NUGENESIS

FINAL PART D

THE LEGAL ISSUES INOLVED IN CRYPTOECONOMICS AND THE NUGENESIS ECOSPHERE

D1 Introduction

The Traditional legal concepts do not properly apply

D1.1 Regulators have been critical that some 83% Whitepapers pay no regard to the legal issues involved with the technology they seek to explain[1].

D1.2 We hope to provide the reader with a comprehensive review of the legal issues as they affect the cryptoverse, at least at it concerns the Nu Genesis ecosystem. We can only do so at a generic global level that deals with the common legal and policy themes that regulators are concerned with.

D1.3 For the reasons detailed below, securities regulations tend to focus on "issuers" and "investors" as terms of their regulatory terms of reference. These are concepts that do not apply properly to blockchain technology and even less so with regard to Nu Genesis.

D1.4 The "issuer" is a decentralised DAO that is led by a New Zealand Charity, First Peoples Advancement Charitable Trust. It was established in 2015 for the purpose of advancing, through efficient trade, the peoples of the South Pacific. The DAO included a range of Australian and International companies and individuals that were interested in developing, through blockchain, financial assets that would include interests in property and infrastructure projects. Therefore the "issuer" is quite an inapplicable concept applied to Nu Genesis in circumstances where there is no ICO. Rather, all that is happening is that NuCoin is being released on publicly traded licenced exchanges around the world opening the ease of access to buy and use it.

D1.5 Nu Coin is the currency of the Nu Genesis ecosystem. It is the means of exchange to access services and opportunities provided by and in the ecosphere. It is also the right to participate in the facilitation of consensus of the blockchain which recognises the digital representation of value (whether in the form of rights[2] or otherwise) which is reliant on cryptography and distributed ledger technology for its accounting and security. It's functionality is wholly incompatible with securities regulation.

[1] FCA Cryptoassets Taskforce: Final Report (October 2018) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752070/cryptoassets_taskforce_final_report_final_web.pdf accessed 12 December 2018

[2] rights to receive a benefit or perform specific functions such as receiving new coins from staker-mining, facilitating consensus, participating in governance and taking part in opportunities.

D1.6 If we were forced to identify an "issuer", that would be rather complex: ranging from all parties involved in the development of blockchain, its ecosphere, the miners and the AI - all of which will be providing access to NuCoin on the international exchanges. There is no contractual relationship sought to be established by any 'managers'; there are merely unknown people who may buy and/or sell with other strangers. Likewise, "investors", are not investing in a potential future promised blockchain as described in a 'white paper' seeking to raise capital to build it.

D1.7 Traditionally, non-functional tokens have the sole function of acting as a fundraising mechanism and are offered to the public when the platform or the network has not been developed. Non-functional tokens do not contain any features that are intrinsically linked to a blockchain project; thus their value is driven only by speculation[3]. The pre-sales of tokens are not unusual. Around 70% of ICOs had been previously offered in a presale to a private investor group prior to the crowdsale.[4]

D1.8 With respect to NuCoin, a prospective participant is not 'investing' in a pre-sale or ICO by an issuer establishing a contractual relationship to build a blockchain. Rather they are a potential participant in a global ecosphere that is complete and fully functional and whose future they, and unknown others, will determine. They are acquiring NuCoin on an international exchange with no contractual relationship between any buyer and seller.

D1.9 The problem is that regulators do not discern regulation on the basis of technology. This means that the same set of statutory rules apply to financial services and transactions, regardless of the type of technology used.[5] Accordingly we must apply the legal concepts as best we can and be guided in that application by the underlying policy of securities regulation to the crypomarket as it has evolved over the last 12 years, and noting where NuGenesis, and NuCoin in particular, stand.

[3] Alfonso Delgado et al. *Towards a Sustainable ICO Process: Community Guidelines on Regulation and Best Practices* (2016), pp. 33

[4] This percentage is based on a sample of 450 ICOs. See Dirk A. Zetzsche, Ross P. Buckley, Douglas W. Arner and Linus Fôhr. The ICO Gold Rush: It's a scam, It's a bubble, It's a super challenge for regulators. EUROPEAN BANKING INSTITUTE WORKING PAPER SERIES 2018 – NO. 18. (2018) pp. 11.

[5] *See, for example*, Eur. Comm'n, Directorate General Financial Stability, *FinTech: A More Competitive and Innovative European Financial Sector* 4, 5, 15 (Consultation Document), http://perma.cc/2JRFHDBM (regarding financial technology regulation in general). According to OICV-IOSCO, most regulators follow the neutrality approach. OICV-IOSCO, UPDATE TO THE REPORT ON THE IOSCO AUTOMATED ADVICE TOOLS SURVEY – FINAL REPORT 4 (File No. FR15/2016, Dec. 2016), http://perma.cc/KS6V-DKUT (regarding the regulation of automated advice tools, specifically).

D2 Securities regulation applied to Blockchain technology

D2.1 The main role of the securities regulator is providing information to the market, mainly through the vehicle of disclosure requirements which, in turn helps the market assign the right price tag to the products sold.[6] For example, any information about the quality of the management of the firm is expected to be included in the price of the firm's securities as long as the information is public. If the information is positive the price of the 'security' is expected to increase as investors rush to purchase it. In other words, there is a hypothesis that as long as the market receives the correct and full information about a firm the market will be efficient.[7]

D2.2 Investors are deemed to require protection against issuers on the basis that the offeror has more information about what is being offered than the buyer. This is compounded by the fact that the value and quality of the security lies primarily in the future, and in the issuer's control.[8] The informational asymmetry between buyer and issuer, in addition to a general lack of factual information, is so extensive that the law deems it inappropriate to place the onus of inquiry and investigation solely on the purchaser.[9]

D2.3 This policy rationale does **not** apply to blockchain technology. To the contrary, blockchain technology on which ICOs are based, intrinsically limits any asymmetries of information.[10] Data stored on a blockchain is decentralised, open-source, and updated by consensus mechanisms. It could be possible that these attributes provide more transparency and availability of information in comparison to traditional companies. In contrast to companies that do not store their financials on a blockchain and only report once per year, in decentralised networks the storage and movement of funds can be viewed in real time. Because token holders can see how their contribution is being used, the structure arguably lends itself to enhanced peer-to-peer governance.[11] Further, the code (which often contains everything from the way funds can be directed, to the bylaws and governance of the issuer) is publicly available and accessible to all participants, enhancing its transparency.[12]

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[6] HADAR Y. JABOTINSKY, FINANCIAL REGULATION in ENCYCLOPEDIA OF LAW AND ECONOMICS (2017)

[7] Burton G. Malkiel, *The Efficient Market Hypothesis and its Critics*, 17 J. ECON. PERSPECTIVES 59, 60 (2003). Note however that this hypothesis has been criticized in many ways, as markets seem to over or under react to new pieces of information and to take into account irrelevant or plausible information JOHN ARMOUR, DAN AWREY, PAUL DAVIES, LUCA ENRIQUES, JEFFREY GORDON, COLIN MAYER & JENNIFER PAYNE, PRINCIPLES OF FINANCIAL REGULATION 101 (2016) at 105.

[8] Ross Grantham and C. E. F. Rickett *Company and Securities Law: Commentary and Materials* (Brookers, Wellington, 2002) at 876.; and generally, A. C Page, R.B Ferguson *Investor Protection* (London, Weidenfeld and Nicholson, 1992) at 36-38.

[9] At 876.

[10] See for example Alex Tarrock and Tyler Cower "The End of Asymmetric Information" (6 April 2015) <https://www.cato-unbound.org/2015/04/06/alex-tabarrok-tyler-cowen/end-asymmetric-information>.

[11] Note the immediate weakness in this argument – only aggregated data reveals the health of a company.

[12] Lior Zysman "DAOs and Securities Regulation" (30 September 2016) Smith and Crown <www.smithandcrown.com/daos-securities-regulation/>.

D2.4 The standard market practice has been that the issuer publishes a so-called "white paper" on its website.[13] Although some white papers are quite comprehensive, their level of detail cannot be compared with a prospectus required under securities regulation.[14] For example, while under securities regulation it is required that the prospectus contains detailed information about the issuer, this element is very often missing from white papers.[15]

D2.5 The implicit assumption is that information about the issuer and its financial history are somehow relevant. It assumes that it is in the issuer that the 'investor' is investing or relying upon to manage their investment. How that thinking can apply to an ICO for which funds are raised to build the blockchain, it certainly does not apply to NuGenesis. The participant is participating in an ecosystem where the issuer's role (in so far as contributing to the building of the blockchain) has finished and a complex governance system applies as to how that ecosystem is to progress and evolve.

D2.6 Significantly, the relationship structure and interest dynamics conceptualised by traditional securities law do not apply. The NuGenesis network is designed to manage the minting and distribution of NuCoin such that the incentives of all stakeholders are aligned[16]. Indeed the participant is 'signing up' to a set of rules whereby the minting of coins is a functional of complex relational system of other participants developing an ecosystem. There are not even 'gas' fees or something that could equate to 'dividends'. There are no profits as such, but a hope by all concerned, for the appreciation of Coin value as more people acquire the Coin to access services. Traditional distinctions between investor/shareholder/customer don't seem to apply.

