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Legal Opinion: CloutContracts

Introduction

This legal opinion was prepared upon request of the **CloutContracts team**, (the team or CloutContracts), to serve as a legal analysis of the business model, the CloutContracts token (CCS) and its compliance with the requirements of the listing rules for the trading venue operated by exchanges.

The requirements considered hereunder reflect the conditions as prescribed by the publicly available legislation and the legal practice in the matter, as well as any guidelines and rules, final or otherwise, published by US and European Authorities. To that end, and for the purpose of a continuous update on the development of cryptocurrency market regulations, this law firm is continuously collaborating, at any given time, with at least twelve (12) relevant law firms from all major jurisdictions around the world, exchanging information and updates on crypto development and its associated legal domain.

This opinion is meant to serve as our legal analysis of the CCS token and conclusions are limited to the matters expressly stated herein, are fully based on information and material provided to us by CloutContracts, and no opinion or conclusion is to be inferred or may be implied beyond the opinions and conclusions expressly set forth herein. This opinion is written in good faith, and cannot be deemed as a guarantee or obligation, or ground of liability for our law firm.

For the purposes of issuance of this opinion, we have assumed without further inquiry that all factual circumstances stated in the provided documentation are a true and correct representation of the actual situation surrounding the company and insofar as such factual circumstances are not or may turn out to be not true and correct, they will have no adverse effect on the opinions stated herein. Therefore, and for the avoidance of doubt, the opinion expressed in this legal opinion is only being written in light of the applicable legislation at the date of issuance, and shall not cover any future changes, amendments and any additional supplementary legislation that may be enacted.

We hereby state that our law firm is EU based, and the interpretation of law is based on authority for exchanges incorporated in the United States of America, the European Union and other relevant international areas, as hereinafter provided.

Business description. Key features.

As a whole concept, CloutContracts presents itself as a smart contracts layer on top of and complimentary to various blockchain-based social media platforms. As a smart contracts layer, many creators onboarded to CloutContracts can create high performance DAPPs w/ an emphasis on low gas fees, customization, speed and various social aspects as well. This will eventually allow creators to build large scale networks, tokenization use cases, and bring blockchain adaptability to their fanbases. Unlike traditional rollup networks or DAPP tools, the emphasis is on the creator, adaptability, and expanded functionalities such as modular tools or microservices. CloutContracts aims to have creators feel like they aren't needing to choose between expanded functionality from running their own blockchain or accessibility from running on top of a network. This creates a new class of blockchain developers, in which ease of access is aimed towards both the most basic level to running complex lightweight apps on JavaScript or Solidity.

CloutContracts as both a smart contracts layer and tool for creators, provides an opportunity for creators to expand their network. It will be decentralized, open source and doesn't need reliance on a specific social media platform's ecosystem. This means that if a compatible social media platform went offline, CloutContracts can still survive on its own, which is a critical aspect to being decentralized. It is also a reason why it is considered both complementary and separate. CloutContracts has the technological capabilities to allow people to build lightweight decentralized applications while at the same time fixing many of the core problems in regards to gas fees, or arguments in regards to consensus algorithms that other networks have faced. This creates an opportunity in which users can essentially launch adaptable DAPPs w/ ease.

The CCS Token

First of all, what is the CCS token? CCS intends to be more than just a utility token, as it will have multiple uses within the CloutContracts Platform. Most of the usecases mentioned are centered around the utilization of CloutContracts as a tool. Many people can launch their own high speed DAPPs and networks with ease, and these are part of the large use cases of CloutContracts as a whole. CloutContracts democratizes social media and allows numerous people to launch truly decentralized social networks. People who build smart contracts on top of CloutContracts are in charge of their private keys. The ledger is there, and so is the history for their smart contract or DAPP. Even major consensus changes need to be approved by nodes, and shouldn't affect the functionality of many of the applications already built on CloutContracts.

Given the expansion of CloutContracts also being adaptable through pegs or wrapped assets, CloutContracts should be highly liquid along w/ certain projects built on top of it. This means that adaptation towards many utility use cases should be an ease in the future, and more incentives regarding development are there. The orientation towards creators suddenly allows for everyone to become some sort of blockchain architect.

