



**LEGAL OPINION**  
**THE PROJECT: CARGOCOIN ICO**

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Albrecht & Vitte Ltd.

#### **I. Introduction, Background and Nature of Blockchain Tokens**

ICO represents a new way of crowd funding that allows promoters to accumulate certain amount of funds for developing and enhancing blockchain start up projects. For example, in consideration of funds received from purchasers, the latter obtains tokens that may be used in numerous ways depending on the specific nature of ICO projects.

There are many types of blockchain tokens, each with its own characteristics. For example, one type of blockchain tokens may be used to support functioning of an application designed for it. That is utility token. In contrast with other types of tokens, which do not have any assets of any kind underlying them and which value is based purely on mass psychology, the utility token has an underlying contractual right. And in this sense its value is determined not only by mass psychology but also by the value of the underlying right attached to it.

Another type of tokens may be utilized as a virtual (digital) currency (protocol token) that serves as a certain medium of exchange not only within the specific blockchain platform but also beyond that. To put it simply, this token is called protocol token because what makes it special is the new or different protocol it uses. Its underlying blockchain serves nothing more than keeping a ledger of transactions between token holders.

Finally, security token. That is a digital asset, the purchase of which vests the owner with a number of rights which are similar to securities such as bonds or stocks.

An inherent feature of any token is to be tradable on a “secondary market” of tokens on a cryptocurrency exchange market. That is to say, a token is free for sale and once it has been issued, a token is subject to market speculations according to the rules of supply and demand.

However, there are a number of complicated legal issues concerning tokens since some of them may fall under the definition of security instrument and, therefore, be subject to US federal or state securities laws. This means that sale of such tokens may be unlawful for US residents.

In many jurisdictions, there may also be issues related to anti-money laundering laws and general consumer protection laws as well as to specific laws depending on the token type.

Based on our analysis of the current case law, regulations of the competent governmental institutions in different parts of the world, including such agencies as SEC (Security and Exchange Commission) or CFTC (Commodity Futures Trading Commission), MAS (Monetary Authority of Singapore), ECB (European Central Bank) as well as based on various facts and materials derived from a plethora of ICOs conducted in different parts of

the world, we come to the conclusion that the appropriately designed token may not entail risks of being recognized as an investment instrument.

Nevertheless, it has to be clearly understood that we cannot provide a thorough review aimed at checking the compliance with the regulatory regime of each jurisdiction. Hence, in this legal opinion we will focus on the United States security law.

This memorandum is devoted to examination of a token (hereinafter - “**Token**” or “**CargoCoin**”) issued by Cargo Technologies Limited according to the token sale terms posted on the website <https://thecargocoin.com/> (hereinafter also “**Founders**” or “**Owners**”) to develop its product (hereinafter “**Platform**” or “**Ecosystem**” or “**CargoCoin Platform**”) with regard to its risks of being considered as an investment instrument.

In Section I, we introduce to you a general concept of ICO and blockchain token. Section II describes a security law framework for blockchain tokens in light of SEC Report. In Section III, we analyze whether Token meets the Howey Test, and then, in Section IV, we sum up whether Tokens fall under the definition of security instruments or not.

It should be noticed that the legal analysis herein may be updated in the future as the law in this area continues to develop. Furthermore, the below analysis is strictly theoretical, as no cases, that we are aware of and that are relevant to the subject matter, have been tested yet in courts as of today.

## **II Security Law Framework for Blockchain Tokens in Light of SEC Report**

In re SEC v C.M. Joiner Leasing Corp., 320 U.S.344, 351 (1943) it is established that

*"The reach of the Securities Act does not stop with the obvious and commonplace. Novel, uncommon, or regular devices, whatever they appear to be, are also reached if it be proved as a matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as "investment contract", or any interest or instrument commonly known as security."*

The same was held in Reves v. Ernst and Young, 494 U.S. 56, 61 (1990):

*"Congress purpose in enacting the securities laws was to regulate investments, in whatever form they are made and whatever name they are called"*.

The U.S. Securities and Exchange Commission adheres to this position and declares that any new forms of investments via smart contracts or blockchain technology fall under the purview of US federal securities laws and on July 25, 2017, it issued a Section 21(a) investigative report, Release No. 81207 (“the Report”) on investigation of DAO case. Among others, the Report distinguishes ICOs where tokens represent securities as described above.

Hence, in this analysis we shall investigate and provide our legal opinion as to whether CargoCoin ICO is the type of crowd funding that triggers prospectus requirements and any of security laws provisions of the United States.

