LATHAM & WATKINS LLP

Token Presale Agreements and the ConsenSys Automated Convertible Note

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Latham & Watkins has collaborated with ConsenSys to launch the Automated Convertible Note to help startups raise capital using a traditional financing instrument with an eye toward a future distribution of tokens.

In recent years, token presale agreements, including the Simple Agreement for Future Tokens (the SAFT),[2] have become a popular type of financing instrument among startups in the blockchain and cryptocurrency sector. These agreements typically provide startups with non-dilutive financing to fund the development of their blockchain-based network or platform and are often used as an alternative to traditional startup financing instruments (such as convertible promissory notes and preferred stock). While these agreements seek to solve certain securities law issues applicable to sales of prefunctional tokens, they raise significant additional concerns with regard to US securities and commodities laws.[3] In light of such concerns, Latham & Watkins has collaborated with ConsenSys to launch the Automated Convertible Note to help startups raise capital using a traditional financing instrument with an eye toward a future distribution of tokens. This analysis surveys the regulatory issues raised by existing token presale agreements and introduces the ConsenSys Automated Convertible Note as a potential solution for capital formation that also addresses future token sales in a manner compliant with US securities and commodities regulations. To access the complimentary online tool, please visit the ConsenSys website.

US SECURITIES LAW ISSUES

While token presale agreements often acknowledge that issuances of the underlying tokens could be securities transactions, the agreements continue to subject issuers and purchasers to significant risks by potentially increasing the likelihood that the underlying tokens will be deemed securities. First, such agreements are regularly marketed as an investment opportunity and securities offering. Of course, this works well for the sale of the instrument, but it also implicitly markets the investment value of the underlying token. For example, such instruments have been and continue to be marketed to purchasers with investment intent, such as hedge funds, venture capital funds, and others. Second, the proceeds from token presale agreements are typically used for the development of the issuer's network or platform, which creates a strong correlation between the sale of the tokens and development, and further supports a finding that US federal securities laws should apply to the offer and sale of such tokens under the *Howey* test.[4] Third, the settlement of these instruments often contemplates delivery of the tokens at network launch,[5] coinciding with the delivery of tokens for consumptive use. This contemplation would seem to make arguing in favor of the proposition that a token launch is not a securities offering more difficult, as the delivery of tokens in settlement of these instruments is not directed solely to consumers.[6]

The consequence of deeming as securities any consumer tokens underlying a token presale agreement could be dire for the issuer and token-based network that depends upon the free transfer of tokens on such network. As US securities laws often require the existence and registration of an intermediary in securities transactions (*i.e.*, the transfer of tokens deemed to be securities), an issuer or any token-based platform for which the underlying tokens have been deemed to be securities may be required to register as a broker-dealer or exchange (or alternative trading system)[7] to permit the functioning of such token-based network.[8] In many cases, such registration requirement would render token-based networks unusable. Although statements by the Securities and Exchange Commission indicate an acceptance of the notion that a digital asset originally issued as a security could subsequently cease to be a security once the network is sufficiently decentralized,[9] the uncertainty that remains regarding the viability and timing of the consumer token sale raises challenges for appropriate disclosures to investors and potential

liability for issuers. For cases in which the entire investment decision is based on the availability and functionality of the underlying token, it would seem to be challenging to craft sufficient disclosure if the entire investment proposition is subject to such a high level of uncertainty.

US COMMODITIES LAW ISSUES

Beyond the securities law concerns, token presale agreements also raise commodities law concerns. Because cryptocurrencies are commodities,[10] a presale of tokens through an instrument that provides the purchaser with a right to receive tokens in the future, or confers such purchaser with the right to exchange or convert such instrument into tokens, may be a forward contract for the sale of a commodity or a commodity option, and subject to regulation by the US Commodity Futures Trading Commission (the CFTC) as a swap, if an exemption is not available.