The core concept: security and the Howey test

D2.7 While it is not surprising that various national securities law frameworks apply different terminology, the structures are highly comparable. As NuCoin does not involve any rights to equity in, dividends from or right to vote in, an issuer, the relevant securities law inquiry to consider is whether there is some sort of collective investment vehicle that is managed by someone who can be called an issuer. The U.S SEC's investigations and enforcement orders have set the tone for the debate on tokens under securities laws. The pivotal term "investment contract" is a subcategory of the general term "security." Singapore, Australia, and New Zealand follow a two-tier approach, distinguishing between tokens as securities and tokens as collective investment agreements. Ultimately the focus of whether there is some sort of collective investment contract or scheme amounts to a 'security'.

D2.8 The E.U. framework focuses on the tradability of tokens on the secondary capital market, and therefore apparently differs from the investment-based approach taken by the other jurisdictions. However, where this framework is applied to NuCoin, there is a great similarity of the issues that arise for consideration.

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13 Dirk A. Zetzsche, Ross P. Buckley, Douglas W. Arner and Linus Fôhr. *The ICO Gold Rush: It's a scam, It's a bubble, It's a super challenge for regulators.* EUROPEAN BANKING INSTITUTE WORKING PAPER SERIES – NO. 18. (2018) at 10.

14 *See id.*

15 *See id.* at 11.

16 See Chriss Dixon, 'Crypto Tokens: A Breakthrough in Open Network Design' (1 June 2017) https://medium.com/@cdixon/crypto-tokens-a-breakthrough-in-open-network-design-e600975be2ef

D2.9 Furthermore, generally there appears to be a common approach by leading developing countries seeking to enforce existing rules by testing crypto currency assets as against a 'securities' classification. Whatever the language used to determine the putative 'security'[17], the case law concerning the application of the famed *Howey test* is helpful for all jurisdictions concerned. It is that designation which gives local Securities Enforcement Regulators the jurisdiction to regulate, firstly by requiring prospectus type registration. Accordingly, we will use the US heading of "securities" as the common point of analysis by jurisdictions and identify any material differences in the discussion.

D2.10 'Security' is the is the gateway concept test for the application of the full array of securities regulation (including, but not limited to, the obligation to publish a prospectus, the creation of prospectus liability, the prohibition of insider trading, and the authorisation of financial intermediaries involved in token sales by national regulators).

Not exhaustive list of legal issues

D2.11 There are of course an almost inexhaustible list of other legal issues such as regarding the jurisdictional tests and exemptions in each jurisdiction, and regarding the exemption for sophisticated investors. As to how each Country asserts jurisdiction in the global marketplace diverges in the extreme.[18] Some national regulators would find it particularly difficult to take action against token offers managed by entities based in a foreign country. For example, the U.K. Financial Conduct Authority (FCA) seems to be painfully aware of its limited powers, stating laconically that ICOs "might be based overseas."[19]

D2.12 At the other extreme, the US has vast and long-standing experience in seeking to apply national securities laws extraterritorially.[20] As there is no wrongful behaviour having harm on US citizens, we leave the mention of this issue under para [D9].

[17] In the US an 'investment contract' is considered a 'security' see para D4.4. In Canada is Section 35 of *The Securities Act,* prohibits anyone trading in a security in the absence of a prospectus and section 1(1)(22)xiii defines security as including "any investment contract, other than an investment contract within the meaning of The Investment Contracts Act". The Supreme Court of Canada's decision in *Pacific Coast Coin Exchange v. Ontario (Securities Commission)*, [1978] 2 S.C.R. 112 applied the US *Howey* test: see para D15.1. In Australia and New Zealand, it is the concept of 'managed investment' which encapsulate similar concepts.

[18] In Australia for example, the "offer of securities" must be "received in Australia": sec 700(4) of the *Corporations Act* 2001.

[19] U.K. FIN. CONDUCT AUTHORITY, *Distributed Ledger Technology – Feedback Statement on Discussion Paper 17/03*, at 15 (Dec. 2017), http://perma.cc/U92Q-VVJZ.
FCA highlights its limited competencies when stating that ICOs "might be based overseas."

[20] See the Dodd-Frank Wall Street & Consumer Protection Act, H.R. 4173, 11Ith Cong. §§ 929P(b), 929Y (2010) (enacted) [hereinafter Dodd-Frank Act]. See also: Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), *abrogated* by *Morrison v. Nat'l Austl. Bank Ltd*., 130 S. Ct. 2869 (2010); *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972), *abrogated by Morrison*, 130 S. Ct. 2869.

D3. The Classification of Coins and Tokens

D3.1 Common practice is to use classifications like “security” token, “utility” token or “payment token” or some combinations thereof[21], as a way to help condense the nature of the analysis.

D3.2 NuCoin would generally be primarily a payment Coin. It is intended to function primarily as a means of payment, which can be freely transferred in a peer-to-peer fashion on a distributed ledger technology or related technology, without usage of an intermediary or geographic limitation. This category of tokens aims to resemble money in its functions, as a means of exchange, a unit of account and as a store of value.[22]

D3.3 However it is also a utility token in that the Coin is necessary for access to services, opportunities and investments in the ecosphere and to applications build upon NuGenesis, parachains or Para-Networks. What it is **not**, is a ‘security’ token that provides economic rights taking any shape comparable to equity ownership in the issuing entity, dividend rights or rights to any transaction fees on the Network[23].

D3.4 This broad classification may be useful, but the focus is the exact rights and benefits that are being offered, viewed in economic reality unconstrained by form[24], when the public come to purchase NuCoin on an exchange.

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[21] Utility-security hybrids are tokens such as NEO and BNB, which are designed to have elements of both utility tokens and security tokens. Utility-security token is the most common form of security tokens. They are interesting as they combine elements of more traditional financial instruments with characteristics of utility tokens.

[22] See for example, the frameworks of Finma, the European Securities and Markets Authority, ‘Own Initiative Report on Initial Coin Offerings and Crypto-Assets’ (19 October 2018) https://www.esma.europa.eu/sites/default/files/library/esma22-106-1338_smsg_advice_-_report_on_icos_and_cryptoassets.pdf, Zetsche, European Banking Authority, ‘Report with advice for the European Commission’ (9 January 2019) https://eba.europa.eu/documents/10180/2545547/EBA+Report+on+crypto+assets.pdf, Thomas Euler, ‘The Token Classification Framework: A multi-dimensional tool for understanding and classifying crypto tokens.’ (18 January 2018) http://www.untitled-inc.com/the-token-classification-framework-a-multi-dimensional-tool-forunderstanding-and-classifying-crypto-tokens/ Monetary Authority of Singapore, ‘A guide to Digital Token Offerings’ http://www.mas.gov.sg/~/media/MAS/News%20and%20Publications/Monographs%20and%20Information%20Papers/G uide%20to%20Digital%20Token%20Offerings%20last%20updated%20on%2030%20Nov.pdf FINMA, ‘Guidelines for enquiries regarding the regulatory framework for initial coin offerings (ICOs) https://www.finma.ch/en/~/media/finma/dokumente/dokumentencenter/myfinma/1bewilligung/fintech/wegleitungico.pdf?la=en Philipp Hacker and Dr. Chris Thomale, LL.M. ‘Crypto-Securities Regulation: ICOs, Token Sales and Cryptocurrencies under EU Financial Law’ (2017) eCFR (forthcoming) available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3075820

[23] Cf for example NEO provides its token holders dividends in the form of another token by the name of GAS, while Binance uses a percentage of the transaction costs paid in BNB to buy back coins and ‘burn’ or destroy them. Although Binance’s model is more comparable to a share repurchase than a dividend, the economic reality is de-facto quite similar, as a decrease in supply should lead to an increase in the value of BNB tokens.

[24] many token issuers have opted to self-classify their token as a utility token (even when, aside from the provided utility, economic rights are provided to the token holder) can be explained by the systemic misunderstanding of applicable securities laws in the eyes of issuers. For some reason, many token issuers seem to have been under the impression that mere classification as a utility token would protect them from the grasp of securities regimes.

The Key Features of Nu Genesis' Nu Coin

D3.5 The Key features of NuCoin in this analysis are as follows:

(a) The NuGenesis blockchain system is fully operational and decentralised with staker-miners minting and producing NuCoin as the currency of the NuGenesis ecosystem;

(b) That is, the public is not being offered (as is typically the case) to invest in a prospective or hoped for blockchain idea where the money raised will be used to build the blockchain;

(c) NuCoins are not pre-mined and are not offered by any issuer or founder. They are the subject of allocation from the Treasury wallets created by the blockchain through the miner-staker and AI system validators and are released to provide sufficient liquidity for the ecosphere to function according to the pre-set tokenomics formula reducing in number over the next 110 years;

(d) Having built the blockchain, the Founder's role has been exhausted. No "investor" is looking to them to build it. The ecosystem thereafter derives its functionality by the roles provided for in the ecosystem: the consensus protocols, the miners and the 313 elected executive positions for governance. Moreover, in the specific case of NuCoin, the contribution is by each and every community member in the ecosystem.