## **III. Security Law Analysis for CargoCoin ICO and Its Token**

A. Understanding the model of Project’s work will help us to understand the nature of CargoCoin. Therefore, we start with the fact-based part of the analysis of this Legal Opinion with an attempt to delve into the matter of global trade and transportation business

in a physical world comprehending the difficulties the shippers, carriers, cosigners and many other players of this market are trying to overcome, and try to reveal solutions the Platform itself suggests in the WP.

For the purpose of this analysis, we have examined the White Paper (hereinafter the “WP”) of CargoCoin ICO, its Onepager, watched video presentations posted on <https://CargoCoin.token.io/en> and numerous ICO reviews on YouTube, studied and scrutinized marketing content available on ICO channels on the Web and on YouTube and revealed the following.

We prelude our analysis from the point of the business difficulties. In the White Paper Founders narrate that conventional framework of trade and transportation market are very conservative where players of the market are reluctant to adopt new technologies and in many instances still continue exchanging paper documentation including shipment contracts, bill of lading or letter of credits. As a result, due to huge volume of paperwork execution of a deal takes too much time and causes considerable delays.

*"Although the shipping industry is one of the largest economic sectors it is the least technologically advanced one. Today paper documents are issued for all shipped cargoes, no matter of the transport means. All original documents are being sent by couriers, taking time and money."*

Founders note that huge paper workload is only one side of the coin. Paper storage of the data including personal (sensitive) data is very insecure and that is a big concern considering new policies of European Union to data processing (General Data Protection Rules).

*"The logistics industry suffers from great losses caused by the use of old fashioned paper documents, such as Bill of Lading, Letter of Credit, CMR, Airway Bill. Paper documents need to be physically transported around the world as they are the title of ownership"*

Inherent problems of the industry are hidden not only in the old fashioned way of communications between the counterparts but also in the choice of traditional means of payments with fiduciary money and via credit institutions. Wire transfers are often subject to scrupulous analysis by the banks and may be suspended at the sole discretion by the financial institution.

*"All cargoes and freights are being paid for in traditional ways - via bank wire transfers or letter of credit. Those are expensive, slow and nonconfidential methods. Increasingly more often USD and EUR transactions are being blocked for weeks by US correspondent banks."*

*"The logistics industry suffers from great losses caused by the use of old fashioned paper documents, such as Bill of Lading, Letter of Credit, CMR, Airway Bill. Paper documents need to be physically transported around the world as they are the title of ownership"*

Founders admit in the White Paper that bank account of a consignee (for instance) may be frozen for further investigation and as a result the latter will not be able to fulfill its contractual obligations. Besides that, Founders state that market players suffer from the lack of trust and high percentage of fraud in the field tends to increase every year.



*"Global Economic Crime Survey in 2014 calculated that the fraud in the transport & logistics sector is up at 34%, steadily increasing each year. Such high rate of fraud accounts to additional high costs."*

*"Parties do not trust each other and often rely on recommendations or limit their business activities to a circle of proven business partners or associate members, limiting their scope of doing business"*

The Founders continue to list challenges faced by the trade and transportation economy, raising the issues of unexploited cargo ships that are idling whereas owners incur losses.

*"Empirical research shows that 25% of its lifespan cargo ships are just idling. Each idling day of a cargo ship costs as little as 10,000 USD, up to 150,000 USD, depending on the vessel size."*

Founders manifested in the White Paper to discover the way to address all the above mentioned issues introducing the Platform with unique ecosystem and features called to attract all participants of a transportation industry and to facilitate the trade.

*"Objective is to provide a global marketplace environment and utilities for facilitation of trade, transport, exchange of documents and payment options at low cost in real time. The platform architecture is based on the principles of high level of security, transparency, traceability and accountability."*

Founders step further and proclaim in the White Paper and Onepager to have an algorithm that would allow shippers, carriers, brokers, agents or any trading company to save the time for document processing, reduce the costs of transportation, minimize delays and increase security of operations.

In particular, CargoCoin ICO suggests that exploiting the Platform and CargoCoin (tokens) as a medium of exchange and way of payments within the Ecosystem, users will be able to save on transactional expenditures. What is more, due to a blockchain technology underlying the Platform, all the transactions within the Ecosystem shall be transparent for the contracting parties (holders CargoCoin).

*"Increasing Trust - CargoCoin relies on the public infrastructure of the Ethereum blockchain, backed by thousands of people in a peer-to-peer decentralised infrastructure. Using a proven and trusted technology speaks for itself."*

Further in the White Paper, the Platform reduces risks of frauds implementing smart contracts that triggers legal consequences upon occurrence or non occurrence of a condition precedent.

