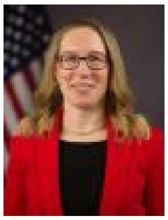
Public Statement

Concurrence in the Matter of Wireline, Inc.



Commissioner Hester M. Peirce

Jan. 15, 2021

I support most of the Commission's settled enforcement action against Wireline, Inc., but write to highlight a concern about the settlement. Wireline offered and sold digital assets using a Simple Agreement for Future Tokens ("SAFT"), pursuant to which purchasers invested money in exchange for the receipt of the tokens to be issued when the Wireline microservices platform went live in the future. These tokens, which never were issued because the platform is not yet operational, were to be the platform's currency. The SAFTs were explicitly sold as part of a securities transaction. Wireline did not, however, register the offers and sales or qualify for an exemption from registration. Moreover, in the course of selling these investment contracts, Wireline materially misrepresented key facts about the state of the platform's development. These violations form the basis for the enforcement action, which I support. However, by including a provision whereby Wireline will not distribute the tokens pursuant to the SAFTs, this settlement perpetuates an approach that suggests that tokens themselves are securities and thus complicates the development of crypto networks.

The Commission and courts have treated the token as inseparable from the SAFT by treating the pre-sale and public distribution of tokens as one event.[1] Although the language is usually a bit vague, the tokens promised in the SAFT are effectively treated as securities when delivered because they were first sold as part of an investment contract. Moreover, tokens sold by the SAFT investors to the general public are similarly treated as securities, albeit usually with some obfuscation and protestation. In *Telegram*, for example, the court insisted that "[w]hile helpful as a shorthand reference, the security in this case is not simply the Gram, which is little more than alphanumeric cryptographic sequence."[2] Yet the court goes on to find "that the delivery of Grams to the Initial Purchasers, who would resell them into the public market, represents . . . the completion of a public distribution of a security without a registration statement."[3] The Gram was the thing being distributed, so it sure sounds as if the Gram is the security under the court's analysis. Similarly, the *Kik* court explained, "Purchasers in the two sales received the same class of securities, fungible Kin that were equal in value."[4] One legal commentator explained the problem this way:

[I]t is one thing to register a fundraising with the SEC—this is something commonly done. . . . 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."[5]

Treating a token as a security is akin (no pun intended) to saying that if in *Howey* investors were permitted to take their profits in kind by taking delivery of the oranges produced by their strip of trees, those oranges would be securities and subsequent sales of these oranges by the investors to citrus-lovers would be securities transactions.[6] You cannot make a security out of an orange by citing to the fact that the groves that produced these oranges were originally developed and sold as part of an investment contract. In the digital asset context, however, the Commission and the courts that have evaluated the issue thus far have allowed the initial sale of a promise to deliver a future token in an investment contract wrapper to brand the promised tokens as securities upon delivery to the investment contract investors and perhaps in subsequent transactions too. Treating the initial pre-sale and the subsequent public token distribution as a single event gives rise to the inference that tokens can be securities.

Why does any of this matter in this enforcement action and more generally? After all, regardless of whether the tokens themselves are deemed to be securities, there was an unregistered securities offering here. The security label applied to tokens, however, carries with it real consequences.[7] Moreover, it prevents the early funders of a network from receiving and selling tokens and thus stifles network effects before they even have a chance to make the network vibrant.

As part of this settlement, Wireline will not distribute the tokens pursuant to the SAFTs, thereby avoiding the securities laws implications of such an action. This undertaking deprives SAFT investors of their direct opportunity to profit from Wireline's future development of the network, if that should occur one day. Under our settlement, SAFT investors likely will receive a portion of the monetary penalties the company is paying, but this amount will be far less than their initial investment. If Wireline successfully develops a platform, investors might seek the return of more of their initial investment, but it is not clear whether they would be entitled to anything beyond their initial investment. By that logic, we ought to have said to the Howey investors, "Your purchase of the orange groves was an unregistered securities transaction, so we're not letting you have the proceeds of the orange sales, but feel free to sue Howey once the crop comes in to get your original investment back." As long as we are permitting Wireline to move forward with the project, we should allow the SAFT investors to profit from the issuance of tokens once the network is ready to go live.

While an enforcement action is appropriate given the facts in this matter, preventing the SAFT investors from directly profiting from the token launch, as the settlement requires, does not seem to be the best outcome for investors. Moreover, given the lack of clarity as to whether the tokens themselves are securities how can a project, even one for which there are many eager users on day one of the network launch, be certain that a sale or even an airdrop of tokens will not be deemed a securities offering? A better course would be for us to treat the original capital-raising event for an unlaunched network as a sale of securities, but not to stretch the securities analysis to include subsequent sales of tokens for use on a launched network.

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[1] *See, e.g.*, SEC v. Kik Interactive, No. 19 Civ. 5244 (AKH), 2020 WL 5819770 (S.D.N.Y. 2020); SEC v. Telegram Group Inc., 448 F. Supp. 3d 352 (S.D.N.Y 2020).

[2] Telegram, 448 F. Supp. 3d at 379.

[3] *Id.* at 382.

[4] Kik Interactive, No. 19 Civ. 5244, at 8.

[5] Lewis Rinaudo Cohen, Ain't Misbehavin': An Examination of Broadway Tickets and Blockchain Tokens, 65 Wayne L. Rev. 81, 96 (2019).

[6] SEC v. W.J. Howey Co., 328 U.S. 293 (1946). In *Howey*, the investors had no right to specific fruit, but were entitled to their allocation of the net profits of the sale of the pooled produce. *Howey* is the seminal case defining an "investment contract," one category of securities under our federal securities laws. The Supreme Court held that the test of an investment contract "is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Id.* at 301.

[7] Again, Lewis Cohen explains: "[P]arties 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." Cohen, supra note 2, at 97.