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First ICO Registration Statement Filed with the SEC Raises More Questions Than Answers

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On March 6, 2018, The Praetorian Group filed with the U.S. Securities and Exchange Commission (SEC) what is reported to be the first Registration Statement covering an initial coin offering, or ICO. The registration statement can be found here: Praetorian Group Form S-1. In the Registration Statement, Praetorian purports to be a "Cryptocurrency Real Estate Investment Vehicle (C.R.E.I.V.) for the sole purpose of acquiring and upgrading residential and commercial real estate properties that are either undervalued and/or located in blighted areas that with proper execution [it] believe[s] can become profitable real estate holdings."

Praetorian seeks to register 15 million PAX tokens, at $5 per token, in order to raise $75 million. As the company intends to create a total of 200 million PAX tokens, Praetorian's implied value based on its proposed ICO price is $1 billion. Note that the company was only formed in November 2017 and appears to have no revenue and little to no assets. The offering is not underwritten, and no investment bankers, law firms or auditors are listed in the prospectus.

In the Registration Statement, Praetorian acknowledges the uncertainties regarding the SEC's view as to whether or not cryptocurrencies or "tokens" constitute "securities" under the federal securities laws, and states that, to its knowledge, the SEC has yet to issue a "formal opinion and/or regulation" in this regard. As part of its "do it yourself" analysis, Praetorian states its belief that "it is more prudent to register the offering with the SEC to avoid any unanticipated regulatory issues with the SEC and/or other regulatory agencies."

Indeed, the SEC has indicated in public statements and enforcement orders that some, if not most, cryptocurrencies or tokens have characteristics of a "security" under the test of an "investment contract" announced by the U.S. Supreme Court in its 1946 ruling in SEC v. W.J. Howey Co.

Unfortunately, the Praetorian Registration Statement and the White Paper "prospectus" it includes appear not to conform to many of the SEC's registration requirements. Although three of Praetorian's executive officers purport to be attorneys, the Registration Statement does not appear to have been prepared with the advice of experienced securities counsel, and it remains to be seen how the SEC Staff will respond to the filing. It is possible that the Staff will conclude that the filing is so deficient that the Staff will not comment on the filing. Given the regulatory uncertainty, however, perhaps the Staff will see fit to provide further public guidance in response to the filing.

The Praetorian ICO Registration Statement comes on the heels of the SEC's shutdown of Munchee Inc.'s ICO in November 2017 (See SEC Release No. 10445/December 11, 2017). Munchee operates a "blockchain meets Yelp" restaurant review site. It intended to raise $15 million in an ICO. But within a day after Munchee's initial marketing period, the SEC ordered the company to stop selling its tokens and return some $60,000 in proceeds to purchasers. In doing so, the SEC found that Munchee's tokens constituted "security" tokens as the company had, among other things, primed purchasers' reasonable expectations of profit through statements on blogs, podcasts, and Facebook like "as more users get on the platform, the more valuable your MUN tokens become."

As with Praetorian, Munchee appears to have conducted a legal analysis regarding the character of its tokens without the actual assistance of experienced securities lawyers. Munchee stated in its White Paper that it had done a "Howey" analysis and concluded that "as currently designed, the sale of MUN utility tokens does not pose a significant risk of implicating federal securities laws."

The Praetorian and Munchee examples highlight the significant need to consult experienced counsel prior to conducting an ICO, particularly given the uncertain regulatory status of ICOs and cryptocurrencies generally. Failure to do so could cause the Staff to not only halt an issuer's ICO, but also order the return of all proceeds to investors or pursue civil and other penalties. Equally unwanted is the potential negative press that could ensue. In the end, Munchee raised no funds from its attempted ICO, but instead garnered an enormous amount of unwanted and negative press. As of the date of this report, it remains unclear whether Munchee continues to operate, much less whether it has since raised funds, as its website no longer appears functional and it has gone silent on social media since the day of its ICO shutdown. This illustrates that do-it-yourself ICO issuers should proceed with caution.

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