*"CargoCoin minimises the risk of fraud and in many cases completely eliminates it, by not releasing any payments until the counter parties' pre-set conditions are met & publicly available proof of the payment has been made or secured in a smart escrow utility. Payments will be guaranteed by default. Fraudulent endorsement and duplication of ownership documents is ruled out."*

Founders continue that the Platform ensure fast communication, approval of documents and payment by the parties regardless of the time zone.

*"Minimising Delays - CargoCoin avoids the delays by providing instant exchange, review and approval of documents and payments between the parties involved. Further delays are caused by different time zones, different public holidays, etc. The blockchain is always at work 24/7 and does not depend on human intervention. It is 7 www.thecargocoin.com estimated that payment delays alone cost around \$19 billion per year (\*UNCATD) in losses."*

As opposed to the above-mentioned, Founders proclaim to create an extremely sophisticated Platform that is cost effective and secure for data storage since allows distribution of a stored data in the chain of blocks in the System.

*"CargoCoin is naturally secured. It relies on the blockchain's proven hashing algorithm technology. There is no possibility of sensitive commercial information leakage by intermediaries, such as banks, brokers, agents, etc"*

While we have to move forward, it is necessary to mention that we prepared and introduced here only the core features of the Project that will help us to analyze the CargoCoin for Howey test.

At this point, we start our evaluation with the major participants of the Platform to understand relations between CargoCoin holders and Founders on the one side, and between CargoCoin holders themselves (participants of the Platform) on the other side. Taking this into account, it is fair to declare that relations between CargoCoin holders will eventually determine relations between CargoCoin holders and Project Founders and, as a result, these relations will lead to the final conclusion of this Legal Opinion.

It is difficult to isolate the core participants in the Platform as the marketplace is huge and diversified. All the players are either in search of clients to render services or in search of particular service providers, for example, to arrange shipment. The CargoCoin holders are:

*"Traders, Importers, exporters, charterers - Private Individuals - Freight Forwarders - NVOCC (Non-vessel operated container carriers) - Container lines - Booking Agents - Ship owners / ship managers / ship operators - Ship brokers - Ship agents - Cargo/vessel/transport equipment Insurance companies & brokers - Warehouses / storage facilities - Customs Agents - Independent cargo surveyors / superintendents / port captains etc."*

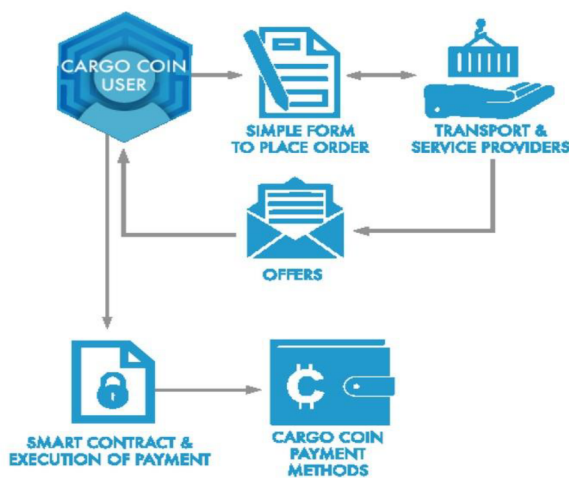
This concept of participants division is very general and we do not have any aim to quote all the potential users of a Platform rather for the purposes of this Legal Opinion to understand relationships between the CargoCoin holders and the CargoCoin and the Platform.

*"The CargoCoin platform target extends globally to any trading company or individual, shipping line, freight forwarder, ship broker and other parties involved in the global trade and transport."*

Platform is another independent player and participant in the CargoCoin Ecosystem that fulfills its own function apart from development and technical support of a Platform. As it follows from the White Paper, Founders serve as a "bridge" that via different services such as "Manning services", "Essential Services" and other described in details in the paragraph 4 (four) of the White Paper.

One of the illustrative examples of services rendering via the Platform is when the user, desiring to arrange shipment of its cargo, submits an order on the Platform and selects appropriate service provider to deliver the freight.