Commodity Forward Contracts

Forward sales of commodities fall within the Commodity Exchange Act's (as amended, the CEA's) broad definition of "swap," which encompasses numerous types of derivatives, and are subject to regulation by the CFTC absent an applicable exclusion.[11] Notably, the sale of a non-financial commodity for deferred shipment or delivery is excluded from the swap definition, so long as it is intended to be physically delivered,[12] but provided such forward contract also qualifies as a commercial merchandising transaction (Non-Financial Forward Contract Exclusion).[13] If such instruments are purchased by investors or speculators, they will not satisfy the requirement of the Non-Financial Forward Contract Exclusion because the purchasers are not "commercial market participants."[14] The CFTC has expressly stated that hedge funds, acting in their capacity as investors, are not commercial market participants.[15] Token presale agreements that include the agreement of the parties on a price or percentage discount on the token to be delivered at a later date are effectively prepaid forward contracts of commodities. Moreover, if these token presale agreements are largely marketed to investors and not commercial market participants,[16] such investors will not be eligible for the Non-Financial Forward Contract Exclusion.

Commodity Options

More recent versions of presale instruments have included token sale-related rights, which provide investors or issuers with a token call or put right, as applicable, upon the consummation of a token sale at an agreed price or discount. Such rights constitute a commodity option that would be subject to CFTC regulation as a swap,[17] unless an exemption applies. Trade options are one such possible exemption, as they are generally exempt from regulation by the CFTC, other than for certain large trader reporting requirements and the CFTC's general anti-fraud and anti-manipulation enforcement authority (the Trade Option Exemption).[18] In order to qualify as a trade option and benefit from the Trade Option Exemption,[19] the commodity option in question must be:

- Intended to be physically settled if exercised;
- Entered into with an offeror who is either an eligible contract participant ("ECP")[20] or a producer, processor or commercial user of, or merchant handling, the commodity (or products or by-products thereof) that is the subject of the option, and such offeror is offering to enter into such option solely for the purposes related to its business as such; and
- Entered into with an offeree who is a producer, processor or commercial user of, or merchant handling, the commodity (or products or by-products thereof) that is the subject of the option, and such offeree is entering into such option solely for the purposes related to its business as such.

The Trade Option Exemption was developed to afford commercial market participants with an exemption from trading in commodities that are physically delivered. The availability of the exemption for commercial market participants is not currently foreclosed to participants solely by virtue of their also being investors. As a result, an option to purchase tokens held by investors who are also network participants as part of their business may be eligible for the Trade Option Exemption if the conditions are met.

Nevertheless, presale agreements are still heavily marketed to investors that are not commercial market participants. As a result, the Trade Option Exemption will not be available in many instances.

Hybrid Instrument Exemption

The Hybrid Instrument Exemption (defined below) may be another avenue for exemption from commodities law regulations applicable to commodity forward contracts and/or commodity options. Under CFTC Rule 34.2(a), a "hybrid instrument" is defined to include an equity or debt security with "one or more commodity-dependent components that have payment features similar to commodity futures or commodity options contracts or combinations thereof."[21] Under Section 2(f) of the CEA, a hybrid instrument that is "predominantly a security" is exempt from the provisions of the CEA if, among other things, the instrument is (i) not marketed as a contract of sale of a commodity for future delivery (or option on such a contract) subject to the CEA (the Marketing Condition), and (ii) the purchaser is not required to make additional payments in addition to the purchase price (the Purchaser Payment Condition) (such exemption being the Hybrid Instrument Exemption).[22]

While token presale instruments may, in theory, be capable of qualifying for the Hybrid Instrument Exemption, because they are often primarily marketed to investors who themselves are solely or in large part motivated to purchase such instrument in order to receive the underlying commodity (*i.e.*, the token), such instruments will often fail to satisfy the requirements of the Marketing Condition of the Hybrid Instrument Exemption.

Coupled with the securities law issues discussed above, these commodities law issues compound the regulatory concerns surrounding the SAFT and similar presale instruments.

POTENTIAL SOLUTIONS: CONSENSYS AUTOMATED CONVERTIBLE NOTE

Traditional early-stage financing structures, such as preferred stock and convertible promissory notes,[23] are well-known structures that generally feature the necessary flexibility to address the needs of early stage companies/token issuers and token platforms. The Automated Convertible Note, which runs on OpenLaw, provides investors with greater protections with respect to their investments in token issuers while simultaneously addressing investor demand for exposure to consumer tokens in a manner compliant with applicable securities and commodities laws.

