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SEC Chair Blasts Lawyers Over 'Disturbing' ICOs

By **JEFF JOHN ROBERTS** January 23, 2018

Securities and Exchange Commission Chairman Jay Clayton delivered a remarkable rebuke on Monday to attorneys who have helped arrange so-called “initial coin offerings” (ICOs), which are a novel and controversial form of fundraising that involves the sale of digital tokens.

Speaking at a legal gathering in San Diego, Clayton warned that some attorneys advising companies on ICOs are breaching their professional duties, and even implied that they might be the target of disciplinary actions themselves.

His words come amid a broader crackdown by the SEC on ICOs, which took off as an alternative form of fundraising last year. The process has allowed numerous companies to raise tens or even hundreds of millions of dollars, even though many of them lacked a product or a cohesive business plan.

When a company uses an ICO to sell a digital token (typically by means of bitcoin or another digital currency), it is basically promising the buyer a way to get access to a computer network. The token—much like a subway token—allows the buyer to get access to a service even if, as is the case with many ICOs, that service hasn’t been built yet.

The problem in the eyes of regulators, however, is that most people appear to be treating the ICO tokens as a speculative investment and not as a real world service. In the worst cases, it’s as if a startup sold advance tickets to a to-be-built subway even though it was unclear when or if the subway would even get built.

While the SEC has issued a number of warning shots over ICOs, and filed charges against several companies, this appears to be the first time Chairman Clayton has singled out the lawyers who helped facilitate the ICOs. In effect, he said some lawyers are colluding with companies to sell securities without a license.

Here are some of his remarks, which include a comment calling the phenomenon "disturbing" (my emphasis):

> *Legal advice (or in the cases I will cite, the lack thereof) surrounding ICOs helps illustrate this point. ...* ***First, and most disturbing to me, there are ICOs where the lawyers involved appear to be, on the one hand, assisting promoters in structuring offerings of products that have many of the key features of a securities offering, but call it an "ICO," which sounds pretty close to an "IPO****." On the other hand, those lawyers claim the products are not securities, and the promoters proceed without compliance with the securities laws...*
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> *Second are ICOs where the lawyers appear to have taken a step back from the key issues – including whether the "coin" is a security and whether the offering qualifies for an exemption from registration – even in circumstances where registration would likely be warranted.* ***These lawyers appear to provide the "it depends" equivocal advice, rather than counseling their clients that the product they are promoting likely is a security.*** *Their clients then proceed with the ICO without complying with the securities laws because those clients are willing to take the risk.*
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> *With respect to these two scenarios,* ***I have instructed the SEC staff to be on high alert for approaches to ICOs that may be contrary to the spirit of our securities laws*** *and the professional obligations of the U.S. securities bar.*

The remarks drew attention from lawyers across the country, including on Twitter. According to Nick Morgan, a partner at Paul Hastings in Los Angeles, Clayton's comments were serious but not surprising.

"His focus is not surprising in light of his comment last November that he has yet to see an ICO that doesn't have "sufficient indicia" of being a securities offering," said

Morgan.

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Meanwhile, the comments set off chatter about which lawyers, in particular, the SEC might have set its sights upon. Clayton did not name anyone in particular, though it is possible his targets might include those who have put forth an aggressive legal framework—known as a SAFT—that purports to put clients on the right side of the law by distinguishing between "utility" tokens and those for speculation.

Whatever his intentions, some think that some attorneys might be facing disciplinary action from the SEC before long.

"His statement that the SEC staff is on 'high alert' for ICOs that are contrary to the spirit of securities laws and 'the professional obligations of the U.S. securities bar' suggests that we may soon see enforcement actions not just against ICO sponsors but also their attorneys," says Robert Crea, a CFA charterholder and an attorney at K&L Gates.

Meanwhile, Clayton also took aim at the trend of public companies rebranding themselves "blockchain" firms, which in the case of Kodak, has led their share price to soar. In his remarks, he mocked the idea of companies renaming themselves as something like "Blockchain-R-Us":

> *I doubt anyone in this audience thinks it would be acceptable for a public company with no meaningful track record in pursuing the commercialization of distributed ledger or blockchain technology to (1) start to dabble in blockchain activities, (2) change its name to something like "Blockchain-R-Us," and (3) immediately offer securities, without providing adequate disclosure to Main Street investors about those changes and the risks involved. The SEC is looking closely at the disclosures of public companies that shift their business models to capitalize on the perceived promise of distributed ledger technology and whether the disclosures comply with the securities laws, particularly in the case of an offering.*

Clayton's remarks came as part of a larger event in which lawyers gathered to discuss trends in securities law and litigation.