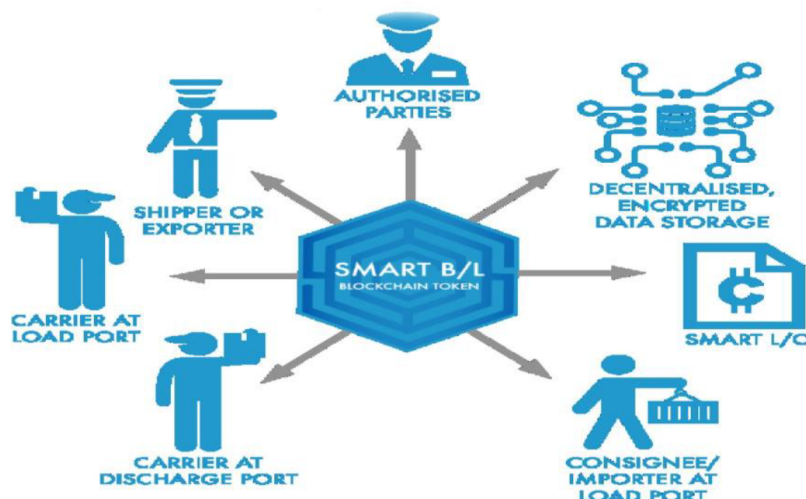
*"Platform users place their cargo order and receive offers and bid from forwarders, booking agents, NVOCCs, container lines, etc. The order goes to subscribed participants, smartly selected, by region, by past destination coverage etc. NVOCC, Freight forwarders, Booking Agents, Container lines.*



E.g. an importer needs a shipping quote in order to facilitate trade. They fill in simple form:

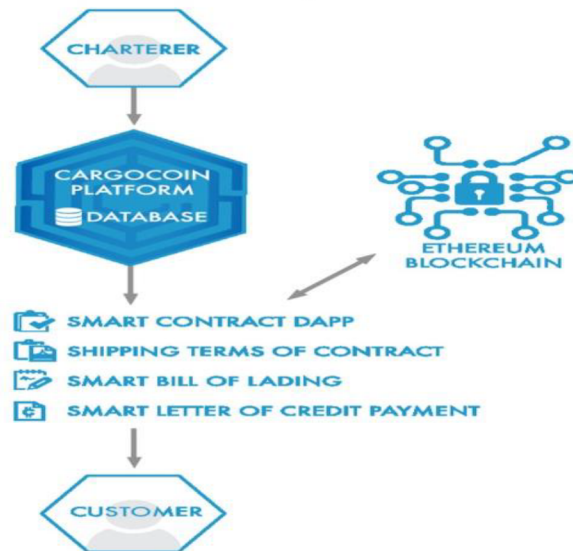
- From/to: Hamburg / Rio De Janeiro
- Cargo description: nature / weight / volume / size
- Dates of load readiness.
- Equipment, and pieces.
- Shipping & Trade terms (e.g. CIF, Liner Out)

The work of a marketplace described above is the core function of a Platform. However, other features are also introduced by the Founders to enhance collaboration of CargoCoin holders. Such, the Ecosystem allows users to exploit smart utilities (smart contracts) based on Ethereum to eliminate any need for hard paper work and to substitute used for ages the bill of ladings and letter of credits.



Founders underline that CargoCoin Ecosystem consists of two programming components that most likely represents intellectual property objects:

*"The Platform has 2 cores i.e. SERVICES & UTILITIES."*



Hence, the form of relationships between the members of the CargoCoin Platform and Founders reminds legal relations between a licensor and licensee where the licensor for the fees (under our circumstances transaction fees) provides access to smart utilities of a Platform.

*"The Core is a Global marketplace platform (SERVICES) facilitating the supply and demand for transport of all cargo types, including other essential services that are vital for shipping and trading."*

*"The CargoCoin platform activities will be self-financed through small, competitive transaction fees charged for the smart Utilities contracts"*

Founders act in the market of the Platform as independent players seeking their own benefits. Such, CargoCoin, platform apart from the transaction fees retained with the CargoCoin holders, monetize their services with other channels.

*"The CargoCoin platform will monetise through the following channels: • Banner and text advertising; • Publishing press releases and news articles; • Providing references to participants for their smart contracts if required; • Providing unbiased market and industry related statistics to interested parties, such as news sites, researchers, universities, governments, etc."*

The analysis of the White Paper may suggest that all members of the Platform are deeply involved in development of the Platform's network and growth of its economy. To simplify, the more shippers of the Platform trust their cargo to the carriers on the Platform, the more complex and flexible the network becomes.



There is now evidence revealed that the CargoCoin application has already been developed. However, the Founders in the White Paper proclaim the prototype to be developed in the last quarter of 2018.

*"Development of the global shipping platform, connecting importers, exporters, ship brokers, forwarders, ship owners, etc. (Stage 1). Developing mobile application."*

Obviously, no legal opinion on Howey Test may obviate the token analysis and we will scrutinize it not only in this part hereof.

The primary function of CargoCoin in the Ecosystem is to provide the Project's members with the means of payment to boost the economy. That is well-known use of a utility token that is accepted in most jurisdictions as an internal medium of exchange that has value only within the particular Platform.

