Disruptive Technology and Legal

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Blockchain/Bitcoin

What is blockchain technology?

- Blockchain technology is a decentralized digital ledger that encrypts and records transactions, as blocks of data, to the chain of transaction/data blocks that came before it to computers around the world and once a block of data, is validated, it cannot be altered

What is Bitcoin?

- Bitcoin was the original cryptocurrency and best first application of blockchain technology (2009)

Ethereum

What is Ethereum?

- Ethereum is a blockchain-based computing platform and operating system that allows for development and execution of smart contracts (code) on the blockchain, which can't be altered, tempered, or hacked

- Ethereum's Ether was the first major utility token (also functions as a currency) and allows users to run smart contracts and code on the Ethereum Blockchain

- "Smart contracts" are not really contracts, and they are not particularly smart either, but are just code - or computer logic - that can execute a contract or certain provisions of a contract

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Initial Coin Offerings (ICO) and Initial Token Offerings (ITO)

What is a coin or token?

- Usage of "coin" and "token" overlaps considerably and though often used interchangeably
- Notionally, there are differences between a "coin" and a "token"

What is an ICO or ITO?

- An ICO or ITO is a new way for early stage companies to attract investment in which the issuer creates and sells a coin or token. The tokens sold in an ICO usually do not represent an ownership stake in the organization but are most often intended to represent the right to a certain value of the future products or services the issuer plans to develop
- Biggest ICO in 2017 was Filecoin, which raised $257m (~$6b total in 2017)
- Block.one is on track to raise $4b in its ICO (over $7b total to date in 2018)

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Currency – Bitcoin, Litecoin, Monero

- Digital cash that acts as a store of value and a medium of exchange
- Like Canadian dollars or any other form of fiat they are worth whatever people choose they are worth based on supply and demand, however, unlike fiat currencies, no government backs the currency
- Since Bitcoin, many other digital currencies have entered the market including Litecoin and Monero

Utility Token – Ethereum, Filecoin, block.one, BlockCAT, Etherparty

- Utility tokens do not have the traits of a classic cryptocurrency but serve as the in-platform tokens to purchase future access to products or services (and typically are not designed as investments)
- Filecoin is developing a platform to facilitate the sharing of computer storage
- Block.one is developing the EOSIO platform, which is expected to compete with Ethereum
- BC's BlockCAT raised tens of millions of dollars ($20m plus?) in an ICO to develop a platform that lets anyone create, manage, and deploy smart contracts on the Ethereum Blockchain
- BC's Etherparty raised tens of millions of dollars ($30m plus?) in an ICO and aims to build easy to use blockchain-based applications for the creation, use, and management of smart contracts

Security (Equity) Token – TokenFunder, Canamex, Kabuni

- Like a traditional stock, a security (equity) token buys you into some level of ownership of an organization and it's success and will almost always be a security under securities laws though it might also function as utility token
- Ontario's TokenFunder just closed its initial security token offering of FNDR tokens, which represent a dividend-like share of TokenFunder's future profits
- BC's Canamex Gold (CSE: CSQ) has launched a private placement of its gold backed GOLDUSA security tokens, which are redeemable for for physical gold
- BC's Kabuni Technologies has announced that it intends to complete a prospectus offering of security tokens, which would then be traded on the Canadian Securities Exchange

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Canadian Securities Laws

What is a security?

- The securities act (or equivalent) in each province/territory provides that "security" includes, among other things, all the things you would typically regard as a security such as a share (and many more) but also an "investment contract"
- Under case law (Pacific Coin), an investment contract exists when there is: an investment of money, in a common enterprise, with the expectation of profit, that comes significantly from the efforts of others (similar to the Howey test under US securities laws)

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Prospectus Requirement

- "prospectus requirement" has the meaning ascribed to that term in National Instrument 14-101 Definitions and, without limiting the foregoing, for reference, means the requirement in securities legislation that prohibits a person or company from distributing a security unless a preliminary prospectus and prospectus for the security have been filed and the regulator has issued receipts for them

Registration Requirement

- "registration requirement" is defined in National Instrument 14-101 Definitions and includes the requirement in securities legislation that prohibits a person or company from acting as a dealer unless that person or company is registered in the appropriate category of registration under securities legislation unless a registration exemption is available

Resale Restrictions

- National Instrument 45-102 Resale of Securities imposes an indefinite hold period on securities issued by non-reporting issuers and a restricted period of four months on stock issued by reporting issuers in a private placement unless a resale exemption may be relied upon to sell these securities

Securities Exchange Recognition/Compliance

- National Instrument 21-101 Marketplace Operation and National Instrument 23-101 Trading Rules regulate securities "marketplaces" and require recognition as an exchange or alternative trading system by the relevant securities regulatory authority or an exemption from recognition (and compliance with the rules governing exchanges or alternative trading systems)

Application of Canadian Securities Laws

Are companies completing ICOs/ITO's distributing securities?