(e) NuCoin does not entitle any right to 'gas fees'; there are no gas fees. Whether or not NuCoin has any value (profit expectation) is entirely a function of all the parts of the ecosystem working together – and the measure of success is a measure of how both independent and interdependent business actors pursuing their individual interests, collaborate and attract new projects work together to contribute to the whole.

(f) To the extent that the founders, or the entity they used as the vehicle to fund the creation and establishment of the NuGenesis blockchain to the point of release, can be considered "issuers" of the offer, they do not and cannot be expected to have any on-going role in the success of the project which any participant can reasonably rely.

(g) Therefore from a policy perspective, it is not disclosure that could possibly be required about the issuers or founders or their vehicle that is important. It is not in their company or them that people are investing. It is to the blockchain, its protocols, governance system and the contribution of unknown people who may come to use and form the community that gives it growth, that a prospective participant must look.

(h) NuCoin is the currency of the NuGenesis blockchain ecosystem. NuCoins do not give an interest, share or any rights in any issuer or founders' company. It is used to acquire services, to participate in projects, to make investments in venture capital projects, to stake in order to ensure the integrity of the blockchain consensus, and to be used for a range of Government services in SDEZ's jurisdictions of participating countries.

(i) NuCoin is a Government recognised form of payment, as a currency in the SDEZ's.

(j) As the prospective community member must look to the ecosystem outlined in this white paper to assess how they may benefit from participating and to what extent they may wish the purchase and utilise NuCoin beyond that which they receive for free on simply becoming a member, the financials and history of the founders are irrelevant.

The essential distinction

D3.6 The best analysis of the test for a security applied to a blockchain protocol is that Offered by Director Hinman the SEC's Director of the Division of Corporate Finance in September 2018 about the legal nature of Ethereum tokens. In his speech, Director Hinman stated that[25]:

> *"If a network on which the token or coin is to function is sufficiently decentralized — where purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts — the assets may not represent an investment contract. Moreover, when the efforts of the third party are no longer a key factor for determining the enterprise's success, material information asymmetries recede. As a network becomes truly decentralized, the ability to identify an issuer or promoter to make the requisite disclosures becomes difficult, and less meaningful."*[185]

D3.7 This "sufficiency of decentralisation test", as it is sometimes referred to, highlights at the core, the difficulty of applying traditional jurisprudence to Distributed Ledger Technologies. The purpose of securities legislation to cure the asymmetry of information that a promoter has over the prospective investor either in the promoter company or an investment pool that the promoter is managing. By contrast, blockchain technology is about creating a trust-less system based on mathematical protocols that are immutable and cannot be corrupted. The Promoter cannot change these. Hence why Satoshi Nakamoro is rightly a pseudonym. He does not control Bitcoin. His identity, financial record is completely irrelevant.

D3.8 Why would an investor need information disclosures about a party, such as the First Peoples Advancement Charitable Trust, that no longer has any influence on the investment which is acquired? When an investor no longer relies on the efforts of the issuer, it makes sense to say that the Coin or Token is not part of an investment scheme managed by an issuer-promoter.

D3.9 The "sufficiently of decentralisation test" should not become an alternative test, without realising that it is a gradual scale. Decentralization is not binary, but instead a multidimensional concept that is a function of many factors, each of which has its own gradual scale of decentralization. NuGenesis is expressly designed to be user-friendly and cost efficient for multiple existing and new blockchain projects to use it, build apps and become para-networks with it.

[25] William Hinman, 'Digital Asset Transactions: When Howey Met Gary (Plastic)' (SEC transcribed speech, 14 June 2018) https://www.sec.gov/news/speech/speech-hinman-061418.

D3.10 In relation to protocol tokens such as NuCoin, the value of a protocol is derived from the usage thereof, from the applications built thereon ,and para networks running off it. We look at the valuation issues at para [B 11] which suggests that the applicable valuation model that fits is valuing NuCoin as:

(a) a currency of an emerging country's economy; or,
(b) a user network following Metcalf's law,

both reliant upon the shift of value created by participants

D4. A Deep Dive into US law and the Howey Test

D4.1 The most prominent parts of U.S. securities legislation are the *Exchange Act* of 1934 and the *Securities Act* of 1933. The former established the Securities and Exchange Commission (SEC) and focuses mainly on secondary transactions and the regulation of intermediaries, whereas the latter is comprised of legislation being directed towards issuers.

D4.2 The applicability of the quite onerous provisions found in these Acts for the issuers is dependent on whether the financial instrument is considered to fall under the definition of 'security' or not. If yes, issuers have to comply with a number of regulatory requirements, such as the approval and registration of a prospectus with the SEC, annual reporting requirements and other disclosure requirements regarding insider trading and other financial misconduct.

D4.3 The US Congress has always encourage a broad reading of the definition of securities in the US *Securities Act* of 1933 and *Securities Exchange Act* of 1934, and long lists of categories are found in the Acts, including stocks, notes, bonds, futures, swaps, participation in profit-sharing agreements, derivatives.[26] If a Coin or token closely resembles any of the defined financial instruments, there is no doubt that an ICO will be a sale of securities. Therefore, many security tokens, or hybrid tokens that provide token holders with economic rights such as dividend rights or a right to the ownership of equity, will be caught by these provisions. While the definition in these acts include well-defined instruments, it also includes 'securities' of a more variable character, such as the broad catch-all category of 'investment contracts'.

D4.4 The definition of an 'investment contract' has been defined in the classic *SEC v. Howey Co* case[27]. In its judgment, the U.S Supreme Court decided to put forward a four-pronged test. The '*Howey test'* focuses on the economic reality of any 'contract, transaction or scheme' to determine whether an investment contract is deemed to fall under the definition of securities. The judgment held that at the core of an investment contract "is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others".[28]

[26] US *Securities Act of 1933* § 2(a)(1) and the US *Securities Exchange Act* of 1934 § 3(a)(10)
[27] *Securities and Exchange Commission v. W. J. Howey Co*. [1946] 328 U.S. 293
[28] Ibid 298-299

D4.5 As such, a court-applied test emerged that investigates the existence of the four elements of this judgment:

i. *A person invests his/her money*
ii. *in a common enterprise and*
iii. *is led to expect profits*
iv. *resulting solely from the efforts of the promoter or a third party.*

Is there a commonality of enterprise?

D4.6 US Case-law has illustrated two distinct approaches towards the establishment of vertical commonality by courts. *Broad* vertical commonality requires that the investor's fortunes are tied to the efficacy of the manager's efforts.[29] *Narrow* vertical commonality requires the same but adds the additional requirement that the investor's profits are tied to the issuer's profits; meaning that they should rise and fall together.[30]

D4.7 In the case of NuCoin, the 'narrow commonality test' of the common enterprise would not apply as the issuer does not own and will never own any NuCoin. The Issuer plays no part in the future of project at all.

D4.8 Those NuCoins that will become available as liquidity to the exchange are the result of decentralised efforts of a number of parties including miners. As noted by by Coincenter's[31] researchers as follows:

> *"If there are many unaffiliated miners, transaction validations, and businesses on the network then there is, effectively, no singular promoter with which investors could have vertical commonality. All of these participants will have individuated profits and losses based on their unique business models and decoupled from the price of the token held by typical users. If, on the other hand, there is little decentralization in the development and maintenance of an altcoin network (i.e. all developers are employed by the same for-profit company and/or there are few and highly centralized transaction validators on the network), then there is a stronger case for vertical commonality"*[32]

D4.9 There is therefore great difficulty in applying the 'commonality' test where, in a complex ecosystem created by NuGenesis, there are multiple actors pursuing their own interests in the business they embark when participating in the ecosystem. The only function of an intersecting 'commonality' is limited to preserving the integrity of the blockchain. It is not for the pooling of money for making an investment.

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[29] see e.g. *SEC v. Unique Fin. Concepts, Inc.* [1999] 196 F.3d at 1199–1200; *Eberhardt v. Waters* [1990] 901 F.2d 1578, *SEC v. Continental Commodities Corp.* [1974] 497 F.2d 516 (5th Cir.), *SEC v. Pinckney* [1996] 923 F. Supp. 76, 82 (E.D.N.C.),

[30] see e.g. *SEC v. Glenn W. Turner Enterprises, Inc*., [1973] 474 F.2d 476, 482 n.7 (9th Cir*); SEC v. SG Ltd.* [2001] 265 F.3d 42, 49 (1st Cir.)

[31] Coin Center is the leading non-profit research and advocacy centre focused on the public policy issues facing cryptocurrency and decentralized computing technologies like Bitcoin and Ethereum. See https://coincenter.org/

[32] Peter van Valkeburgh, 'Framework for Securities Regulation of Cryptocurrencies' (Coin Center Report, January) https://coincenter.org/wp-content/uploads/2016/01/SECFramework2.5.pdf

Is there the requisite expectation of profits from that common enterprise?

