

Legal Assessment

GET Token and Howey Test

Stichting GET Foundation

8 January 2018

1 Introduction

- 1.1 We have been asked to assess whether Guaranteed Entrance Tokens (**GET**) offered (for exchange) by Stichting GET Foundation (**GET Foundation**), a foundation incorporated under Dutch law, are likely or unlikely to be deemed an investment contract as defined under the United States Securities Act of 1933, § 2(a)(1), 15 U.S.C. § 77(b)(1) and Securities Exchange Act of 1934, § 3(a)(10), 15 U.S.C. § 78c(a)(10) (**Investment Contract**) upon application of the so-called "Howey test" formulated by the United States Supreme Court in SEC v. W.J. Howey Co., 328 U.S. 293 (1946) (**Howey**) and further case law, in particular United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975) (**Forman**).

2 Framework for our assessment

- 2.1 According to the test formulated in Howey, a scheme is an Investment Contract if it involves an (i) investment of money (ii) in a common enterprise (iii) with profits to come solely from the efforts of others. The prongs were further clarified/refined in subsequent case law, which, to the extent required, we will elaborate on below when we apply the facts to this framework.

3 Facts

- 3.1 The GET Foundation has provided us with the following explanation of the characteristics, functionalities and use of GET and the way and to whom it was offered:
- a) The GET Foundation will further develop a blockchain based protocol (**GET Protocol**) that up until recently was developed by GUTS International B.V. (a Dutch limited liability company).
 - b) The GET Protocol allows organizers of events to sell tickets via the blockchain. The GET Protocol also allows consumers who have purchased tickets to sell tickets to other consumers via the blockchain.
 - c) Guaranteed Entrance Tokens (GET) are ERC20 tokens that were minted by the GET Foundation.
 - d) For the GET Protocol to function, usage of GET is requisite. Every interaction with the GET Protocol requires GET (the GET Protocol requires **fuel** or needs to be **fueled**). GET are required for event organisers/ticketing companies and ticket owners to use and interact with the GET Protocol, meaning that certain amounts of GET need to be transferred between users of the GET Protocol and the GET Foundation in order to create events, (re)sell tickets and validate the authenticity of a ticket. GET are also required for every other interaction with the GET Protocol by ticketowners.
 - e) The cost for an event organizer/ticketing company to sell tickets via the GET Protocol is about €0,50 per ticket. That amount needs to be obtained in GET so the GET Protocol can be fueled. An algorithm (**Event Value Algorithm**) determines how much GET is required by establishing the average exchange rate against Ethereum (**Ether**) at certain exchanges over an average period and the exchange rate of Ether against euro at certain exchanges over an average period. If the Event Value Algorithm finds that the value of a GET is less than €0,50 in Ether, the exchange rate will be set at one GET against an amount of Ether equalling a value of €0,50.
 - f) To the extent that event organizers/ticketing companies do not have (sufficient) GET, the GET Protocol, on behalf of the event organizer/ticketing company, will offer on certain

exchanges, publicly and indiscriminately, to exchange the required amount of GET against Ether against the exchange rate determined by the Event Value Algorithm. As described above, the exchange offered rate will not be lower than an amount of Ether equalling €0,50 for each GET. The latter has been communicated as the **Guaranteed Exchange Rate**.

- g) The GET Foundation communicated that it would like to add functionalities to GET in the future, such as allowing owners of GET to use GET to purchase beverages and merchandise at venues, however clearly adding that it is highly uncertain whether such will be made available at all, inter alia, because of regulatory constraints.
- h) GET were offered in exchange for Ether to various persons, including event organisers/ticketing companies in a so-called private exchange between @ 2017 and @ 2017. GET were offered in exchange for Ether to the general public in a so-called public exchange (the **Exchange** during the **Exchange Period**). The exchange rate for GET against Ether, the latter denominated in euro against Ether, during the Exchange Period was invariably less than €0,50 for each GET.
- i) Ether obtained by the GET Foundation will be used to fund further development and operation of the GET Protocol.
- j) The Exchange was not marketed by or on behalf of the GET Foundation as an investment that could result in a profit. Communication revolved around functionality of GET.