*"The CargoCoin Ecosystem, its services and the Smart B/L utility provides sound foundations for decentralized instant crypto transactions by CargoCoin tokens. The Smart B/L security is an element that actively promotes further the Platform Crypto transactions"*

In a similar way, any means of payment operate within the gaming platforms or forms of employees incentives within closed systems. Without any doubts, such kinds of tokens are not legal tenders and have no value in real world unless they are converted to real money.

Thorough investigation of the WP has not determined that the Founders offer any distribution of dividends to prospective CargoCoin holders derived from the use of the Platform or any other form of investments return. Marketing materials of the Project do not contain any aggressive promotion of the CargoCoin as an investment instrument to speculate on the exchange market. The Founders also supply the WP's reader with disclaimers.

*"CargoCoin does not believe that the distribution of CargoCoins themselves are securities, commodities, swaps on either securities or commodities, or similar financial instruments. The CargoCoins are not designed for investment or speculative purposes and should not be considered as a type of investment".*

#### *B. Howey Test and Its Adoption by the Federal Courts*

In accordance with Section 2(a)(1) of the Securities Act, security is an:

*"any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement ... investment contract ... or, in general, any interest or instrument commonly known as a 'security', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of.."*

Exchange and Securities Acts tend to control issuing of investment instruments and to testify particular interests attached to them. However, Security Law promotes a priority of the substance over the form. Therefore, if the Security and Exchange Commission reveals any type of cooperation promising any future profits merely out of signing particular contract, it may investigate the case and declare this contract a security instrument. Under

such circumstances, promoters of such instrument shall disclose particular information and submit it to SEC.

The Supreme Court case for determining whether an instrument meets the definition of security is SEC v. Howey, 328 U.S. 293 (1946). In that case, a promoter offered to purchase certain services (cultivation of land) for the fixed price and cost of services. It is important to note that further the promoter was delegated to distribute the net profits derived from the sale of fertile land among the holders of land plots during the harvesting period. There were only 42 investors interested in purchasing the land.

Analyzing the fact pattern, the Court construes the “*investment contract*” term within the definition of security and notes that it has been used to classify those instruments that are of a “*more variable character*” that may be considered as a form of “*contract, transaction, or scheme whereby an investor lays out money in a way intended to secure income or profit from its employment.*” 11 Howey, 328 U.S. at 298; Golden v. Garafolo, 678 F.2d 1139, 1144 (2d. Cir. 1982).

More specifically, the court comes to the conclusion that the contract between the promoter and investor constitutes an investment contract. The court explains the definition of the security transaction as follows:

*“a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.”*

Moreover, the court said that this definition was “*crystallized*” in the state courts cases long before adoption of the federal act. The Supreme Court continues that the term

*“had been broadly construed by state courts so as to afford the investing public a full measure of protection. Form was disregarded for substance and emphasis was placed on economic reality.”*

The Court stated that its definition of investment contracts

*“embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.”*

Eventually, to determine that this is an investment contract, the court has to establish that the following applies: four- (i) *investment of money*; (ii) *common enterprise*; (iii) *expectation of profits*; (iv) *solely from the efforts of others* (e.g., from a promoter or third party).

With regard to the first prong “*investment of money*”, there is no basis for disagreement. The only issue that may arise here is whether cryptocurrency may constitute viable consideration interest in lieu of the obtained interests attached to the token. This issue is addressed by the Supreme Court itself holding that the first prong requires only

*“tangible and definable consideration in return for an interest that had substantially the characteristics of a security.”*

However, the Supreme Court fails to specify the definition of a common enterprise. Federal circuits developed two different concepts to analyze underlying contractual relationships of the parties. The first doctrine is “*horizontal commonality*” and the second is “*vertical commonality*”.

Horizontal commonality is found when a) investors’ contributions are pooled together (and according to some courts, there is a pro rata sharing of profits) b) the fortune of each investor depends on the success of the overall enterprise.

In contrast, vertical commonality presupposes that common enterprise may be found where the investors’ fortune is dependent on the expertise of the promoter or third parties. In case of narrow vertical commonality, investors’ profits shall be tied to the profits of promoters.

It is not necessary that the funds of investors are pooled; what must be shown is that the fortunes of the investors are linked with those of the promoters, thereby establishing the requisite element of vertical commonality. Thus, a common enterprise exists if a direct correlation has been established between success or failure of the promoter's efforts and success or failure of the investment.

According to this view, the test is satisfied if the promoter and the investor are both exposed to risk and the profits and losses of investor and promoter are correlated.

In broad vertical commonality, investors’ success depends on the efficacy of the managers or third parties. Both the Fifth Circuit and the Eleventh Circuit follow this view. If the investor relies on the promoter's expertise, then the transaction or scheme represents a common enterprise and satisfies the second prong of the Howey test.