First, due to the inherent and significant value of the unissued consumer tokens and corresponding network protocols of any creator or developer of such technologies, the Automated Convertible Note provides noteholders with certain voting rights with respect to the creation and distribution of tokens.[24] Eventually, as the pathway for consumer token sales becomes more clear, these voting rights may be more narrowly tailored to apply only when such sales do not meet certain specifications, including regulatory compliance. In addition, noteholders may seek additional protections to prevent potential uses of the issuer's token-based network that circumvent their consumer token-related economic and participation rights.

Second, the ConsenSys Automated Convertible Note replaces the conversion and exchange rights featured in other token presale instruments with appropriately limited rights to participate in the future token sale of the issuer (the Token Purchase Option) as well as certain additional economic rights that reduce the securities law-related regulatory risks associated with consumer token sales discussed above. In particular, the Token Purchase Option included in the Automated Convertible Note does not represent a conversion or exchange of the convertible note (which is itself a security), but is a supplemental right provided alongside the other traditional rights granted to the noteholders. The exercise of such Token Purchase Option also provides the parties with flexibility to structure the subsequent sales or distributions of any consumer tokens that could be deemed securities, including by enabling the parties to delay the issuance and sale of such tokens until a time when the relevant token-based network has achieved sufficient decentralization.[25] The Token Purchase Option can be further limited at the time of purchase to require that any noteholder's purchase of tokens be for an actual use or to limit the total number of consumer tokens reserved for distribution or sale to investors, thereby ensuring that any distributions or sales thereof occur in a manner that supports the broader consumer token-based network. The Token Purchase Option included in the Automated Convertible Note is coupled with a "most favored nation" (MFN) pricing provision, which guarantees noteholders the best token sale and distribution terms offered by the issuer to any third party.

The Token Purchase Option is supplemented with certain token economic rights that are triggered upon consummation of a token sale by the issuer. In particular, in such event the Automated Convertible Note enables the noteholder to elect for such convertible note to either be repaid a pre-negotiated multiple of the convertible note's aggregate principal amount or converted into preferred stock of the issuer. While the Automated Convertible Note does not dictate the terms of such preferred stock, the parties could agree to modify customary preferred stock rights to provide economic benefits to the holders of such stock upon consummation of future token sales, including through the inclusion of token-based dividend and/or redemption rights. The careful balancing of the Token Purchase Option and these additional economic rights should enable issuers to provide investors access to consumer tokens while protecting development of the underlying network and consumer tokens from the application of the securities law.

Finally, the Automated Convertible Note is preferable to other token presale agreements from a commodities law perspective for several reasons. First, conferring future participation rights on an investor to participate in a token sale (*i.e.*, the Token Purchase Option), or conferring economic rights to an investor in respect of future distributions, is not clearly a swap under the CEA and subject to CFTC regulation. There is no set strike price or final price differential that creates market risk that the CFTC would necessarily be incentivized to regulate in the commodity options market. While no regulatory certainty currently exists as to the treatment of the Token Purchase Option as a swap (or not) subject to CFTC jurisdiction, the Token Purchase Option seeks to reduce economic risk and loss attributable to other token presale agreements and simply affords the investor an MFN pricing provision to purchase the token at spot, which is likely to drastically reduce economic risk of loss for an investor. In addition, a noteholder cannot be said to have provided anything of value in exchange for the Token Purchase Option, as such noteholder is under no obligation to purchase tokens in any token sale and may elect to have the entire principal amount of the convertible note repaid upon consummation of such token sale in the same manner as though the issuer had completed a change of control.

The ConsenSys Automated Convertible Note also provides built-in protections for token purchasers who will also participate on the network as part of their business and intend to benefit from the Trade Option Exemption. If such Trade Option Exemption is not otherwise available, it will direct the user to confer with counsel as to whether such instrument should be regulated as a swap and if the noteholder and issuer meet the requirements to be eligible to enter into the swap. In order to trade over-the-counter, swaps