3.2 We have reviewed the exchange agreement (version for the public and private exchange varied slightly) that was entered into between the GET Foundation and each of its counterparties during the Exchange Period. We also reviewed white paper prepared by the GET Foundation. On the basis of that review, we find that the explanation by the GET Foundation provided to us is materially correct. Our additional observations will be set out below.

4 **Application of the facts to the framework**

4.1 Investment of money: This prong of the test is met because GET were exchanged for Ether.

4.2 Common Enterprise: U.S. Circuit Courts apply different standards for this second prong. The Supreme Court has not clarified which standard is to be applied. It is therefore difficult to assess whether this prong is met. Below we will assess the three standards currently applied.

4.2.1 *Horizontal commonality* is characterised by a pooling of assets with distribution of profits and losses on a pro-rata basis among investors. Arguably the Exchange resulted in a pooling of assets. To the extent event organizers/ticket companies do not have GET to fuel the GET Protocol, the GET Protocol will, on behalf of such event organizers/ticket companies, offer to exchange GET against at least the Guaranteed Exchange Rate. This, however, in our opinion does not constitute an obligation to distribute profits on a pro rata basis, let alone on a continuous basis. Moreover, exchanging GET is an alternative to actually using GET to use interact with the GET Protocol. So if “distribution of profits and losses on a pro-rata basis among investors” is to be interpreted strictly, arguably this standard is not met. If a less strict interpretation would be applicable, the standard in our opinion is met if the standard of the third prong (“profits derived solely from the efforts of others”) discussed below is met.

4.2.2 *Broad vertical commonality* is deemed to exist if the investors are dependent upon the expertise or efforts of the investment promoter for their returns. This standard (again) implies that the standard of the third prong is satisfied. If that third prong is satisfied, this standard under this second prong is likely to be met. We note that this standard in our understanding is not accepted by most courts.

4.2.3 *Narrow vertical commonality* is less widely accepted by courts than *horizontal commonality*, but more than *broad vertical commonality* and is deemed to exist if the promoter and the investor are both exposed to risk and the profits and losses of investor and promoter are correlated. The most important difference to the horizontal commonality is that funds of investors need not be pooled and therefore pro rata distribution of profits between investors is not required. Given the nature of this difference, and taking into account that in our opinion the Exchange entails pooling of assets, our assessment for horizontal commonality also applies to narrow vertical commonality.

4.3 Profits derived solely from the efforts of others: The test for the third prong was further clarified in subsequent case law, notably in Forman:

The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. By profits, the Court has meant either capital appreciation resulting from the development of the initial investment, as in Joiner, supra (sale of oil leases conditioned on promoters' agreement to drill exploratory well), or a participation in earnings resulting from the use of investors' funds, as in Tcherepnin v. Knight, supra (dividends on the investment based on savings and loan association's profits). In such cases the investor is "attracted solely by the prospects of a return" on his investment. Howey, supra, at 300, 66 S.Ct., at 1103. By contrast, when a purchaser is motivated by a desire to use or consume the item purchased – "to occupy the land or to develop it themselves," as the Howey Court put it, ibid. – the securities laws do not apply.