D4.10 An increase in value of the initial investment counts as satisfying the expectation of profits test[33]. However, many entities own large amounts of commodities for both use and the enjoyment of value maximisation. Exxon holds large quantities of Oil and De Beers owns large quantities of diamonds. The complexity arises where investment and speculation is but one of multiple purposes, such as in NuGenesis, where the NuCoin is essential for its multiple utility in the payment of services and in the participation in opportunities, such as collaborations with other projects (internal and external), seeking of funding or specific launching of projects.

D4.11 In *SEC v. Life Partners* for example, it was held that *"*for there to be an expectation of profits, the purchaser's motivation must be securing 'a financial return,' *not* consumption or use."[34] Thus the Howey test is difficult to apply to the multi-motivational incentives that exist in the complex economy created by NuGenesis in which NuCoin is the base currency.

D4.12 The first time such a dual-motivation case resulted in a judgment was in *United Housing Foundation, Inc. v. Forman.*[35] In this case, United Housing required tenants of their affordable apartments to buy shares of what United Housing called 'stock' which acted as representations of the requested rooms. After a dispute about a raise in the monthly rental charges, it was argued that the structure used by United Housing constituted a sale of securities. After all, it could be argued that there was an investment element to the motivation of potential tenants. An investigation of facts and circumstances however showed that the purchase of the apartments in question, arguably based on the dual motivation of utility and investment, was in fact not an investment contract.

D4.13 The court in *Forman* held that "when a purchaser is motivated by a desire to use or consume the item purchase (…) the securities laws do not apply".[36] In relation to utility token sales, this precedent is often used to argue that utility tokens are not securities.[37] There were however restrictions in resale in this case which limit its utility as a legal precedent.[38]

D4.14 In *Rice v. Branigar*, the eleventh circuit concluded that a sale of housing lots did not pass the *Howey* test because purchasers bought them primarily to use them, rather than to derive profits. The court's reasoning was based on the prior *Forman* case, and the believe of the court that "people buy houses and lots in a beach-club development primarily to use them, not to derive profits from the entrepreneurial efforts of the developers."[39]

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[33] *SEC v. Edwards* [2004] 540 U.S. 389, 390

[34] *SEC v. Life Partners. Inc* [1996] 87 F.3d 536, 547 (D.C. Cir.)

[35] *United Housing Foundation, Inc. v. Forman* [1975] 421 U.S. 837

[36] Ibid 852

[37] Marco Santori, Juan Batiz-Benet and Jesse Clayburgh, 'The SAFT Project: Toward a Compliant Token Sale Framework' p. 9 (SAFT Whitepaper, 2 October 2017) https://saftproject.com/static/SAFT- Project-Whitepaper.pdf p, 9 8

[38] In *Forman,* apartments and their representative 'stock' were subject to a number of strict resale limitations and did not provide residents with any dividends. In fact, residents were required to offer the apartments and stock back to the seller for a fixed price. The court defined profit here as "capital appreciation" or a "participation in earnings resulting from the use of investors' funds." Due to the resale limitations imposed on tenants, both were not deemed to exist in this case.

[39] *Rice v. Branigar Organization Inc* [1991] 922 F. 2d 788 (11th Cir.)

Is there reliance on the efforts of others?

D4.15 It has been held that a 'possible enhancement in value at resale is not within the Securities Act, where the essential element of reliance on the managerial, operational or developmental efforts of others is not present.'[40] This approach satisfies the policy concern regarding the asymmetry of information and expertise, and the beholden an investor is to the promoter carrying out what is promised for the value of their investment to appreciate.

D4.16 By well settled US case law, the word 'solely' is not to be taken literally.[41] In fact, the term is also interpreted to include 'significant or essential managerial or other efforts necessary to the success of the investment'.[42] In both *Glenn Turner* and in *Aldrich,* the test was whether the efforts made by those other than the investor are the undeniably significant ones; the essential managerial efforts which affect the failure or success of the enterprise.[43] Although courts employ a variety of formulations, the core of the fourth prong of *Howey* is the degree of reliance of the investor on the efforts of others.

D4.17 In *SEC v. Life Partners, Inc*. the D.C. Circuit Court of Appeal held that the need for securities regulation is greatly diminished where "the value of the promoter's efforts has already been impounded into the promoter's fees or into the purchase price of the investment, and if neither the promoter nor anyone else is expected to make further efforts that will affect the outcome of the investment".[44] If a blockchain's utility is, after an ICO, no longer developed in any way, then the value seems to not be dependent on the managerial efforts of the issuer.

D4.18 The US case law on circumstances where limited partnership interests can amount to securities is based on whether limited partners exercise effective control over the enterprise.[45] General partnership interests on the other hand are clearly not investment contracts as the general partner takes an active part in the managerial efforts of the partnership.[46] This is difficult to sensibly apply to the NuGenesis blockchain where every NuCoin holder is miner-staker and participates in the network; they cannot be passive.

D4.19 In *Williamson v. Tucker* it was decided that a general partnership interest is presumed not to be an investment contract because of the control exercised by the general partner, therefore constituting a lack of reliance on the efforts of others.[47] This is particularly instructive case law that would be relevant to Australia's and New Zealand's managed investment scheme characterisation that looks to effective day to day control by the participants.

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[40] Held in *McConathy v Dal Mac Commercial Real Estate, Inc.* [1977] 545 S.W.2d 871 based upon earlier case law, such as *Polk v. Chandler* [1936] 276 Mich. 527, 268 N.W. 732; *Wardowski v. Guardian Trust Co.,* [1933] 262 Mich. 422, N.W. 908 ; *Busch v. Noerenberg* [1938] 278 N.W. 34

[41] *SEC v. The International Mining Exchange, Inc.* [1981] 515 F.Supp 1062, 1067 (D. Colo.); see also *Crowley v. Montgomery Ward & Co.* [1978] 570 F.2d 877 (10th Cir.); *Hector v. Wiens* [1976] 533 F.2d 429, 433 (9th Cir.);

[42] *SEC v. Koscot Interplanetary, Inc.* [1974] 497 F.2d 473 (5th Cir.)

[43] Glenn Turner *SEC v. Glenn W. Turner Enterprises Inc.* [1973], 474 F.2d 476 (9th Cir.) p. 478 and *Aldrich v. McCulloch Properties, Inc.,* [1980] 627 F.2d 1036 at p. 1038

[44] *SEC v. Life Partners. Inc* [1996] 87 F.3d 536 (D.C. Cir.) at p. 547

[45] Stephen Jung Choi and Adam C. Pritchard, *Securities Regulation Cases and Analysis* (Fourth edition, University Casebook Series 2015) 30

[46] *Williamson v. Tucker* [1981] 645 F.2d 404, 422 (5th Cir.) *United States v. Herr* [1964] 338 F.2d 607 (7th Cir.)

[47] *Williamson v. Tucker* [1981] 645 F.2d 404, 422 (5th Cir.)

D4.20 Within the NuGenesis ecosystem, it seems futile to inquiry into relative 'voting power' where possessed by amount of system validators associated with particular individuals when the entire system is underscored by AI. Any concentration of voting power that impinges on the integrity of the NuGenesis blockchain which a participant is considering joining, is neutralised by the AI.

D4.21 The individual participant does not have to 'invest' or acquire NuCoin at all. They can receive and generate free NuCoin (commonly referred to as Airdops) by mere activation of their social media NuGenesis account and the small effort mining automatically therein on their smartphone or laptop. They can stop there. They do not have to participate any further. They control whether to participate in any of the multiple opportunities available to them in the ecosystem.

D4.22 If participants wish to purchase NuCoin, they do so on the exchange. If this is not because they want to utilise NuCoin to undertake a particular business activity in the ecosystem that they choose to undertake and the extent to which they choose to undertake it, it is because they believe the ecosystem will have value that increases over time. Even then any expectation of value increase of NuCoin can only be because of the functionality it enables for infinite unknown others to collaborate, develop applications and create opportunities.

D4.23 The important distinction is that any "issuers" are not in the same/common enterprise with a participant who merely purchases NuCoin. The NuGenesis blockchain ecosystem is an infrastructure for which to undertake enterprises. Whatever enterprise the individual may choose to participate in amongst the opportunities and collaborations that present are unknown.

D4.24 What will increase the value of NuCoin, is not the system in itself, but use which both the community of participants and the individual participant make of the system. The Social Media dashboard is live with trading data about the entire crypto space, videos, forums and chats about opportunities. It is live with collaborative opportunities, services that can be acquired including educational opportunities.

D4.25 The control over the participant's NuCoin is primarily with the participant. It is an active environment, not a passive one. If the participant chooses to take a passive role, it is because he makes the active choice to do that.

D4.26 A participant knows that the issuer will not take any future role in the development of the blockchain. The governance, including management process has been laid out. Even the role of marketing, traditionally associated with the 'promoter' or 'issuer', has been replaced with a complex affiliate marketing system rewarding referrals and comprehensive marketing efforts provided for in the treasuries created by the minting system. There is an incentive system created for maximising the network effort by creating a greater number of users. An investor must look to the infinite unknown players and its own efforts for any appreciation of value of their NuCoin. See further the discussion on valuation at para [C 11]

How does the voting/governance system impact on relative control?

