

SEC Shuts Down Initial Coin Offering Using Blockchain for Failure to File Securities Registration Statement

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On December 11, 2017, the SEC instituted cease-and-desist proceedings against Munchee Inc., the creator of an iPhone application that allows users to review restaurant meals, with regard to Munchee's planned initial coin offering (ICO) using blockchain or a distributed ledger. Munchee conducted the ICO to raise \$15 million in capital by selling digital tokens that it created so it could improve the app and recruit users. The tokens were purchased by using either Bitcoin or Ether. The SEC proceedings contend that, in connection with the ICO, Munchee represented that its digital tokens would increase in value based on its efforts and that they would be traded on secondary markets.

The SEC, citing the 1946 Supreme Court decision in *SEC v. Howey*, 421 U.S. 837 (1946), took the position that the tokens were securities as defined by section 2(a)(1) of the Securities Act of 1933 as they are "investment contracts," in large part, because the purchasers of the tokens had expectations of making a profit. Thus, the SEC took the position that Munchee should have filed a registration statement or otherwise qualified for an exemption from registration.

In anticipation of the SEC's initiation of these proceedings, Munchee submitted a settlement offer, which denied all wrongdoing except for agreeing that the SEC had jurisdiction over it. In the settlement, Munchee shut down the ICO before delivering any of the tokens to the purchasers and returned all money received. The SEC was seemingly pleased with the quick settlement and decided not to pursue a civil penalty.

The impact of the Munchee proceedings cannot be understated. They confirm that the SEC will employ the *Howey* test to assert jurisdiction, seek to regulate, and potentially impose civil penalties, with respect to ICO transactions. What's more, the exchanges or platforms that facilitate the trades of digital tokens should also take notice as the SEC may take the position that they too are subject to U.S. Securities laws and must register as a national securities exchange pursuant to Section 6 of the Securities Exchange Act of 1934.

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Topics

Securities & Exchange Commission, Blockchain