

## Cryptocurrency as security

In a recent order, the Securities and Exchange Commission (SEC) directed four of businessman Joseph Calata's companies to cease and desist from engaging in the initial coin offering (ICO) of Krops tokens, also referred to as kropcoins. The ICO was advertised on a website operated by one of Calata's companies.

Kropcoins, a form of digital money, were being offered for sale to investors (local and foreign) in exchange for legal tender or other cryptocurrencies in order to raise funds for a technology-based startup company called Krops. The value of kropcoins will be established through the establishment of a technology-based agricultural marketplace that will drive its market share, leading buyers to expect their investment will eventually appreciate in value and create profit. Investors do not need to participate in the establishment and development of the agricultural marketplace.

The basis for the SEC order is that kropcoins are "securities" under the Securities Regulation Code (SRC), which defines the term as "shares, participation or interests in a corporation or in a

commercial enterprise or profit-making venture and evidenced by a certificate, contract, instrument, whether written or electronic in character." The SEC is of the view that kropcoins are interests in a profit-making venture, as evidenced by instruments in electronic form.

Kropcoins may also be considered as investment contracts, which are considered securities under the SRC. In *Power Homes v. SEC* (546 SCRA 567 [2008]), the Supreme Court recognized there were two tests in determining whether a contract was an investment contract.

The first is the *Howey* test, which traces its roots to the *SEC v. W.J. Howey Co.* (328 US 293 [1946]) case in the United States. The decision held that a contract, transaction or scheme is an investment contract where a person (a) invests his money (b) in a common enterprise (c) with an expectation of profits (d) solely from the efforts of others.

The other test is the *Turner* test based on a later case at the Court of Appeals—*SEC vs. Turner* (474 F.2d 476, 9th Cir. 1973)—which basically has the same elements as the *Howey* test except that the profit was described "primarily" from the efforts of others.

The SRC does not define an investment contract. Neither has our Supreme Court made its mind as to what test should finally be adopted in the Philippines. Significantly, however, the 2015 SRC Rules adopt the *Turner* test, which will most probably be upheld by the high court given the deference it gives to the interpretation of a law by the administrative agency tasked to enforce it.

But insofar as kropcoins are concerned, the distinction seems immaterial because there is an expectation of profits by the investing public whether it is solely or primarily from the efforts of the Calata group.

What are the legal implications if kropcoins are sold to the investing public without the required registration? There are potential criminal liabilities for violation of the SRC. Furthermore, innocent investors will be allowed to recover their entire investment in case of loss. Additionally, the SRC authorizes the courts to award damages in an amount not exceeding triple the total amount of the transaction on top of actual damages.

In short, it's a no-win situation for the Calata group, legally speaking, at least. INQ

\* MONEY

\* MARKETING