must be entered into between ECPs. While some investors (and certain token issuers) may qualify as ECPs, token issuers who are early-stage companies that do not have at least US$10 million gross assets would not satisfy the ECP test. A swap entered into by parties who are not ECPs would be in violation of the CEA and CFTC regulation, and both parties could face penalties and sanctions for such actions. Separately and importantly, swaps are also subject to trade reporting obligations. As a result, if the Token Purchase Option does not otherwise qualify for the Trade Option Exemption, issuers and investors will want to carefully consider the swap analysis with regard to their respective Token Purchase Option. Importantly, the ConsenSys Automated Convertible Note does not qualify for the Hybrid Instrument Exemption because, as a threshold matter, the Purchaser Payment Condition is not satisfied. However, it is this element — *i.e.*, no payment or price risk taken on by the purchaser — of the Token Purchase Option that arguably places it outside the definition of swap as discussed above. Of course, while each instrument would need to be analyzed on its own merits, and while regulatory certainty does not yet exist with respect to the application of CFTC regulation to the Token Purchase Option, this alternate structure represented by the ConsenSys Automated Convertible Note at a minimum significantly mitigates the regulatory risks of the SAFT and other similar presale structures, and at best may offer a clear path to avoid characterization as a swap subject to CFTC jurisdiction.

The ConsenSys Automated Convertible Note is preferable from a securities law perspective for many similar reasons: the investor is receiving a more traditional security, the various rights they are purchasing are far less ambiguous, and appropriate disclosures regarding the material aspects of the investment are more easily crafted.

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Endnotes

[1] The following discussion assumes readers are familiar with the US securities law and commodities law frameworks applicable to sales of tokens in the United States. For a further discussion of such frameworks, see our article, The Yellow Brick Road to Consumer Tokens: The Path to SEC and CFTC Compliance. In addition, the following discussion seeks to address only fundraising instruments utilized for pure consumer token issuances and not instruments utilized for pure security token issuances, which often have similar terms. We note that the presale of a token designed to be a security is a far easier analysis, as each of the instruments should be offered and sold in compliance with securities law requirements and ordinary corporate finance practices.

[2] *See, e.g.,* Juan Batiz-Benet, Jesse Clayburgh & Marco Santori, The SAFT Project: Toward a Compliant Token Sale Framework (Oct. 2, 2017), [hereinafter SAFT Whitepaper].

[3] In addition to the securities law issues and commodities law issues discussed below, the SAFT and similar token presale agreements can raise tax concerns in light of the uncertainty regarding their treatment for US federal income tax purposes. It is possible that an issuer could be subject to US federal income tax on proceeds from SAFT sales on a current basis, particularly if the underlying tokens are consumer tokens.

[4] The *Howey* test determines whether an asset constitutes an "investment contact," one of the enumerated types of instruments defined in the securities law (15 U.S.C. §§ 77b(a)(1), 78c(a)(10)). The test states that an investment contract involves: (i) an investment of money, (ii) in a common enterprise, (iii) in which the investor is led to expect profits, (iv) derived from the entrepreneurial or managerial efforts of one or more third parties. If the test is satisfied, it is immaterial whether the enterprise is speculative or non-speculative, or whether there is a sale of property with or without intrinsic value. *See SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

[5] Defined in the SAFT as "a *bona fide* transaction or series of transactions, pursuant to which the [issuer] will sell the Tokens to the general public in a publicized product launch." Simple Agreement for Future Token (last visited May 10, 2019).

[6] We note that some practitioners have proposed that if the network launch occurs more than six months after the SAFT sale, they should constitute two distinct plans of financing and thus would not be integrated in accordance with the safe harbor of Rule 502 under the Securities Act of 1933. In this regard, we would consider the concurrent settlement to negate this proposition. Similarly, the SAFT itself may constitute an offering of the underlying token that is continuous until delivery. In any event, we would expect that the tokens received by SAFT investors would nevertheless constitute securities on the date of delivery given the nature of the SAFT offering and the delivery of tokens to investors, unless the network has become sufficiently decentralized in the interim such that the "efforts" prong of the *Howey* test was no longer satisfied.

[7] It is worth noting that the US House of Representatives has passed several bills aimed at improving capital formation for smaller companies. For example, the Main Street Growth Act would amend the Securities Exchange Act of 1934, as amended, to allow registration of venture exchanges that would provide trading venues tailored for smaller companies, such as blockchain-based startups, whose securities are considered less liquid than those of larger companies. Main Street Growth Act, H.R. 5877, 115th Congress (as passed by the House, July 10, 2018); *see* Tom Zanki, House Passes Bill to Allow Venture Exchanges, LAW360 (July 11, 2018).

