the question of whether the market price for these hypothetical tickets can be manipulated and whether fraudulent or deceptive practices with regard to the tickets can occur is still highly relevant. The question is whether federal or state securities laws should have any bearing on the buying and selling of these tickets. Even in circumstances in which the original producer is still engaged in the production, federal and state securities regulation may be unwarranted.

VI. CONCLUSION

This Article has discussed the application of securities law to the sale of cryptographic tokens and has found that a critical distinction has largely been ignored: the difference between investment schemes and their objects. One can trace this framework from cases pre-dating *Howey* into the modern era. SEC Chairman Jay Clayton's Broadway ticket analogy provides an ideal lens through which to look more closely at this distinction, as it relates to the sale of cryptographic tokens issued in connection with ICOs.

Acknowledging that many cryptographic tokens are not themselves securities—and are more properly characterized as commodities—is an important step to develop a healthy and sustainable blockchain industry in the United States. It will also provide much-needed certainty to market participants and will align the U.S. regulatory regime to that developing in the rest of the world. Most importantly, it allows blockchain platforms in the process of becoming decentralized to grow their user base without treating those using their platform like parties engaged in securities transactions, something the author of this Article believes is incompatible with the development of decentralized blockchain systems in the United States.

Nonetheless, there are significant concerns about rampant fraud and market manipulation in the secondary markets for cryptographic tokens.[220] While there is clearly a need for more self-regulation to come from within the blockchain industry, there are also many regulatory and enforcement tools capable of addressing these systemic concerns already in place through enforcement of consumer and commodities laws.[221] Nevertheless, the dialogue concerning the most appropriate way to regulate secondary markets for cryptographic tokens should continue. This includes a close examination of whether the CFTC should be given supervisory authority over spot markets in cryptographic tokens and any other intangible assets that may be traded on futures markets. There have

220. *See* Alexandre, *supra* note 40.

221. *See supra* Section IV.D.

already been many thoughtful legislative proposals at the state-level, and federal legislation continues to develop. This Article welcomes further thoughtful and vigorous discussion on these topics from market participants and the general public alike.