**Position Paper: The Patreos Airdrop should not be Regulated as Distribution of a Security**

The extent to which the federal securities laws apply to cryptoassets and transactions has obviously been something that the SEC’s has been considering for some time. In 2017, the SEC published a report dealing with its conclusions in the context of The DAO. SEC, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO,’34 Act Release No. 81207 (July 25, 2017) [archived at <https://perma.cc/F862-YS5V>]

In that report, the SEC took the position that cryptoassets should be evaluated as investment contracts under the rules set out by the U.S. Supreme Court in SEC v. W.J. Howey Co., 328 U.S. 293 (1946). The conclusion of that report was that under the traditional *Howey* investment contract test, crypto should often be regarded and regulated as a security. The SEC focused on the particular facts and circumstances surrounding The DAO, and concluded that based on longstanding principles, the proposed DAO tokens were indeed investment contracts, and therefore securities.

As explained in *Howey*, an investment contract is a contract, transaction or scheme where purchasers are "led to invest money in a common enterprise with the expectation that they would earn a profit solely through the efforts of the promoter or of someone other than themselves." 328 U.S. at 298. This test, now widely referred to simply as the *Howey* test, has been substantially expanded and clarified over the past decades, but it continues to provide the basis for determining when an interest qualifies as an investment contract.

Speaking very broadly, an interest will be classified as an investment contract under *Howey* if it satisfies **all** of the following elements:

(i) there is an investment of money (or something else of value);

(ii) in a common enterprise;

(iii) where the purchaser expects to receive profits; and

(iv) the expectation of profits is from the essential entrepreneurial efforts of others.

With regard to the Patreos airdrop, it is the first of these elements that is missing.

In order to understand this claim, it is obviously important to understand the “airdrop” that took place. Airdrop is not a regulatory term of art, and instead is a phrase that has come to be used in the crypto-community to mean “the process whereby a cryptocurrency enterprise distributes cryptocurrency tokens to the wallets of some users free of charge.”[[1]](#footnote-1) The critical component of this definition and this process is that the distribution of coins or tokens is essentially free to the recipient.

It is also worth noting that not everything that is called an “airdrop” is in fact completely free. For example, while noting that crypto airdrops generally refer to a distribution of “free tokens,” one source also explains that “[t]o qualify for this free gift, one may need to perform certain tasks that include posting on social media forums, connecting with a particular member of the blockchain project, or writing a blog post.”[[2]](#footnote-2) There is even terminology to distinguish between a truly “free” airdrop and one that requires specific protocols to be followed. An “automatic airdrop” does not require the recipient to do anything other than hold a suitable, active wallet. A “manual” airdrop is one where specific requirements are imposed in the protocol devised by the project developers.[[3]](#footnote-3) Alternative nomenclature sometimes refers to programs that require more substantial efforts from recipients as “bounty programs,” rather than airdrops. Usually these require completion of specific tasks or jobs, such as creation of new graphics, translations, marketing and promotion for the project, or writing content.[[4]](#footnote-4)

The Patreos airdrop was a truly free, automatic airdrop. Recipients were not required to opt in, did not need to register, did not have to join any social media groups, and in fact did not have to do anything that they were not already doing. Recipients were persons who already owned EOS tokens and therefore had a wallet capable of holding tokens produced on that blockchain (such as the Patreos token). That is it. Nothing else.

This can be distinguished from all the other instances where something similar was determined to involve a security. For example, in 1999 the SEC concluded giveaways of stock still involved the distribution of securities back in 1999.[[5]](#footnote-5) However, the Supreme Court held in Landreth Timber Co. v. Landreth, 471 U.S. 681 (1985) that stock that has the ordinary attributes of stock is always to be treated as a security; there is no requirement that the stock be exchanged for money or something of value. This is different from the *Howey* investment contract analysis, which among other things looks specifically at whether there is an investment of money or something else of value.

Patreos is also aware that on August 14, 2018, the SEC issued a cease and desist order (the “Tomahawk Order”) against a company and its founder for actions in connection with an ICO of cryptoassets called “Tomahawkcoins” or “TOM.”[[6]](#footnote-6) In the Tomahawk Order,[[7]](#footnote-7) the SEC found that the issuer’s “Bounty Program” constituted an offer and sale of securities because the company “provided TOM to investors in exchange for services designed to advance Tomahawk’s economic interests and foster a trading market for its securities.”[[8]](#footnote-8) The lack of payment did not prevent the distribution from involving securities, because the company “received value in exchange for the bounty distributions, in the form of online marketing….”[[9]](#footnote-9) It is really worth emphasizing that Tomohawk program was not an airdrop, was not called an airdrop (even the company categorizing it as a bounty program), and required a significant degree in order to participate. In addition, the determination by the SEC was not confirmed by any court, since Tomohawk settled the proceedings.

Certainly, U.S. law on airdrops is unclear, and no formal pronouncements have been made by the SEC. But the Patreos distribution did not even come close to the line articulated in *Howey.* Nothing of value was required to be contributed, and no effort was required.

1. Katalyse.io, Mission.Org, *What are “Airdrops” in Crypto World?* Medium (Feb 15, 2018) [archived at <https://perma.cc/DCN8-TB8E>] (this same source also notes that established blockchain-based enterprises such as trading platforms or wallet services can conduct airdrops as well.) [↑](#footnote-ref-1)
2. CoinBundle Team, *What Are Airdrops,* Medium (Sept. 14, 2018) [archived at <https://perma.cc/U5SE-TUPJ>]. [↑](#footnote-ref-2)
3. *See* Marko Vidrih, *Airdrops — What exactly is an Airdrop?,* Medium (Jun. 12, 2018) [archived at <https://perma.cc/8WM9-7YA6>]. [↑](#footnote-ref-3)
4. *See generally* Winco, *What is the difference between Faucets, Airdrops, and Bounties?,* Good Audience Blog (Oct. 10, 2018) [archived at <https://perma.cc/V6WP-SZ68>]. [↑](#footnote-ref-4)
5. *See* Brady Dale, *So Long ICOs, Hello Airdrops: The Free Token Giveaway Craze Is Here*, CoinDesk (Updated Mar. 17, 2018) [archived at https://perma.cc/H2DU-7RDN]. citing Todd Kornfeld, counsel at the Pepper Hamilton LLP law firm, as expressing concern based on SEC actions from 1999 that targeted giveaways of free equity interests. [↑](#footnote-ref-5)
6. U.S. SEC, Press Release, *SEC Bars Perpetrator of Initial Coin Offering Fraud*, 2018-152 (Aug. 14, 2018) [archived at <https://perma.cc/G2G2-3N2P>]. [↑](#footnote-ref-6)
7. A copy of the Tomahawk Cease and Desist Order is archived at <https://perma.cc/3ZGB-BD79> . [↑](#footnote-ref-7)
8. The specific things for which “bounties” were offered included things such as “as making requests to list TOM on token trading platforms, promoting TOM on blogs and other online forums like Twitter or Facebook, and creating professional picture file designs, YouTube videos or other promotional materials.” Tomahawk Order, *supra* note 28 at ¶ 21. [↑](#footnote-ref-8)
9. *Id.* at ¶ 34. [↑](#footnote-ref-9)