It is, thus, the team's intention that the CCS token will also be used as a utility asset that can transfer a certain value between holders. Utility tokens are digital assets that are used to finance the network and incentivize its use by providing customers with a guarantee of being able to benefit from the full range of the network's services.

United States of America

From a US legal standpoint, the institution of "securities" is being regulated by section 2(a)(1) of the Securities Act of 1933, which defines them as: "…any note, stock, treasury stock, security future, security based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit sharing agreement ... investment contract ... or, in general, any interest or instrument commonly known as a 'security', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

In order for us to have a deeper understanding of the issue under debate, we should take into consideration the US Supreme Court case SEC v. Howey, 328 U.S. 293 (1946), which provides further clarifications on determining whether an instrument meets the definition of a security, or not. In this Supreme Court case, Howey focuses specifically on the term "investment contract" within the definition of "security". Obviously, not every contract or agreement is an "investment contract".

The court determined that a contract constitutes as an investment contract that meets the definition of “security” if there is:

1. An investment of money;
2. In a common enterprise;
3. With an expectation of profits;
4. Solely from the (entrepreneurial or managerial) efforts of others (e.g., a promoter or third party);

The four factors must be met all together, in order to be legally considered a “security”. Because this Supreme Court decision is widely considered as fundamental to the determining elements of a “security”, we will base our analysis on its conditional factors.

1. Is this an investment? Yes! It is generally accepted that an investment of money may include not only the provision of capital, assets and cash, but also of goods, services or of promissory notes. CCS has been distributed through an airdrop program by the issuer CloutContracts to selected users, with a price set per token, so the first factor is NOT met, as no user initially holding the token has made an investment.
2. Is this a common enterprise? A common enterprise is deemed to exist where investors pool funds into an investment and the profits of each token buyer correlate with those of the other investors. Whether funds are pooled appears to be the key question, and thus in cases where there is no proportional sharing of profits or pooling of funds, a common enterprise may be deemed not to exist. CCS is unlikely to be deemed a “security” at this stage of the project, and that is taking into consideration the fact that the platform is not yet fully operational. Therefore, CCS is substantially a utility coin consumed to transfer value across the blockchain with a relatively stable value across various exchanges. The second factor is not met.
3. Is there an expectation of profit? In our legal opinion, this factor is irrelevant to the matter, but we will analyze it in respect of the Supreme Court decision. From an economic point of view, regarding the buyers of the token, and not the users being airdropped, any type of investment is made with an expectation of profit. But just because there is a return on investment or profit, does not mean that the investment contract is a “security”. Moreover, the main purpose of CCS is creating a blockchain-based optimistic rollup and exchange platform, among others. So, the expectation of profit is mainly oriented towards another, subsidiary, category of economic activities, not on CCS tokens, which renders somewhat irrelevant the profits from an eventual token airdrop or ulterior acquisition. Even so, this factor is probably met, on a low scale, provided that CCS is purchased by investors with an expectation of capital gain, even though we clearly express the opinion that this factor should not weigh in decisively on the matter.
4. Is the “solely on the efforts of others” factor met? No! The profit of the platform user always depends on his own actions. As we said, even though there is also an investment in CCS tokens, the expectation of profits results mainly from economic activity, not from volatility of the tokens. So, any such incentives should ideally be derived through their own efforts, rather than through a passive investment. In such a case, the factor is not met.

European Union and UK

From an EU and UK legal standpoint, when we conducted a detailed decomposition and analysis of all online CCS token business processes, we were unable to detect and identify any process that can be regarded as a relationship between an investor and an issuer of securities. On the other hand, if we aim to register the issue of securities, we will not be able to prove to the regulatory body that tokens are securities. Moreover, the main token holders are interested in the trading transactions, and this is peer-to-peer mainly.

In our opinion, the expertise of the CCS token under the EU securities legislation cannot be applied to the CCS token due to the fact that all business processes and relationships within the platform are classic relationships for blockchain platforms, and are all in a permissionless manner. There is no contribution to any business venture.