D4.27 The governance system is referred to in para [C 5] and reward system in para [B 13].

D4.28 An example of an issue that prioritised for community vote is whether to ban 'pump and dump' schemes on the exchange. The case is put forward based on the studies that demonstrate that evidence that 'pump and dump' schemes profit only the promoters and to a lesser extent those that manage to get out within the first 40 secs, but adversely impact on the project being pumped. Identified reading material is provided. A participant has as much voting power as the founder to accept or reject the proposal.

D4.29 Another example is whether the permissioned blockchain will go fully open-sourced. All NuCoin holders have the same voting rights as each other.

D4.30 Executive and Managers can be replaced. There are 200 elected positions in the 313 executives. The new participant has as much voting power as any other participant, including the founders or issuers, as to who to vote for. There is no particular unique expertise or ability that is beyond the participants' reach that could be identified to deny that the actual control the participant has is less than its theoretical control by virtue of some lack of expertise.

Reliance on others in respect of particular enterprises

D4.31 It is difficult to think in terms of a participant having a common enterprise with issuer in terms of the entirety of the NuGenesis platform- such an analysis is too vague, when the point of the platform is to facilitate the blossoming of infinite enterprises. We believe it makes better sense to talk in terms of what kind of "enterprise" within the NuGenesis ecosystem can be identified as being one in common between the participant and issuer. At its most basic, a participant NuCoin gives access to projects that become available on the platform. The participant uses their NuCoin to go into particular projects and therefore it is rules of *that* particular collaboration become relevant. It is likely that their effective control within the common enterprise is greater than that arising from the general functioning of the blockchain as a whole. Participants may wish to collaborate in a VC project and set conditions upon which when funds will be made available to the managers of that collaborative project. This can include, for example, requiring signature application on a multi-signature wallet.

No reliance upon the funds of the issuer

D4.31 Another useful indicator may be the extent to which the issuer's foundation and funds are necessary for the success of the project. The NuGenesis ecosphere is designed for example:

(a) for other persons to develop customised NuGenesis blockchains to run their own Para-networks and para-chains;
(b) for other person to build dApps and use cases using the NuGenesis blockchain; and,
(c) for investment, collaborative, and technical solution opportunities to be created by others.

D4.32 The apparent offering by NuGenesis is the capability to create opportunities by others. An illustration is the booming market for NFTs and Defi. The NuGenesis blockchain offers not application, but the capability through their version of these, being the "Digital Notarised Contracts ('**DNC's'**)" and "Serialised Notarised Digital Assets ('**SNDA's**')", for others to design and build applications and use cases in respect of.

D5. The Life-cycle and evolution of legal character

D5.1 A quite challenging conception for the way we traditionally think of securities, but one that also been recognized by Brian Quintenz, commissioner of the U.S. Commodities and Futures Trading Commission (CFTC):

> *" [ICOs or tokens] may start their life as a security from a capital-raising perspective but then at some point -- maybe possibly quickly or even immediately -- turn into a commodity."*[48]

D5.2 We quite agree that the legal character of the digital asset crypto currency changes during its economic life-cycle evolution. For this reason, NuCoin was not made available for purchase by participants until *after* there was fully functional blockchain operational, NuCoin was being minted, the governance and consensus framework was working and the broader elements for an ecosystem were in place.

D6 The impact of marketing on the legal character

D6.1 Even in scenarios where a cryptocurrency or utility token does not borrow any characteristics of a security token, it might still be deemed a security in some jurisdictions, due to, for example the marketing and/or monetary and fiscal policy of the issuer and the method of issuance.

D6.2 In *Teague v. Bakker,* a case where individuals could purchase 'Lifetime Partnerships' from an entity known as PTL. By doing so, they were entitled to a short stay annually in a hotel at a vacation retreat constructed by PTL. However, there was also a profit element resulting from the efforts of a third party. Interestingly, it was held by the court that, because the "promotional materials allow[ed] the reader to infer that the value of the [lifetime partnerships] was enhanced by virtue of the commercial activities of the PTL facilities in catering to patrons paying full price," there was an expectation of profits. In fact, it was deemed that the profit that was expected from this financing product was deemed to outweigh the utility aspects of the lifetime partnerships in the eyes of the investor, and for this reason, it was a security.[49]

[48] Jerry Brito, 'CFTC commissioner: tokens that start as securities may "transform" into commodities.'' (20 October 2017) https://coincenter.org/link/cftc-commissioner-tokens-that-start-as-securities-may-transform-into-commodities

[49] *Teague v. Bakker* [2002] 213 F. Supp. 2d 571 (W.D.N.C.), upheld in *Teague II,* Similarly, concerning investments in aircraft interests, the deciding factor is whether or not the expectation of profits involved outweigh the expectation that the aircraft interests were being purchased for use solely as a means of

D6.3 Aside from the motivation of the investor, the promotional materials from the issuer are of importance for determination of whether there is an expectation of profits in the eyes of the investor under the third prong of the *Howey* test. In *Warfield v. Alanzis,* investors were given the opportunity to participate in charitable giving while being promised financial gain. There was again a dual motivation, but here the court concluded that "consideration of the Foundation's promotional literature, as well as the annuity contracts themselves, demonstrates that the Foundation presented the gift annuity as an opportunity for financial gain." In appeal, the 9th Circuit court of Appeals affirmed that courts conduct an inquiry on basis of what the purchasers were 'led to expect.[50]

D6.4 Indeed, courts have frequently examined the promotional materials associated with an instrument or transaction in determining whether an investment contract is present.[51] In *SEC v. C.M. Joiner Leasing Corp,* it was even held that while "the test rather is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect, it "is not inappropriate that promoters' offerings be judged as being what they were represented to be".[52] This suggests that, even if the utility-element of a token clearly outweighs the token's investment element, an expectation of profits can still be deemed to exist based on the promotional strategy and representation of the token by the issuer. Many, if not all, self-proclaimed utility-tokens target their online promotions directly at websites with audiences that mainly consist of retail investors. Often, an expectation of financial gain is also created. This is not to say that a token is much safer from the reach of securities legislation if the whitepaper says that the token is 'definitely not a security', as in such a case, the economic reality of the instrument and the subjective motivation of investors prevails.[53]

D6.5 In *Aldrich* v. *McCulloch* it was moreover held that an expectation of profits exists when the issuer represents future development plans in a manner calculated to induce investments in the project, essentially making a contractual promise to carry through development plans to augment the value of the investment.[54] Of importance is whether the issuer makes a 'contractual promise' of continuous development (which logically results in an appreciated valuation).[55]

transportation: *Kenneth P. Krohn,* 'Fractional Ownership and Timeshare Programs: Are They Subject to the Securities Act of 1933 and Securities Exchange Act of 1934?' [1999] 54 (3) TBL 1209

[50] *Warfield v. Alaniz*, [2009] 569 F.3d 1018 (9th Cir.)

[51] *E.g. Teague v. Bakker* [2002] 213 F. Supp. 2d 571 (W.D.N.C.) at 990; *SEC v. Edwards* [2004] 540 U.S. 389 at 392; *Rice v. Branigar Organization Inc* [1991] 922 F. 2d 788 (11th Cir.); and *Aldrich v. McCulloch Properties, Inc.,* [1980] 627 F.2d 1036, 1039-40

[52] *SEC v. Joiner Leasing Corporation* [1943] 320 U.S. 344, 352-353

[53] Any other conclusion would be incompatible with *Howey, p.* 298

[54] *Aldrich v. McCulloch Properties, Inc.*, [1980] 627 F.2d 1036Aldrich at 1039; see also *Plaskin v. Bruno* [1993] 838 F. Supp. 658, 667

[55] *McCown v. Heidler* [1975] 527 F.2d at 208-09

Is there anything in the marketing that would change the legal character of NuCoin?

D6.6 Tokens that are sold to the public in so-called 'pre-sales', where investors can acquire tokens before the actual ICO for a discount, are more likely to be deemed a security than tokens that are sold in an ICO. These issues do not apply to NuCoin. The NuCoin price was established in a public auction in February 2021. Miners had a limited miners release in June 2021. The prices therefore are a function of the open global market where both the buyers and sellers are unknown. There is no promise to sell at discount to realise a profit.

D6.7 The white paper comprehensively sets out the infrastructure for an ecosystem where it is apparent that the system is designed to:

(a) maximise user adoption with:

(i) user-friendly cost effective and easy to use tools;
(ii) the ability to sell and acquire services and expertise;
(iii) legal recognition of the digital assets created and protected in the ecosphere;

(b) to encourage inter-user collaboration and participation in projects to be launched or attracted to the system;

(c) encourage governance with maximum participation;

(d) NuCoin minting is governed by a protocol with system validators and underscored by AI, not by the efforts of issuers/promoters;

(e) has a complex reward and incentive system to maximise the exponential network effect from attracting further users.