- "by and large, the structures of ICOs that I have seen involve the offer and sale of securities" and "[m]erely calling a token a 'utility' token or structuring it to provide some utility does not prevent the token from being a security." - Jay Clayton, SEC Chairman

Are such companies subject to the prospectus requirement?

- If a security, yes

Are such companies subject to the registration requirement?

- If a security and in the business of trading, yes

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Are these coins/tokens subject to restrictions on transfer?

- If a security and if distributed pursuant to an exemption then yes, an indefinite hold period on securities issued by non-reporting issuers and a restricted period of four months on shares issued by reporting issuers in a private placement unless a resale exemption may be relied upon to sell these securities

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Do exchanges trading these coins/tokens need to be recognized as securities exchanges and comply with applicable requirements?

- If a security, yes, and the Ontario Securities Commission recently indicated that they "are aware of several cryptocurrency trading platforms operating in Ontario and are gathering information about their activities. To date, none have been recognized as an exchange, or exempted from recognition."

Compliance with Canadian Securities Laws

Ensure coin is not a security

- True currencies, such as Bitcoin, are likely not securities

Set up operations elsewhere and don't offer in Canada

- Move to Switzerland, Gibraltar or Liechtenstein where the regimes are more accommodating (at the opposite extreme, ICOs have been banned outright in China, South Korea)
- BC's Dot Media Inc. moved their RightMesh project to Switzerland and are now finally completing their token generating event (read ICO/ITO) after having been delayed while BCSC investigated their links to BC

Simple Agreement for Future Tokens (SAFT) Model

- Under the SAFT model, investors receive the right to receive functional utility tokens once the company has developed the platform that consumes the tokens in an attempt to mitigate the risk of utility tokens being deemed securities
- Filecoin incorporated the SAFT model into its ICO process in raising over $257m last year

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Obtain an order of the securities regulatory authorities for exemptions from certain requirements

- Quebec's Impak Finance received exemptive relief orders from Quebec's Autorité des marchés financiers (AMF), as the principal regulator, along with the Ontario Securities Commission, from registration requirement and prospectus requirement with respect to their offering of Impak Coins
- Ontario's Tokenfunder received an exemptive relief order from the Ontario Securities Commission from registration requirement for its smart token asset management platform, which is intended to, among other things, facilitate third-party issuers raising capital through the offering of tokens and coins
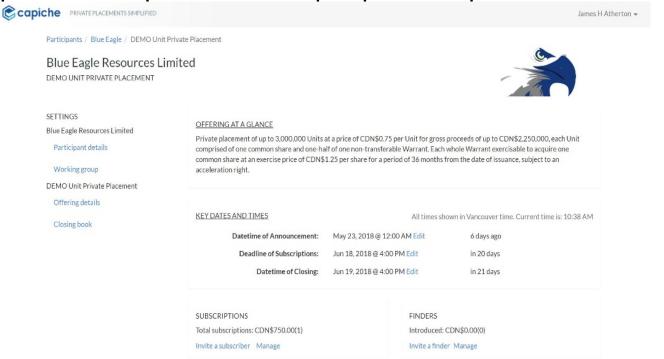
Distribute token under an exemption from the prospectus requirement, avoid the requirement to register, restrict trading and allow to trade only on a recognized securities exchange

- Capiche ensures offerings of securities are completed pursuant to applicable exemptions from the prospectus requirement

The Future: Smart Securities

Share rights and transfers

- The rights attaching to a share typically include the right to attend and vote at general meetings, the right to participate in the distribution of assets on dissolution of the company, and the right to receive dividends, if and when declared, and these rights can all be programmed into a smart security token
- Smart security tokens and and blockchain platforms can be designed and programmed to comply with resale restrictions

Connected Ecosystem

- Electronically connecting issuers with not only subscribers but with all others involved in the process (e.g. transfer agents, SEDAR, SEDI, news wire dissemination services, legal counsel, auditors, investment dealers, stock exchanges, securities commissions) has the potential to add momentous efficiencies to the capital markets

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THANK YOU!

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