[8] *See* 15 U.S.C. § 78c(a)(4)(A) (defining "broker" as "any person engaged in the business of effecting transactions in securities for the account of others"); 15 U.S.C. § 78c(a) (5)(A) (defining "dealer" as "any person engaged in the business of buying and selling securities ... for such person's own account"); 15 U.S.C. § 78c(a)(1) (defining "exchange" as "any organization, association or group of persons, whether incorporated or unincorporated, which constitutes, maintains or provides a marketplace or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such exchange.").

[9] *See* William Hinman, Dir., Div. Corp. Fin., Sec. & Exch. Comm'n, Digital Asset Transactions: When Howey Met Gary (Plastic) (June 14, 2018), https://www.sec.gov/news/speech/speech-hinman-061418 [hereinafter Hinman Speech].

[10] Timothy Massad, Chairman, Commodity Futures Trading Comm'n, Testimony of Chairman Timothy Massad before the US Senate Committee on Agriculture, Nutrition & Forestry (Dec. 10, 2014) [hereinafter 2014 Massad Senate Testimony].

[11] *See* 7 U.S.C. § 1a(47)(A)(ii) ("the term 'swap' means any agreement, contract, or transaction ... that provides for any purchase, sale, payment, or delivery ... that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence."). Swap contracts are subject to a myriad of CFTC regulations under the CEA, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act), including the requirement that over-the-counter (OTC) swap counterparties be "eligible contract participants." *Id.* § 1a(18) (defining eligible contract participants (ECPs)). An individual can only qualify as an ECP if such person has amounts invested on a discretionary basis, the aggregate of which is in excess of US$10 million; or US$5 million and enters into swaps in order to manage the risk associated with an asset owned or liability incurred (or reasonably likely to be owned or incurred) by such person. *Id.* § 1a(18)(A)(xi). If one or both of the parties to a swap transaction are non-ECPs, the swap must be executed on a CFTC-registered designated contract market. *Id.* § 2(e).

[12] Both the CEA and CFTC regulations thereunder have long recognized a forward contract exclusion from futures contracts. *See* 7 U.S.C. § 1a(27) ("The term 'future delivery' does not include any sale of any cash commodity for deferred shipment or delivery."). Following enactment of the Dodd-Frank Act, the sale of a non-financial commodity for deferred shipment or delivery was also excluded from the definition of "swap" in Section 1a(47) of the CEA under the Non-Financial Forward Contract Exclusion. *Id.* § 1a(47)(B)(ii).

[13] *See* Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 Fed. Reg. 48208, 48228 (Aug. 13, 2012) [hereinafter *Products Release*].

[14] As the CFTC has noted, "the underlying postulate of the [forward] exclusion is that the [CEA's] regulatory scheme for futures trading simply should not apply to private commercial merchandising transactions which create enforceable obligations to deliver but in which delivery is deferred for reasons of commercial convenience or necessity." *Id.* at 48228.

[15] The CFTC drew a clear distinction between commercial market participants and investors in the Products Release, stating that "[a] hedge fund's investment activity is not commercial activity within the CFTC's longstanding view of the Brent Interpretation." *Id.* at 48229. The Brent Interpretation refers to the CFTC's 1990 interpretation of the application of the forward contract exclusion from the definition of "future delivery" in the context of "book-outs" transactions, which the CFTC extended in the Products Release to apply to the forward contract exclusion from the swap definition for non- financial commodities. Statutory Interpretation Concerning Forward Transactions, 55 Fed. Reg. 39188 (Sept. 25, 1990).

Moreover, the CFTC continued to elaborate on its discerning view of "commercial" in the Products Release, stating that "an investment vehicle taking delivery of gold as part of its investment strategy would not be engaging in a commercial activity within the meaning of the Brent Interpretation." Products Release at 48229. However, if the investment vehicle were to own a chain of jewelry stores and would purchase gold on a forward basis to provide raw materials for the jewelry store, the CFTC would consider such activity to fall within the forward contract exclusion under the Brent Interpretation. *Id.* Notably, the CFTC stated in the Products Release that, for purposes of the "swap" definition, the Non-Financial Forward Contract Exclusion will be interpreted in a manner consistent with the CFTC's historical interpretation of the existing forward exclusion with respect to futures. As a result, the Brent Interpretation analysis is applicable for purposes of evaluating the Non-Financial Forward Contract Exclusion as it pertains to the "swap" definition. *Id.* at 48227-48228.