D6.8 The valuation methodology contemplates that growth and value appreciation is dependent upon user adoption, the project, collaborations and applications that are built upon the NuGenesis ecosphere infrastructure. These include the attractiveness of the legal instruments recognised by the Special Digital Economic Zones ('SDEZ's') that are participating.

D6.9 As a result, we contend that the NuGenesis digital economic infrastructure is sufficiently matured that the future value does not depend on the efforts of any issuer/promoter. Further that this white paper makes clear that value appreciation of NuCoin, like currency in a developing Country, depends upon the success of its economic actors that use the economic infrastructure.

D7. The Currency Exemption

D7.1 The definition of security under section 2(a)(1) of the *Exchange Act*, explicitly provides "shall not include currency". Whilst usually issued by Governments, it certainly does not have to be such as the case with Banks issuing Hong Kong currency. The issue then arises that because NuCoin is accepted and endorsed as a currency for payment, including for Government services in the Special Digital Economic Zones ('SDEZ's') of participating Countries, the exemption from the definition is triggered. There seems no reason why NuCoin should not be exempt from the definition of security.

D8. The SEC v Ripple litigation

D8.1 As the above-captioned litigation is before the courts, the comments should be limited.[56] This litigation has had a major impact on the crypto market and in particular to those who acquired XRP on the open market, up to 7 years from when Ripple commenced the offering and sales of XRP.

D8.2 The difficulty with the litigation as guide is that the impact of the litigation has not been properly understood by the market, including the U.S. exchanges that de-listed XRP in December 2020 when the SEC filed suit against Ripple and two of its officers. What is significant to point out is that:

(a) the SEC did not seek any declaratory judgement that XRP is now a security;
(b) there was no reason therefore, why the U.S. exchanges de-listed XRP;
(c) the action was limited to the conduct of the defendants during the formative years where the transactions with respect to particular sales are viewed by the SEC to be the sale of securities;
(d) the concern relates to the billions of pre-minted XRP held by the Defendants who had a particularly significant impact on the market price as both dominant buyer and seller and extreme informational asymmetry they have with the investors;
(e) the proceeds of sales were necessary to fund the operations of the promoters; and,
(f) XRP is a pure payment Coin, not a system upon which other projects are built upon or connected to.

D8.3 The approach of the SEC is instructive. The so-called 'technologically neutral' approach of Securities regulation does not apply generally to blockchain technology. Blockchain technology is designed to eliminate reliance upon trust between parties; the very anti-thesis of a fiduciary-type relationship contemplated in a managed scheme in is an investment contract. Little regard was paid by the SEC to the fact that Ripple did not rely upon an ICO to raise the funds to build its blockchain; or to the economic cycle involved in the necessary function of building, and role of, liquidity and depth of market as part of establishing the utility of its payment system.

[56] We have to assume for the purposes of this Paper that the facts alleged by the SEC are provable. This implicitly disfavours Ripple unfairly. We have no reason to do this. Indeed, Ripple is to be congratulated on its successful evolution of XRP into a solid and respected global payment system founded on superior blockchain technology. However, it is irresponsible in a paper purport to address these very issues, not to take notice of the concerns raised by the SEC and to ensure that we are in compliance.

D8.4 What dominates the SEC's complaint is a more generalised concern arising from when a large volume of pre-minted cryptocurrency that has no functional utility (at that point), is sold by the promoter-issuers to persons had no use for it (at that point) beyond pure speculative investment and in respect to which there is informational asymmetry and dependence on the Defendants. More precisely where, absence of utility being established, there is a vulnerability to price manipulation on behalf of the issuer promoters. The concern was the inherent conflict considered in using the proceeds of those sales to fund the operations of Ripple.

D8.5 NuCoin has not been released to the public in a pre-minted form without utility being established in order to fund the development of the blockchain. There is no dependence that can be expected of any issuer-promoter for any non-functional (pre-utility) coins to have a value who have, as consequence, informational asymmetry with any speculator. The blockchain and the ecosystem has been built and is functional. The reliance any participant has is in the protocols, the staker-miners, the governance bodies for the integrity of the system and most importantly for economic success, on the use to which new participants make of it.

D9. US. Extraterritoriality

D9.1 Prior to the *Morrison v. National Australia Bank Ltd* decision handed down by the Supreme Court on June 24, 2010, the Second Circuit Court paved the way for the extraterritoriality of the securities regulation's anti-fraud provisions by using mainly two tests: a) the effects test, which examined whether the wrongful conduct had a substantial and foreseeable negative effect on the US or its citizens;[57] and b) the conduct test, which by contrast, requires the wrongful conduct to take place within the US.[58]

D9.2 Courts disagreed regarding the degree to which the behaviour in question had to have an effect on the US or its citizens.[59] This question of degree has only become more difficult to answer with the development of the internet and other new technologies.[60] US legal scholars and practitioners felt a growing unease when considering the possibility that these tests might breach another country's sovereignty and lead to a deterioration in foreign relations.[61]

D9.3 In 2010, the *Morrison v. National Australia Bank Ltd*[62] case cancelled the conduct and the effect tests. According to the court the main test that should be used in order to determine the reach of Section 10(b) of the Securities Exchange Act, which deals with fraudulent behaviour, is the transactional test.[63] The court held that in order to qualify

[57] Kun Young Chang, *Multinational Enforcement of U.S. Securities Laws: The Need for the Clear and Restrained Scope of Extraterritorial Subject-Matter Jurisdiction*, 9 FORDHAM J. CORP. & FIN. L. 89, 95 (2003); Junsun Park, *Global Expansion of National Securities Laws: Extraterritoriality and Jurisdictional Conflicts*, 12 U.N.H. L. Rev. 69, 70 (2014); Berger, 322 F.3d at 192-93; Morrison, 130 S. Ct. at 2879.
[58] Park, supra n57, at 71; Berger, 322 F.3d at 192-93; Morrison, 130 S. Ct. at 2879.
[59] Park, supra n57 at 73.
[60] George Nnona, *International Insider Trading: Reassessing the Propriety and Feasibility of the U.S. Regulatory Approach*, 27 N.C. J. INT'L L. & COM. REG. 185, 198 (2001); Park, supra n57, at 73.
[61] Park, supra n57, at 73.
[62] Morrison, 130 S. Ct. 2869.
[63] *Id*. at 2884.

for the test, the fraudulent behaviour must accompany the purchase or the sale of a security, whether or not it is a registered security on a national securities exchange.

D9.4 In view of the reliance by prospective participants on the blockchain operating globally, the express declarations that value depends upon the adoption by users and economic activity created by the ecosphere, that all main actors are outside the US, we believe there cannot be transaction which can be linked with any cause or harm to a US citizen to enliven extraterritorial reach.

D10. European Securities Law

Is NuCoin a transferable security?

D10.1 The general environment of services related to capital markets is one of the vast areas covered by the new EU Directive on markets in financial instruments (henceforth: MiFID II).[64] The basic thrust of MiFID II is "to establish a comprehensive regulatory regime governing the execution of transactions in financial instruments irrespective of the trading methods used."[65] In general, EU law employs three rather formal criteria and one more substantive criterion define a security. The formal ones are transferability; standardization; and negotiability on capital markets (with negotiability, however, being a subcase of transferability[66]).

D10.2 An alternative argument could be made that many utility tokens might be deemed to fall under the category of 'other forms of securitized debt' under Art. 4(1)(44), indent (b). While this might sound counterintuitive at first glance, as tokens are virtually never structured to resemble bonds, it is true that a substantial amount of utility tokens confer a right to claim services from the issuer in return for the token. In this sense, the token can be seen as a sort of liability towards the token holder, and it could arguably be deemed a form of securitized debt. No such relationship with the issuer exists with NuCoin.

D10.3 'Capital markets' require the ongoing relationship between the issuer and the investor based on the traded instrument. If the Coin/token does not provide any such equity-membership rights, comparable rights, or monetary streams, it is not a 'transferable security'. If the possible return on investment can only stem from an increased value of the tokens in the secondary market, the respective token is not an investment token and *a priori* cannot be considered a "transferable security."

[64] Directive 2014/65/EU of 15 May 2014 on markets in financial instruments.
[65] Recital 13 MiFIID II.
[66] Assmann/Schneider, Wertpapierhandelsgesetz Kommentar (6th ed. 2012), § 2 para. 10.