Nowadays, the matters of cryptocurrency turnover and production of digital assets have no special legal regulation. There are neither special laws, nor separate legal institutes or branches of law. Therefore, we can not qualify a token as a unique legal essence.

Token taxonomy according to the ESMA and the EBA
Although not legally binding at a supranational level, it is advisable to refer to the regulatory framework structured on the Advice on Initial Coin Offerings and Crypto-Assets of ESMA4 and the Report with advice for the European Commission on crypto-assets of EBA5; both published on 9th January 2019.

Presently, there is no common taxonomy of crypto assets in use by international standard-setting bodies. However, even if crypto assets may have different features or serve different functions, a basic taxonomy of crypto assets generally comprises three main categories:

Payment/Exchange/Currency tokens: Payment tokens are tokens which have no tangible value, except for the expectation they may serve as a means of exchange or payment to pay for goods or services that are external to the ecosystem in which they are built. "Stablecoins" are a relatively new form of payment/exchange token that are typically asset backed (by physical collateral or crypto-assets) or in the form of an algorithmic "stablecoin".

Utility tokens: Utility tokens are tokens which are intended to typically enable access to a specific product or service often provided using a DLT platform but are not accepted as a means of payment for other products or services.

Investment tokens: Investment tokens may represent financial assets such as a debt or equity claim on the Issuer. Investment tokens promise, for example, a share in future company earnings or future capital flows. In terms of their economic function, therefore, these tokens are analogous to financial instruments. However, investment tokens may also exclusively reflect the ownership rights of an asset, which may not be deemed as a financial instrument.

There are a wide variety of crypto-assets, some of which have features spanning more than one of the categories identified above. The individual token classifications are not mutually exclusive.

We will further analyze the legal qualification of crypto assets under the European Banking legislation and ESMA's remit (MiFID II), and under the E-Money Act in line with the second Electronic Money Directive (EMD2) and the second Payment Services Directive (PS2). Reflecting on the above, the current perimeter of regulation is such that crypto assets may, depending on their characteristics, qualify as financial instruments, electronic money, or none of the foregoing.

The definition of a financial instrument is the key element towards determining whether trading services with respect to a token can be deemed to be regulated in terms of the Banking Act and other relevant laws.

Financial instruments are defined in terms of Section C of the Banking Act as follows:
1. Transferable securities of all classes which are negotiable on the capital market, such as:
a) shares in companies and other securities equivalent to shares in companies, partnerships, or other entities, including depositary receipts in respect of such securities;
b) bonds or other forms of securitized debt, including depositary receipts in respect of such securities;
c) any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, or other indices or measures;
2. Money-market instruments which are normally dealt in on the money market, such as treasury bills, certificates of deposit, and commercial papers and excluding instruments of payment;
3. Units in undertakings for collective investment in transferable securities, units in investment undertakings, and units in alternative investment funds;

4. Options, futures, swaps, forward rate agreements, and any other derivative contract relating to securities, currencies, interest rates or yields, emission allowances or other derivative instruments, financial indices or financial measures which may be settled physically or in cash;
5. Options, futures, swaps, forwards and any other derivative contract relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination events;
6. Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market, a multilateral trading facility, or an organized trading facility, except for wholesale energy products traded on an organized trading facility that must be physically settled;
7. Options, futures, swaps, forwards and any other derivative contract relating to commodities that can be physically settled, not otherwise mentioned in point 6 and not being for commercial purposes, which have the characteristics of other derivative financial instruments;
8. Derivative instruments for the transfer of credit risk;
9. Financial contracts for differences; or
10. Options, futures, swaps, forward rate agreements and any other derivative contract relating to climatic variables, freight rates or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination events, as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this section, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market, multilateral trading facility, or organized trading facility.
11. Emission allowances consisting of any units recognized for compliance within the requirements of the Emissions Trading legislation.

