

Implications for Launch of tZERO, First U.S. Registered ATS

Blockchain and the Law Blog on January 5, 2018

The world's first SEC-registered cryptocurrency exchange may be just around the corner. As detailed in their October 24 [Form 8-K](#), Overstock.com subsidiary tZERO has entered into a joint venture with The Argon Group and RenGen LLC to launch a U.S. registered Alternative Trading System ("ATS") for digital tokens. If successful, the tZERO ATS may represent a monumental development in the evolving landscape of blockchain-based fundraising by providing secondary market liquidity for ICO tokens affirmatively offered and sold as securities.

tZERO's potential importance to the token ecosystem emerges from the context of the uncertain regulatory environment in which ICOs operate today. If ICO tokens are "securities" they are subject to the federal securities laws; yet whether any particular token constitutes a security turns on a case-by-case determination that must be made in accordance with the economic realities of a given transaction.

Lacking much clear, unequivocal guidance, potential ICO issuers are left in a quandary. Depending on the characteristics of the tokens, the network they operate on, and the manner in which they are offered and sold, ICO tokens [may](#) – or may not – be securities.

So far, most ICO issuers have responded with attempts to avoid the securities laws by designing tokens that do not possess security-like features, and instead derive value from various forms of actual or supposed utility. To further insulate issuers from legal risk, these so-called "utility tokens" have been coupled with creative offering structures, of which the [SAFT](#) is the most recent example.

There are a number of drawbacks to approaches designed to avoid or end-around the securities laws. [Indications](#) from the SEC signal that it may be difficult if not impossible to conduct any unregistered ICO without running afoul of the securities laws, regardless of the characteristics of the underlying tokens. Further, a [series](#) of class action complaints demonstrate that regulatory enforcement is not the only, or perhaps even the most immediate, operational threat to ICO issuers. Even the SAFT structure has come under [criticism](#). Meanwhile, lacking any rights in or claims against the issuing entity, many existing utility tokens arguably possess little real value beyond their ability to fetch ever-higher prices on the secondary market due to the emergence of a dangerous speculative bubble.

Thus, it seems at least some ICO issuers could benefit from registering their tokens as securities or selling them pursuant to an exemption. Doing so would provide issuers with greater certainty; a more stable foundation upon which they can build out their projects (and perhaps sleep a bit more soundly at night). It would give developers freedom to program tokens with an array of functionalities that they may otherwise be tempted to avoid, such as ownership, dividend and liquidation rights, or coupons and redemption schedules. Investors may respond positively, and pay a meaningful premium, for tokens that are presumed more legitimate and reliable because issued in connection with the SEC's uniform disclosure requirements. Such ICOs might even provide issuers with access to certain markets they may otherwise be unable to reach, such as institutional capital prohibited by organizational documents or applicable regulation from investing in the unregistered and non-exempt ICOs that are common today.

So why haven't we seen more ICOs that self-identify their tokens as securities and sell them accordingly?

To be sure, the requirements for compliance with securities laws are too costly or constraining for many issuers – and may be particularly problematic for certain distributed applications that rely upon the free and ready transferability of their tokens in order to properly function. But there is currently an additional important and often under-appreciated problem that besets such an approach: an utter lack of secondary market liquidity for tokens that are explicitly and undeniably also securities.

[According to](#) the SEC, any exchange platform that facilitates transactions in tokenized securities must register as a national securities exchange or operate pursuant to an exemption. This bars any unregistered, non-exempt secondary trading platform – *i.e.*, every cryptocurrency exchange in operation today – from listing tokens that are offered and sold as securities.

tZERO promises to fill this void. As a registered ATS, tZERO would provide access to secondary market liquidity for ICO tokens brought to market through proper SEC processes. The existence of such a platform could change the calculus for many developers considering designing tokens with security-like characteristics or offering their tokens as securities via avenues such as Regulation A+, Regulation CF and Regulation D. Additionally, other registered exchanges are sure to be created if tZERO takes off, perhaps even bearing further technological capabilities in order to establish competitive advantage.

While there will most certainly be barriers to full-fledged adoption, the tZERO experiment is a live illustration of the dialectical relationship between regulation and innovation, which just may dramatically alter the landscape of blockchain-based fundraising as we know it today.

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