The Payment Instrument Exemption

D10.4 According to Article 4(1)(44) MiFiD2, "payment instruments" are expressly excluded and therefore **not** transferable securities. The reason for this exclusion is that instruments of payment fall under a related, but separate regime under EU financial law: banking and payment services regulation.[67] While securities regulation is mainly concerned with the integrity of markets and the protection of investors, the oversight of payment instruments is aimed at ensuring the soundness and efficiency of payments made with such instruments.[68]

D10.5 Similar to "capital markets," the term "payment instrument" is not defined by MiFiD2[69] and needs to be interpreted according to the general understanding in the markets. The definition encompasses classical means of payment such as cash and checks.[70] It also applies to non-cash payment mediums such as debit or credit cards, credit transfers, direct debits, and e-money.[71] Currency tokens fall within this category because they are designed to function as a means of payment, which means that they are payment instruments and thus not transferable securities. They exhibit strong similarities to e-money,[72] which is classified as a payment instrument.[73] This view is in line with the famous *Hedqvist* decision in which the CJEU held that Bitcoins are contractual payment instruments.[74] U.S. Magistrate Judge Mazzant expressed a similar view in SEC litigation against a Ponzi scheme based on a Bitcoin operation.[75]

D10.6 The consensus of legal opinion is that cryptocurrencies fall outside of the scope of EU securities legislation, due to the exclusion of instruments of payment form the definition of transferable securities. The 2015 landmark *Hedqvist* case, the Court of Justice of the European Union (CJEU) gave a ruling in relation to the classification of Bitcoin.[76] The CJEU

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[67] For an overview of Directives and Regulations of EU banking and financial services law, see https://ec.europa.eu/info/law/law-topic/eu-banking-and-financial-services-law_en

[68] European Central Bank, 'Harmonised Oversight Approach and Oversight Standards for Payment Instruments [February 2009] https://www.ecb.europa.eu/pub/pdf/other/harmonisedoversightpaymentinstruments2009en.pdf?5d726b97e5ece0bb3536 6632d6e828b6 accessed 15 January 2019

[69] The definition in Article 4(14) of Directive (EU) 2015/2366 (Second Payment Services Directive) referring to "personalised devices" cannot be applied because it is used in a non-capital markets context.

[70] Gregor Roth *in* KÖLNER KOMMENTAR ZUM WpHG § 2 ¶ 37 (Heribert Hirte & Thomas Möllers eds., 2d ed. 2014); at § 2 ¶ 41; Assmann, *supra* note 66, at § 2 ¶ 12.

[71] *See Payment Instruments*, EUROPEAN CENTRAL BANK, http://perma.cc/YS4B-BKFJ.

[72] *Id*.

[73] Philipp Hacker & Chris Thomale, *Crypto-Securities Regulation: ICOs, Token Sales and Cryptocurrencies under EU Financial Law* 33–37 (last revised May 2, 2018), http://perma.cc/5HAL-Z3KG, at 31.

[74] Case C-264/14, *Skatteverket v. David Hedqvist*, 2015 E.C.R. 718. In this case, a Swedish national wanted to offer a service enabling customers to change money into Bitcoin and vice versa. Traditional currency exchanges are exempt from value added tax under Article 135(1) of Directive 2006/112/EC (VAT Directive). Thus, the issue was whether Bitcoin could be considered equivalent to a legal tender within the meaning of the Directive. Although the CJEU affirmed the application of the exemption, it is unclear if this can also apply to securities regulation because the structure and purpose differs from tax law.

[75] *SEC v. Shavers*, No. 4:13-CV-416, 2013 WL 4028182, at *2 (E.D. Tex. Aug. 6, 2013) ("It is clear that Bitcoin can be used as money").

[76] Case C-264/14 *Skatteverket v David Hedqvist* [2015]

explicitly stated that bitcoin is "neither a security conferring a property right nor a security of a comparable nature".[77]

D10.7 Hedgvist was a VAT case however, not a securities law case.[78] A definition of 'payment instrument' is found in the EU's second Payment Services Directive (PSD2), which defines 'payment instrument' as 'a personalised device(s) and/or set of procedures agreed between the payment service user and the payment service provider and used in order to initiate a payment order.'[79] However, in the field of (pure) cryptocurrencies (i.e. cryptocurrencies with no central issuer, issued solely through staking or mining, without a token sale), this definition is not very relevant, as there is no payment service provider[80]. At the same time, stable coin issuers classifying as a payment service provider could potentially argue that their coins are excluded from MiFID's definition of transferable securities due to classification under PSD2's definition of payment instruments.

D10.7 A more common sense-based approach consistent with the policy structure of the Directives would suggest that there is no need for information disclosure to gap information asymmetries when it concerns pure cryptocurrencies, as cryptocurrencies in general share far more similarities to cash than to a security.

[77] Ibid. para. 55

[78] Art. 135(1)(f) VAT Directive, which the CJEU interpreted, differs from the one in MiFID: Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ 2006 L 347/1.
It lacks, for example, the reference to equivalents of shares in other entities, and to other forms of securitised debt. Therefore, some uncertainty persists as to whether the court would reach a similar conclusion under EU securities regulation. It seems likely, however, that it would, in the end, qualify pure currency tokens as exempt from prospectus regulation.

[79] Council Directive 2015/2366/EU on payment services in the internal market OJ L 3337 Art. 4(14)

[80] Ibid Art. 4(11)

D11 The United Kingdom

D11.1 An activity is a "regulated" activity if, amongst other things, it relates to a "specified investment". Furthermore, communicating in the course of a business an invitation or inducement to engage in investment activity is also generally prohibited, unless the relevant person is authorised. Again, an activity is an investment activity for this purpose if, amongst other things, it relates to "specified investments".[81]

D11.2 The Financial Conduct Authority (FCA) statement referred to "utility tokens" (which are neither transferable securities nor regulated products and only allow access to a network or product with no other legal rights attached) as generally falling outside the FCA's regulatory perimeter.[82]

D12 Germany

D12.1 According to the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungs-aufsicht, BaFin), tokens in an ICO qualify typically as financial instruments in the form of units of accounts (Rechnungseinheiten) within the meaning of Sec. 1 para. 11 no. 7 of the German Banking Act (Kreditwesengesetz, KWG). However, the BaFin has determined that the German Stock Corporation Act (Aktiengesetz, AktG) would not apply to ICOs.

D13 France

D13.1 The French Autorité des Marchés Financiers (AMF) published a discussion paper on ICOs.[83] The AMF remarked that tokens may be classified "as equity securities if they bestow the same economic and governance rights as those traditionally attached to shares or preference shares."[84] However, the AMF concluded the tokens issued in France would not be classified as securities and thus would not fall under French regulations.[85]

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[81] The concepts of "specified investments" and "specified activities" are defined in the *Financial Services and Markets Act 2000 (Regulated Activities) Order 2001* (SI 2001/544).

[82] Financial Markets Law Committee Paper of 2019 published by the Financial Markets Law Committee (FMLC) made the standard distinction between the classes of Coins/Tokens as follows:

Utility Tokens

2.8. Utility tokens are typically offered whilst the issuer is developing a platform. The issuer uses the funds received from the sale of the tokens towards the development of the platform. Utility tokens do not generally entitle the holder to any rights in the business. Utility tokens can be structured in a number of different ways, but generally grant the holder (early) access to the platform or the ability to redeem the token for goods or services (or as a discount for such goods or services). In this sense, utility tokens resemble rewards-based crowdfunding, whereby the holder of the utility token retains no ownership rights in the issue.

2.9. These cryptoassets are likely to fall outside the regulatory perimeter, although owing to their ability to be exchanged for goods or services, utility tokens could potentially be considered E-Money and therefore be subject to the E-Money Regulations. Given the limited spending potential of utility tokens, which are only intended to be used within a platform created by the issuer, however, this may be less likely. In 2017, Binance issued a utility token by way of an ICO which enabled the prospective holder to swap a range of cryptocurrencies, including Bitcoin, in return for BNB coins.

[83] *Discussion Paper on Initial Coin Offerings,* AUTORITÉ DES MARCHÉS FINANCIERS (Oct. 26, 2017), http://perma.cc/4BHQ-KHP7.

[84] *Id.* at 7.

[85] *Id.* at 8.

D14 Singapore

D14.1 Securities are defined by section 2(1) of *Securities and Futures Act (*SFA). Typical examples are shares, debentures, and units in a collective investment scheme.[86] The offer of digital tokens that offer securities or shares in a collective investment scheme must be published in a prospectus approved by the SFA and registered by the Monetary Authority of Singapore ('MAS'). According to the MAS units in a collective investment scheme (CIS) can also include digital tokens if they constitute a right or a participation in a CIS or an option to acquire a right or participation in a CIS.

D14.2 The MAS included six case studies in its release, providing guidance for typical and non-typical token sales.[87] The case studies give an excellent idea of the MAS's views. For example, tokens comparable to shares would be considered securities (Case 2), while tokens granting access to company services would not (Case 1). The MAS did not go into detail regarding the classification of hybrid tokens. Thus, some commentators presume that the MUN token, which only granted limited investment rights, would most likely not have been classified as a security. [88]

D15 Canada

D15.1 As foreshadowed in para D2.9 above, The Supreme Court of Canada has adopted the Howey test[89] and for the same policy rationale in determining what is "any investment contract" defined in section 1(1) (22)xiii in the definition of 'security' for the purposes the prohibition of trading in a security in the absence of a prospectus by Section 35 of the *Securities Act: Pacific Coast Coin Exchange v. Ontario (Securities Commission)*, [1978] 2 S.C.R. 112.[90]

D15.2 Therefore the considerations discussed above regarding why NuCoin is not a security, apply to Canada equally. Significantly, the Supreme Court referred to the case of *Turner*[91], to define the expression "common enterprise" (p. 482) as "one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties". The reasoning helpfully delineates, where in the case of a platform for enterprises to take effect such as NuGenesis, those enterprises are not common between each other or with the platform itself. The delineation of the common enterprise is where the issuer-promoter's fortunes are intertwined with the investor. That is, the economic responsiveness to the investors efforts are substantially that of the issuer-promoter rather than other enterprises that the investor gets involved in.

