

[Securities Regulation Daily Wrap Up, TOP STORY—SEC halts unregistered ICO; Clayton issues general ICO statement, \(Dec. 11, 2017\)](#)

Securities Regulation Daily Wrap Up

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By [Jacquelyn Lumb](#)

Within hours after being notified by the SEC that its offering of digital tokens to investors constituted an illegal unregistered securities offering, Munchee Inc., a blockchain-based food review services company, halted the initial coin offering (ICO). The SEC did not impose a penalty since the company promptly ceased the ICO and returned the proceeds before issuing any tokens. Munchee cooperated in the SEC's investigation and consented to a cease-and-desist order without admitting or denying the findings. The case underscores that the SEC will bring an enforcement action even when there are no underlying fraud claims (*In the Matter of Munchee Inc.*, [Release No. 33-10445](#), December 11, 2017).

Clayton statement. SEC Chairman Jay Clayton released a [statement](#) later in the day in which he outlined his general views on cryptocurrency and the ICO markets. He noted that currently there is much less investor protection relating to cryptocurrency and the IPO markets than for traditional markets, which creates more opportunities for fraud and manipulation. He wanted investors to understand that to date, no ICOs have been registered with the SEC, and no cryptocurrency type products have been approved for listing and trading. He urged investors to ask questions and demand clear answers before investing. He also urged market professionals to review the SEC's enforcement actions and investigative report released earlier this year.

Clayton noted that after the issuance of the SEC's investigative report, a number of market professionals attempted to highlight utility characteristics of their proposed ICOs in an effort to claim that their tokens or coins were not securities. He said many of the assertions appeared to elevate form over substance and reminded gatekeepers to focus on their responsibilities. He also warned against touting the offer and sale of coins without first determining whether the securities laws apply.

CFTC Chairman J. Christopher Giancarlo issued a [statement](#) in which he commended Clayton for his remarks on ICOs. He noted that virtual currencies are unlike any commodity with which the CFTC has dealt in the past, and understands the challenges they pose.

The offering. Munchee set out to raise \$15 million to improve its existing app and recruit users to buy advertisements, write reviews, and sell food with transactions using the digital tokens. Munchee described the tokens as instruments that would increase in value as a result of its efforts and would trade on secondary markets. The offering was described in a white paper, on the company's website, in a blog, and on Facebook, Twitter, and Bitcoin Talk.

Munchee's white paper made reference to the SEC's report of investigation known as the DAO Report and also claimed that Munchee had done a "Howey analysis," referring to the Supreme Court's opinion in *SEC v. W.J. Howey Co.* (1946) which defined the attributes of investment contracts, and said it had concluded that the offering did not pose a significant risk of implicating the federal securities laws.

Tokens were securities. However, as a result of the token's attributes, the SEC said they constituted investment contracts which were sold in violation of Securities Act Sections 5(a) and 5(c) since they were offered and sold without having filed a registration statement or qualifying for an exemption from registration.

Report of investigation. In the DAO report of investigation ([Release No. 34-81207](#), July 25, 2017), the SEC chose not to bring an enforcement action against a German corporation even though it may have violated the federal securities laws. The DAO was a decentralized autonomous organization, which is a virtual organization embodied in computer code and executed on a distributed ledger or blockchain. The SEC advised in the report

of investigation that those who use the DAO or other distributed ledger or blockchain for capital raising must take appropriate steps to ensure compliance with the U.S. federal securities laws. The SEC also issued an [investor bulletin](#) on July 25 to alert investors to the potential risks of participating in initial coin offerings.

Message to the industry. While the SEC believes that investors should have a variety of investment opportunities, they should also have the information and disclosure required by the federal securities laws, according to the [press release](#) announcing the order. ICOs remain an area of focus, and one that the SEC will monitor closely, even in the absence of fraud. This is an area with significant activity and one in which the SEC's enforcement actions are intended to send a message to the industry.

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