As it was mentioned above, the circuits now disagree over the term “*common enterprise*”.

The third prong is an “*expectation of profit derived from the entrepreneurial or managerial efforts of others*”. Analyzing this prong, courts consider whether potential investors 1) expect to receive profits from their own efforts (use of rights or services obtained from promoters) or 2) from the efforts (managerial expertise) of the ICO founders.

Even though in re Howey, the Court used the phrase “solely” from the efforts of others, the lower courts relaxed this prong, adopting concepts of “*undeniably significant*” or “*predominantly*” (Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc., 840 F.2d 236, 240 n.4 (4th Cir. 1988) SEC v. Life Partners, Inc., 87 F.3d 536, 545 (D.C. Cir. 1996); SEC v. Int’l Loan Network, Inc., 968 F.2d 1304, 1308 (D.C. Cir. 1992). SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 483 (5th Cir. 1974) (quoting SEC v. Glenn W. Turner Enters., Inc., 474 F.2d 476, 482 (9th Cir. 1973).

In United Housing Foundation, Inc. v. Forman, the Supreme Court stated, “*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.*” 421 U.S. 837, 852 (1975)

Since that time, some courts are investigating whether there is de minimis efforts of investors and whether efforts of them are insubstantial factor for the investor to participate in the contract.

Other courts have a look whether the efforts of offerors of the contract are predominant and more significant in comparison with those of investors in light of future expectation of

profits or that efforts of those other than the investors are “*the undeniably significant ones*”.

Finally, some courts hold that the forth prong is satisfied when the expectations of profits derive from the managerial and entrepreneurial efforts of the offerors, “*in unspecified measure and unspecified comparative weight as to the relative significance with investors’ efforts and offerors’ or third parties’ efforts.*”

C. *Analysis Under the Howey Test*

We provide our analysis of CargoCoin below based on each Howey Test factor.

**(1) Investment of Money**

As we can see in the case law analysis above, it was not difficult for courts to establish the “*investment money*” prong, and it was not difficult for us either.

The CargoCoin has been offered to public predominantly with cryptocurrency such as Bitcoin or Ethereum. These are not money as such but on August 6<sup>th</sup>, 2013, the U.S. District Court for the Eastern District of Texas held that Bitcoin was within the definition of “*money*”.

It is stated in the court’s decision that Bitcoin may be used to purchase goods or services or to pay for individual living expenses. The only limitation of Bitcoin is that it is limited to those places that accept it as the currency.

Since Bitcoin or any other cryptocurrency has all functions inherent to a real currency, it can be considered as the “*money*” when it is used as consideration in forming an investment contract.

Therefore, this element of the test is straightforward for us and push the scale towards the CargoCoin being an investment instrument.

**(2) Common Enterprise**

In contrast with the “*Investment of Money*” prong, the CargoCoin does not satisfy either common enterprise or vertical element of the Howey Test.

According to the abovementioned rules, the horizontal common enterprise is found where investors combine their investments in one pool and the fortune of each investor depends on the success of the overall enterprise. And in some courts, judges are seeking to decide whether a pro rata sharing of profits takes place.

The key essence of this approach is that investors are tied together in their risks either to receive or to lose everything. That is not the case in our circumstances.

Beyond the doubt, the one would definitely fail to argue that investments are not pulled together. The founders of the project are those who undeniably promote gathering of funds not only for further development of the Platform but for marketing and personal purposes also. The WP proclaims that funds must be collected and used in accordance with their business plan. The road map and funds distribution is provided in the WP.



It is reasonable and the structure of each ICO presupposes investment collection in a single pair of hands that will determine and coordinate its spending as declared in the WP. In some instances and at sole discretion of the ICO founders (key investors), more elaborate corporate structure may be created with the use of funds administered by the director for the sake of the token holders. However, we believe that this is only one side of the story.

Another element for the horizontal common enterprise that has to be found is the dependence or, on the contrary, independence of the enterprise founders and each token holder. Under our circumstances, it cannot be inferred that the fortune of each investor depends on the success of the overall enterprise.

The one would definitely argue and will be right that in respect of launching the Platform success of each token holder shall indeed be equal to success of another, as the failure to develop the Platform would affect all token holders. What is more, we have revealed above that Founders serve the core of a Platform supplying various services and smart utilities for its users without which the marketplace will not work properly. However, this argument has many flaws.

First of all, the Platform has already been developing and in accordance with the White Paper will be released by the end of December, 2018.