[16] *See Id.*

[17] 7 U.S.C. § 1a(47)(A)(i) ("the term 'swap' means any agreement, contract, or transaction ... that is a put, call, cap, floor, collar, or similar option of any kind that is for the purchase or sale, or based on the value, of 1 or more ... commodities").

[18] *See* 17 C.F.R. § 32.3(a).

[19] *See* 17 C.F.R. § 32.3(c).

[20] *See supra* text accompanying note 12.

[21] 17 C.F.R. § 34.3(a).

[22] Under Section 2(f) of the CEA, a hybrid instrument is "predominantly a security" and exempt from the provisions of the CEA if:

—the hybrid instrument issuer receives payment in full of the hybrid instrument's purchase price, substantially contemporaneously with delivery of the hybrid instrument;

—the hybrid instrument purchaser/holder is not required to make any payment to the issuer in addition to the purchase price described above, whether as margin, settlement payment or otherwise, during the life of the hybrid instrument or at maturity;

—the hybrid instrument issuer is not subject by the instrument's terms to mark-to- market margining requirements; and

—the hybrid instrument is not marketed as a contract of sale of a commodity for future delivery (or option on such a contract) subject to the CEA.

7 U.S.C. § 2(f)(2).

[23] Such securities offerings are almost exclusively accomplished through the use of an exemption from registration, such as in a private placement that is limited to participants who are "accredited investors," as defined in 17 C.F.R. § 230.501, either under the more traditional style private placement of Regulation D, Rule 506(b), or the crowdfunding compatible, Regulation D, Rule 506(c). Issuers may also consider utilizing Regulation CF or Regulation A, which permit sales to non-accredited investors after making certain filings with the SEC. For additional information, see Latham & Watkins, SEC Adopts Final Crowdfunding Rules,

Client Alert No. 1893 (Nov. 10, 2015); Stephen P. Wink and Brett M. Ackerman, Crowdfunding Under the SEC's New Rules, 49 REV. OF SEC. & COMMODITIES REG. 267 (Dec. 21, 2016).

[24] While issuers should be cautious when granting such rights, generally the enterprise and its investors are best served when their interests align. In consumer token sales, the parties share a direct interest in ensuring the offering or distribution complies with applicable securities and commodities laws. In addition, all participants should share a similar interest in the maturing of the market for token presales, as in the traditional venture capital space, to attract capital from investors that have yet to approach the sector due to regulatory risks.

[25] Two of the most widely held and well-known digital assets — Bitcoin and Ether — provide good examples of digital assets that the SEC has indicated no longer constitute securities, primarily due to the decentralized nature of their use. See *Hinman Speech*. The "efforts of others" prong of the *Howey* Test requires that such efforts must be "undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." See *SEC v. Glenn W. Turner Enterprises Inc.*, 474 F.2d 476, 482 (9th Cir. 1973) ("[T]he fact that the investors here were required to exert some efforts if a return were to be achieved should not automatically preclude a finding that the Plan or Adventure is an investment contract. To do so would not serve the purpose of the legislation. Rather we adopt a more realistic test, whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise."); see *United Housing Found., Inc. v. Forman, 421 U.S. 837, 855 (1975)* (the "efforts of others" prong of the Howey Test requires that investors have a reasonable expectation of profi t derived from the efforts of others). Two seminal cases provide guidance on this prong for instruments traded in well-developed markets such as Bitcoin and Ether. In both *Noa v. Key Futures* (*Noa v. Key Futures, Inc.*, 638 F.2d. 77 (9th Cir. 1980).) and *SEC v. Belmont Reid & Co.* (*SEC v. Belmont Reid & Co*, 794 F.2d 1388 (9th Cir. 1986)), the Ninth Circuit applied the Howey Test to the sale of precious metals, finding that the Howey Test is not satisfied if the expectation of economic return is based on market forces, and not on the efforts of a promoter. Thus, the applicability of these cases to the analysis of Bitcoin and Ether within this prong of the Howey Test (and therefore the analysis of whether either Bitcoin or Ether is a security) depends on the existence of an established, decentralized market where the spot price is determined by ordinary market forces.