To round up a conclusion we can safely iterate the following:

- The market price of the token does not influence the company's profit and the company profit does not influence the token market price.
- There are no declarations in the whitepaper promising "An expectation of profits" to the token buyers. Token holders can receive any income from the token by their own efforts, or they can also lose the tokens while trading.
- A CCS token is clearly not for greenhouse emission allowances.
- A CCS token does not constitute any sort of debt obligation. For essentially the same reason a CCS token is not a bond or other tradable debt obligation.
- A CCS token does not constitute a share because it neither entitles its holder to a dividend nor grants its holder any right to participate in the governance of CloutContracts or of any other company.
- A CCS token is not a subscription right or other tradable right granting the right to acquire securities. A CCS token simply does not give its holder any option to acquire a bond or a share.
- The Company does not propose to use the monies received from the sale of CCS tokens for following any defined investment policy for the benefit of the buyers of CCS tokens in question and in their common interests: the buyers of CCS tokens will not have distributed to them any income earned as a result of operating the platform.

Furthermore, a derivative security comprises a tradable security expressing a right or an obligation to acquire, exchange or transfer, provided that its value depends, directly or indirectly, on:

1. The exchange or market price of a security;
2. On any interest rate;
3. Securities index, other financial index or financial indicator, including the inflation rate, freight rate, emission allowances or other official economic statistics;
4. Currency exchange rates;
5. Credit risk and other risks, including climatic variables;
6. The exchange or market price of a commodity.

The CCS token does not represent any of such cases.

While the value of a CCS token would likely depend on the success of the ecosystem, the content available via that ecosystem does not constitute a commodity. Thus, a CCS token is neither a derivative security nor a derivative contract.

Electronic money is commonly defined as a digital alternative to cash allowing users to make cashless payments with money stored over the internet with the final aim to facilitate the emergence of innovative electronic money services and encourage effective competition between all market participants.
A token is to be classified as electronic money if the following conditions are met altogether:

- Is electronically stored;
- Has monetary value;
- Represents a claim on the Issuer;
- Is issued on receipt of funds;
- Is issued for the purpose of making payment transactions;
- Is accepted by persons other than the Issuer.

In our legal view, the CCS token shall serve as an integral feature of the core processes of the platform as denoted in the whitepaper. However, nothing in the whitepaper provided by the protocol indicates that CCS token holders can have a claim against the issuer's assets arising from funds which were initially placed against such issuance of CCS and/or that such holders can redeem their funds at par value. Therefore, CCS tokens fall outside the scope of the definition of Electronic Money.

Finally, CCS tokens are likewise not depositary receipts. A depositary receipt is a security that represents ownership of the securities of a foreign issuer and which can be admitted to trading on a regulated market independent from the securities of the foreign issuer. To constitute a depositary, receipt of a CCS token would need to represent an ownership of a security. All the functions of a CCS token are listed above. An instrument fulfilling only those functions does not constitute a security.

Conclusion

1. The CCS token is more likely not to be deemed a "security" under the US, EU and other international legislation.

2. In the future stage, the CCS token should maintain the utility legal qualification, based on the company's business plan and the technical development of the blockchain.

3. We have found no signs of possible fraud and scam, Ponzi scheme, tort, consumer fraud, or known schemes of income laundering and tax evasion.

4. Token buyers do not have any rights to company profit. The CCS token doesn't give equal rights to their holders. This fact excludes the identification of the token as securities.

5. The founders of CloutContracts do not possess any ability to affect the token price. The market price of a token does not influence a company's profit and a company's profit does not influence the token market price.

6. All scenarios of the turnover of the token are strictly ordered and implemented on the blockchain by smart contracts. No other scenarios are technically feasible. None of the scenarios of utilizing the token has the signs of security rights realizing.

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Disclaimer:
The above analysis is based on information obtained from a representative of CloutContracts, the team's whitepaper, publicly available information, and the law as it exists as of the date hereof. Considered herein were the U.S. federal and the EU securities laws. We have also analyzed other legislations. No opinion is expressed with regard to any other body of law or legal construct, including without limitation the franchise laws of any other country. No court has addressed the question of whether any blockchain-based tokens are "securities" under U.S.

federal law; as such, the SEC or a court of competent jurisdiction may reach an alternative conclusion to that stated in this opinion letter. No warranties or guarantees of any kind as to the future treatment of the CCS Token are being made herein.