

Civil Liability for Initial Coin Offerings: Tokens Offered in ICOs May Constitute "Securities" Under the Louisiana Securities Law

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03.29.2019

With the recent rise in popularity of cryptocurrencies, a relatively new method for private companies to raise capital has emerged — Initial Coin Offerings ("ICOs"). ICOs, which are often referred to as "token offerings," involve the creation of a digital asset for public sale. Some of the tokens offered for sale provide access to products or services, while others serve as investment vehicles and are constructed like shares in an investment fund.

ICOs frequently share many similarities with Initial Public Offerings ("IPOs"), but they often attempt, sometimes impermissibly, to avoid traditional capital markets and applicable regulations. Experts characterize this use of ICOs as a hybrid form of funding that lies somewhere between a traditional IPO and a fundraising campaign.

Companies initiating ICOs should carefully consider whether the coin or token offered for sale constitutes a "security" as defined under applicable law and regulations. If the coin is a security, the ICO will be subject to the regulations of the Securities and Exchange Commission ("SEC") and state counterparts, failure to comply with which may result in criminal penalties. But such regulation is only one potential implication of conducting an ICO, and companies often overlook the potential for civil liability.

In Louisiana, if the coin offered constitutes a security, the ICO may expose the offering company to civil liability under the Louisiana Securities Law. A private right of action is supplied to Louisiana investors by Louisiana Revised Statutes § 51:712(A)(2) and 51:714.

First, Section 51:712(A)(2) prohibits certain conduct when selling a security. It provides:

It shall be unlawful for any person to offer to sell or to sell **a security** by means of any oral or written untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, the buyer not knowing of the untruth or omission, if such person in the exercise of reasonable care could not have known of the untruth or omission.

Section 51:714 imposes civil liability on "[a]ny person who violates R.S. 51:712(A)."

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Reading these statutes together, the first element necessary to establish a private cause of action is the offer to sell or the sale of a "security." If the coin or token offered in an ICO fits within the definition of security, the company may be subject to civil liability when the other elements of § 712(A)(2) are satisfied.

Louisiana's lengthy definition of security, as outlined in Louisiana Revised Statute § 51:702(15)(a), includes items such as notes, stocks, bonds, and investment contracts. While ICO tokens are not traditional notes, stocks, or bonds, tokens may constitute investment contracts in certain situations.

An investment contract is a contract, transaction, or scheme whereby a person invests money in a common enterprise and is led to expect profits resulting from the significant efforts of a promoter or third party. See *Cooper v, Primary Care Solutions, Inc.*, No. 16-259, 2017 U.S. Dist. LEXIS 40308, at *25-26 (M.D. La. Mar. 21, 2017). Each ICO should be carefully analyzed to determine whether the particular offering fits within this definition. While there is no Louisiana jurisprudence analyzing this issue, both the SEC and federal district courts, applying corresponding federal law, have ruled that certain ICOs constituted sales of securities because they fit within the investment-contract definition.

If an ICO is considered a sale of a security under § 51:712(A)(2), the offering company generally must abide by applicable regulations and be cognizant of the exposure to civil liability for the unlawful sale of a security under Sections 712(A)(2) and 714.

For the above reasons, companies considering an ICO should consult an expert to analyze whether the coin to be sold is a security and determine what steps should be taken to comply with applicable laws and regulations.