*"Development of the global shipping platform, connecting importers, exporters, ship brokers, forwarders, ship owners, etc. (Stage 1). Developing mobile application."*

Secondly, we believe that with regard to the use of the Platform participants and the Founders are more likely independent. As it was recorded in the fact-based analysis *"the Founders act in the market of the Platform as independent players seeking their own benefits."* Hence, we may declare that it is more likely that the fortune of each CargoCoin holder does not depend on the fortune of the Project.

Thirdly and as it is stated in the White Paper, the Platform allows CargoCoin holders to build on its blockchain its own smart contracts and hereby to take legal obligations and to render services to other participants of a Platform. In this sense, each CargoCoin holder within the Platform may be considered as an independent business enterprise and its fortune and success may not depend on the Founders.

*"Such, the Ecosystem allows users to exploit smart utilities (smart contracts) based on Ethereum to eliminate any need for hard paper work and to substitute used for ages the bill of lading and letter of credits."*

*"One of the illustrative examples of services rendering via the Platform is when the user, desiring to arrange shipment of its cargo, submits an order on the Platform and selects appropriate service provider to deliver the freight."*

Finally, the CargoCoin Platform is not designed to share any profits with the verifiers, farmers, developers or miners. It has to be emphasized that in the White Paper the founders evidenced their approach to the CargoCoin as follows:

*"CargoCoin does not believe that the distribution of CargoCoins themselves are securities, commodities, swaps on either securities or commodities, or similar financial instruments."*

*The CargoCoins are not designed for investment or speculative purposes and should not be considered as a type of investment".*

*"In the vertical enterprise test, it is not necessary that the funds of investors are pooled; what must be shown is that the fortunes of the investors are linked with those of the promoters, thereby establishing the requisite element of vertical commonality." Thus, a narrow vertical enterprise exists if a direct correlation has been established between success and failure of the promoter's efforts and success and failure of the investor.*

The risks a CargoCoin holder accepts are more likely of different nature as compared with those risks that promoters incur (founders or some third parties).

The Promoter's risks are failing to use the funds in a manner not prescribed in the WP or in a proper way or end in a fiasco either with operation of funds or with developing the system or its running or not finding the critical amount of users that would boost the economy of the System. In all other cases, it is more likely that the promoters' risks do not correlate with those of the users. We are inclined to believe that, in general, CargoCoin holders risk only if the declarations contained in the WP will not be implemented.

In broad vertical commonality, investors' success depends on the efficacy of the managers or third parties. If the investor relies on the promoter's expertise, then the transaction or scheme represents a common enterprise and satisfies the second prong of the Howey Test.

Once the Project has been launched and the Platform works properly, every member of the Project starts to pursue its own purposes and thus in such pursuit will face its own risks, misfortunes and failures that would not be commingled with the fortunes of the Project enterprise.

Therefore, and taking into account the above-mentioned, in our opinion, CargoCoin is more likely not to match a common enterprise element of the Howey Test.

### **(3) Expectation of Profits**

We consider that the "*Expectation of Profits*" element is also not matched for the following reasons.

The case law that we have analyzed above revealed that the "*Profits*" definition may be construed broadly and may include not only the fiat money but also other benefits. However, even though the above-foregoing is true, it would be a superficial analysis of the Project at stake.

The case is that the expectation of profits from a purchase of any subject of value almost always takes place. Merely expectation of profit is trivial and not enough to satisfy this prong. In contrast, the one has to be primarily motivated and has to have speculative interest, for example, to resale the commodity or the right rather than interest in personally consuming the subject of value.

The case law also differentiates this distinction - for example, in Re Forman Case it was established that:

*“It is an investment where one parts with his money in the hope of receiving the profits from the efforts of others, and not where he purchases a commodity for personal consumption or living quarters for personal use”.*

Applying the above-mentioned law to the case at bar, we can infer that like in any other ICO project CargoCoin holders will be inevitably divided into two groups - those who are seeking to use the Product and those who merely intend to trade on the secondary market. And we have to admit that some people in the first group of the CargoCoin holders may enter the exchange market to sell the Tokens due to its market price appreciation.

Nevertheless, this profit may not be deemed as generated from the *“efforts of others”*. As we see from the facts described below, the CargoCoin Platform is designed in a way to provide its holders with real licensing rights.

As we revealed in the WP, Platform introduces an independent intellectual property object that is the Platform that consists of two intellectual property objects: the marketplace ( the services) and smart utilities for creating smart contracts. And in this regard it is likely that CargoCoin holders merely use both of them as a software. And, perhaps, that is a predominate interest of CargoCoin holders.