- 4.4 We understand this reasoning as a clarification of the "profit derived solely from the efforts of others" prong with the effect that in order to qualify as an Investment Contract, the person to whom an offer is made to enter into a contract does so solely because of the prospect of a return (a profit, which is to be defined broadly, and may be variable or fixed returns). Conversely, when the person to whom the offer is made, accepts it because that person wants to use or consume the product offered, it is not a security.
- 4.5 Under the assumption that in order to qualify as Investment Contract, investors need to be attracted solely by the prospect of a return, GET would not meet the standard of this prong as GET can be used and consumed by any person that obtained GET during the Exchange Period: it is required to use and interact with the GET Protocol. The GET Foundation in offering GET predominantly also marketed it on the basis of these functionalities.
- 4.6 Should the standard be less binary, by which we mean that investors need to be attracted mainly or predominantly but not solely by the prospect of a return, the test in our opinion revolves around the expectations that were raised by the GET Foundation, and if indeed expectations of profit were raised, whether one can reasonably conclude that such expectations were an important or predominant reason for person to perform the Exchange.
- 4.7 In that respect we find that:
- 4.7.1 The GET Foundation did not promise or suggest that GET would increase in value over time. There are no clear characteristics of GET or the GET Protocol on the basis of which a value increase can be expected, perhaps except for the Guaranteed Exchange Rate.
- 4.7.2 The GET Foundation did not promise, suggest or agree that it itself would facilitate secondary trading between owners of GET. The prospect of secondary trading could, however, be implicitly inferred from the stated intention of the GET Foundation to base the Event Value Algorithm on exchange rates for GET found on exchange platforms.
- 4.7.3 The GET Foundation did promise that if the GET Protocol would offer to exchange GET against Ether on behalf of event organizers/ticketing companies, it would do so against at least the Guaranteed Exchange Rate. The GET Foundation did, however, explicitly communicate that it is under no obligation to actually exchange back GET. At the start of the Exchange Period, the Guaranteed Exchange Rate was more favourable than the exchange rate offered by the GET Foundation, which arguably meant that one could expect to profit from entering into the Exchange with the GET Foundation. But during the Exchange Period the value of Ether appreciated sharply and to such an extent that the Guaranteed Exchange Rate became less favourable than the exchange rate offered during the Exchange Period. Accordingly, one could not expect to profit from entering into the Exchange with the GET Foundation anymore. Nonetheless, up until the end of the Exchange Period persons continued to exchange Ether for GET.
- 4.7.4 The GET Foundation did not market the Guaranteed Exchange Rate as the primary reason to enter into the Exchange. The GET Foundation predominantly communicated how the GET Protocol would work, the utility of GET in the GET Protocol and how users interact with the GET Protocol using GET.
- 4.7.5 The GET Foundation did not promise or agree to add additional functionalities to GET.
- 4.8 On the basis of a weighing of the factors above, we are of the opinion that the GET Foundation did not raise expectations of profits, save perhaps for the Guaranteed Exchange Rate. In our opinion, however, even if the Guaranteed Exchange Rate raised such expectations, one cannot

reasonably conclude that such an expectation was an important or predominant reason for persons to perform the Exchange. We in particular find support in that conclusion because of the fact that persons continued to exchange Ether for GET even when the Guaranteed Exchange Rate became less favourable than the exchange rate during the Exchange Period.

- 4.9 Accordingly, we do not need to address whether the such profits are derived from the entrepreneurial or managerial efforts of others.

5 Conclusion

- 5.1 Whether GET are Investment Contracts as per the Howey Test in our opinion hinges on the expectations raised by the GET Foundation when offering to exchange Ether against GET during the Exchange Period as GET do not confer upon its owner any contractual or legal right to any profit. GET are primarily functional/utility tokens.

- 5.2 We find that GET have been offered primarily as such. It could, however, be argued that the Guaranteed Exchange Rate, although not being a focal point of the marketing efforts of the GET Foundation, did raise an expectation of profit. But the fact that persons still performed the Exchange even after the Guaranteed Exchange Rate became less favourable than the exchange rate during the Exchange Period, in our view is convincing evidence that the Guaranteed Exchange Rate was not an important reasons for person to enter into Exchange.

- 5.3 On the basis of the above, we find that it is probable that a court will conclude that GET are not an Investment Contract. Put differently, a proper case can be made against a claim by the SEC that GET are indeed a Investment Contract.

6 About this assessment

- 6.1 The above analysis is based on information obtained from representatives of the GET Foundation, its whitepaper, the terms applicable to the exchange of Ether to GET, and the United States Securities Act of 1933 and Securities Exchange Act of 1934 as it exists as of the date hereof. No opinion is expressed with regard to any other body of law or legal construct, including without limitation the franchise laws of any US state. No court has addressed the question of whether any blockchain tokens are “securities” under federal law. As such, the SEC or a court of competent jurisdiction may reach an alternative conclusion to that stated in this assessment. Accordingly, no warranties, representations or guarantees of any kind as to the future treatment of GET or similar tokens are being made herein, by us, De Roos Advocaten Coöperatief U.A., a Dutch law firm, meaning that (i) no reader can rely on this assessment providing legal certainty and that (ii) any reader acknowledges that we cannot be held liable if a court or administrative body would come to a different conclusion as contained in this assessment.