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[86] *Id.* at § 2.3.

[87] *MAS clarifies regulatory position on the offer of digital tokens in Singapore*, MONETARY AUTHORITY OF SINGAPORE (Aug. 1, 2017), http://perma.cc/49KV-3EZK; *A Guide to Digital Token Offerings*, MONETARY AUTHORITY OF SINGAPORE (Nov. 14, 2017), http://perma.cc/3Z6E-BB3C.

[88] *See* Jonathan Rohr & Aaron Wright, *Blockchain-Based Token Sales, Initial Coin Offerings, and the Democratization of Public Capital Markets* 6 (U. Tenn. Legal Stud. Res. Paper No. 338, Cardozo Legal Stud. Res. Paper No. 527, 2018) at 94.

[89] The Chief Justice noted: "the policy behind the legislation in the two countries is exactly the same, so that considering the dearth of Canadian authorities, it is a wise course to look at the decisions reached by the U.S. Courts."

[90] The policy of the Securities legislation is: "the protection of the investing public through full, true and plain disclosure of all material facts relating to securities being issued.

[91] *SEC v. Glenn W. Turner Enterprises Inc.* [1973], 474 F.2d 476 (9th Cir.)

D 16 Australia

D16.1 In Australia, whilst the Australian Taxation Office ('ATO') considered digital currencies to be 'intangible assets', The Australian Securities and Investments Commission ('ASIC') does not discuss digital currency's inclusion in regimes as an 'intangible asset', but focuses on whether it can constitute a financial product for the purposes of regulation[92].

D16.2 ASIC has stated that 'digital currencies themselves do not fit within the current legal definitions of a "financial product"'.[93] A financial product is, broadly, a facility through which a person makes a financial investment, manages financial risk or makes a non-cash payment.[83] For the purposes of regulation, ASIC finds that digital currency does not fall within the scope of that definition, stating that 'the definition of "making a financial investment" does not include real property or bullion and we consider that it would similarly not include digital currencies'.[94] Digital currencies are also generally not a facility through which a person manages risk, or makes a non-cash payment.[95]

D16.3 Comparable to the position of the ATO, ASIC considers that digital currency is not 'currency' or money. Relevantly, ASIC states:[96]

> …digital currencies are not a currency or money for the purposes of the Corporations Act. Digital currencies such as bitcoins are more akin to a commodity. We note that this view is consistent with the views expressed by the Australian Taxation Office (ATO) that digital currencies are not a 'currency'. For this reason, we consider that contracts for the exchange of digital currency with a national currency are not foreign exchange contracts.

D16.4 In providing some guidance on an appropriate definitional framework for digital currencies, ASIC notes that they could be treated in a similar manner to national currencies. This point was not discussed in great detail, concluding that it would need further consideration as such a definition could create 'a more significant issue for other Australian regulators, and so broader consideration of the impact of such a change is appropriate'.[97]

D16.5 If an ICO constitutes a managed investment scheme ('MIS') then there will be obligations under the Corporations Act with respect to reporting and disclosure.[98] This would be relevant where the value of the Coin is a function of the management of the scheme arrangement[99].

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[92] Securities are broadly regulated pursuant to various provisions of the Corporations Act 2001 (Corporations Act) and the Australian Securities and Investments Commission Act 2001 (ASIC Act). ASIC is the responsible body for the regulation of Australian companies, financial markets, and financial services organisations and professionals.

[93] Australian Securities and Investments Commission, 'Senate inquiry into digital currency - Submission by the Australian Securities and Investments Commission', Submission 44 (December 2014) [5].

[94] Ibid [47].

[95] Ibid [48], [49].

[96] Ibid [50].

[97] Ibid [12].

[98] A managed investment scheme is defined in section 9 of the *Corporations Act* 2001 and those schemes that need to be registered with ASIC are defined in Ch 5C section 601EB of the Act.

[99] Initial coin offerings, AUSTRALIAN SECURITIES & INVESTMENT COMMISSION (Oct. 11, 2017), http://perma.cc/L8Z9-BNDA. See also INFO 225

D16.6 However, as ASIC notes:[100]

> …many of the obligations under the legislation ASIC administers apply to the issuers of financial products, who are responsible for the obligations to product holders under the terms of the product. On the other hand, digital currencies do not have an identifiable 'issuer', as there is no centralised authority responsible for their creation or any obligations owed to digital currency holders.

D16.7 Hence where there is no pre-sale or ICO there is no relationship created between any issuer and prospective purchaser of NuCoin who can only purchase on an international exchange where both the seller and purchaser are unknown strangers. The "issuer" undertakes no management of any 'scheme'. The infrastructure provided by the NuGenesis blockchain that produces NuCoin is decentralised protocol involving a globally dispersed network of validators and staker-miners. Information about the 'issuer' who takes no further part is not relevant and does not offend any policy concerning the financial disclosure of the issuer.

D16.8 It is an important distinction that the NuGenesis blockchain and platform is fully built and functional. The prospective acquirer of NuCoin from an unknown seller on an exchange does not fund the development of the NuGenesis blockchain or the platform. Rather they can only acquire NuCoin to use the platform and take such further business and collaborate opportunities available to them. What these ventures the participant undertakes are not a common scheme with original establishment of the blockchain.

D17 New Zealand

D17.1 A cryptoasset can be a 'financial product' in New Zealand under *the Financial Markets Conduct Act* 2013 (FMC Act) based on the traditional criteria as to whether it is a security token. Utility and payment tokens could be caught as a managed investment product if they are an interest in a Managed investment scheme, where (a) the purpose or effect is for people to contribute money to a scheme where they acquire interest therein, (b) the interest/rights acquired from the efforts of another person under the scheme and (c) the investor does not have day to day control of the scheme.

D17.2 The language is comparable to the Australian regime and in substance aligns with the considerations in the case law concerning the Howey test. Without derogating from what is said above, there cannot be the same 'scheme' for an investor to acquire from an exchange from unknown persons with anything involving an issuer who has a completed and fully functional blockchain. The investor acquires no rights over any person to receive in the benefits from that other person's efforts, but from the general economic growth of the ecosphere. Accordingly, it is not surprising that a close analysis of many tokens often reveals that they look more like a software or a commodity, which do not historically trigger securities regulations.[101]

[100] Australian Securities and Investments Commission, 'Senate inquiry into digital currency - Submission by the Australian Securities and Investments Commission', above n 93, [43].
[101] Thomas Gibbons "Purpose and Principles of Securities Regulation" in Stace (ed) Financial Markets Conduct Regulation a Practitioner's Guide (LexisNexis, Wellington, 2014) 3 at 4-5.; *R v Moses* [2011] NZHC 646 at [35].

D 18 Conclusion

D18.1 There are conceptual difficulties in seeking to apply securities regulation which relies on horizontal contractual relationships between parties to a software protocol whose purpose is to allow transactions by parties on a peer-to-peer basis on a trust less basis. Securities regulation is founded upon the premise that an investor has to trust the issuer who has an asymmetry of information and power and upon whom the investor relies for the management of their investment. There is no such relationship in decentralised technology as the fundamental purpose of it is flat decentralised interaction.

D18.2 Nevertheless, depending upon the type of crypto asset, some are more liable to be resemble and consequently fall within the concept of 'security' than others. If there are pre-created or pre-minted non-functional coins, with large amounts reserved for the founders issued as part of ICO promising to build a blockchain technology with the proceeds of the ICO, they are likely to be considered securities.

D18.3 In the case of the NuGenesis blockchain, NuCoin is not a security. The blockchain is fully operational. No investment is sought by any founders to build a blockchain through the issue of non-functional tokens. The blockchain is designed to mint coins pursuant to a tokenomics protocol designed to be self-evolving in funding through rewards, its on-going development. The role of any 'issuers' in the classical understanding has been spent.

D18.4 NuCoin holders acquire and sell NuCoins on international licenced exchanges from persons they have no legal relationship with. NuCoins do not entitle gas fees. The platform does not charge it. It is designed to be attractive to build economic activity upon it. Therefore, NuCoin is the currency of NuGenesis ecosystem paying for services by a community offering their services and providing access to opportunities for economic activity that may be created by parties unknown to each other.

D18.5 It is unremarkable to conclude that NuCoin is **not** a security in the jurisdictions reviewed. The participant relies on decentralised protocols to enter an ecosphere that this protocol provides precisely because there is no need for trust in a central authority. There is no issuer with whom a prospective purchaser is forming a legal relationship where they rely upon them to manage their investment such as building the blockchain. The blockchain is built and functional. Whatever price a participant acquires NuCoin from an international exchange, its expectation of value will be from the self-evolution by the protocol and from the economic activity that unknown persons will create upon it.