*"The Platform has 2 cores i.e. SERVICES & UTILITIES."*

*"The work of a marketplace described above is the core function of a Platform. However, other features are also introduced by the Founders to enhance collaboration of CargoCoin holders. Such, the Ecosystem allows users to exploit smart utilities (smart contracts) based on Ethereum to eliminate any need for hard paper work and to substitute used for ages the bill of ladings and letter of credits."*

Therefore, it is more likely that CargoCoin holders’ genuine interest in using Tokens is predominantly centered around consumption.

Should we believe we in another scenario, an investment contract would be met every time in our life when we acquire any commodity or right since many subjects may be appreciated in the future and sold on the secondary market. Several case laws also support this conclusion. In Re Sinva the court asserted that

*“The mere presence of a speculative motive on the part of the purchaser or seller does not evidence the existence of an "investment contract" within the meaning of the securities act. In a sense anyone who buys or sells the horse or an automobile hopes to realize a "profitable investment". But the expected return is not contingent upon continuing efforts of another”. Sinva v Merrill Lynch, 253 F. Supp/ 359, 367 ( S.D.N.Y.1966).*

We also investigated the marketing campaign run by the Founders, and it does not reveal any provocative material that would entice people to use CargoCoin for speculation purposes on the exchange market and in any other way save for personal use.

Therefore, and taking into account the foregoing, we suppose this prong is more likely to push the scale towards the CargoCoin being not deemed as a security. However, for the secondary market players it might be deemed fulfilled.

#### **(4) Solely from the Managerial Efforts of Others**

Analyzing this prong, courts consider whether the potential investors expect to receive profits 1) from their own efforts (use of rights or services obtained from promoters) or 2) from the efforts (managerial expertise) of the others (promoters, managers).

As we discussed above, not all courts share the approach of the Supreme Court using the term “solely” that defines the efforts of others.

If we apply the concept “only” from the efforts of others, this prong is more likely not to be satisfied. In our opinion, CargoCoin holders use it also as means of payment, so the more transactions they make, the more attractive Platform’s Ecosystem is.

*“The analysis of the White Paper may suggest that all members of the Platform are deeply involved in development of the Platform’s network and growth of its economy. To simplify, the more shippers of the Platform trusts their cargo to the carriers on the Platform, the more complex and flexible the network becomes.”*

However, some federal courts later relaxed this approach exploiting “de minimis” efforts of others or the concept of “undeniably significant” or “predominantly” after *In Re Forman* case. So even if the investor has the power to be involved, the transaction may still be an investment contract if the efforts of others predominate.

*“Whether the efforts made by those other than the investor are the undeniable significant ones, those essential managerial efforts which affect the failure or success of the enterprise” (The forman case; SEC v Glenn W turner Enters., 474 F.2 d 476 sec.28 ( Feb.1, 1973).*

However, we are inclined to believe that CargoCoin holder will rely on the managerial and entrepreneurial efforts of the Founders only to the extent that the latter will further develop the Platform that would permit all parties of the Ecosystem to communicate and apply all functionality of the System as they deem fit. Besides that all profit derived from the use of the Platform may be obtained predominantly from their efforts of CargoCoin holders.

Without any doubts, CargoCoin holders observe the marketing campaign. However, as we may see from the facts analysis provided above, the Founders do not assert in any marketing materials either on the website or in the ICO reviews that the Project may generate any investment profits for CargoCoin holders.

At any rate, this prong is more likely not to be satisfied.

#### **IV. Summary and Conclusion**

The first prong is definitively satisfied and no one shall state that courts will consider in another way.

The second prong is more difficult and debatable. However, our analysis has revealed that this element is not satisfied under both theories applied by the federal courts.

The third element is not satisfied too as far as the personal consumers are concerned but is likely to be fulfilled for the purchasers with the intent to sell the tokens on the secondary market for profits.



Finally, the last prong is not satisfied.

To conclude, since not all the elements of Howey Test are met, in our opinion, CargoCoin may not be considered as a security instrument.

Nevertheless, it should be noted that the Howey Test has not yet been directly applied by courts to any utility tokens before.

**THE ABOVE ANALYSIS IS BASED ON INFORMATION OBTAINED FROM A REPRESENTATIVE OF THE PLATFORM, WHITE PAPER OF THE PROJECT AND ITS WEBSITE. THE SEC OR A COURT OF COMPETENT JURISDICTION MAY REACH AN ALTERNATIVE CONCLUSION TO THAT STATED IN THIS LEGAL OPINION LETTER. NO WARRANTIES OR GUARANTEES OF ANY KIND AS TO THE FUTURE TREATMENT OF CARGOCOIN OR SIMILAR TOKENS ARE BEING MADE HEREIN.**

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