

Signed Hereunder:-

*Gurpreet Mata*

Attorney at Law

June 4th, 2018

**Cargo Technologies Ltd.**

Dear Sir,

*Re: Legal Opinion: The Compliance of The CargoCoin Token Sale with Securities Laws and Regulations*

This legal document has been prepared for reference purposes only and can be relied only by whom this legal opinion is furnished. No third party can bring a claim against AGS Legal LLP or any of its partners.

This document is prepared by AGS Legal LLP based on the information given to us by The CargoCoin and available on their website <https://thecargocoin.com/> which was last accessed on 01/06/2018.

All materials in this document is prepared in order to legally assess that CargoCoin would be considered as "Security" as defined by Securities and Exchange Commission of the United States of America, here we have made every possible effort to analyze the legal aspects of the token which would in our opinion fall in either of the category i.e a security and hence coming under the purview of SEC and if it doesn't it would be a Non-Security making it outside of the purview of SEC, the opinion hereby expressed is based on subjective interpretation of the factors which are important to decide the nature of token as a security.

The CargoCoin can download, print, use this document for non-commercial use. CargoCoin in securities law framework would be tagged as a Utility Token as it would provide access to the ecosystem which a user can take advantage of, on the CargoCoin Online Platform. They are not designed as an investment nor should anyone interpret or invest keeping in mind the same, The CargoCoin serve this limited yet much important function and hence can only be termed as Utility Tokens and not a Security as per existing Securities Law Framework  
As more fully set forth in the component parts of this document, the document does not constitute legal advice and should not be relied on by any person.

**CargoCoin which have been issued by the Cargo Technologies Limited, UK**

According to the information you have provided us, the CargoCoin which is the subject matter of this analysis, will be used by the token holders to use the platform of Online Platform for various purposes which will be developed in the coming months, CargoCoin

is the fundamental unit on the Cargo Platform. **CargoCoin** is to be based on the newest ERC223 token standard. The Platform has 2 cores i.e. **SERVICES & UTILITIES**. The CargoCoin shall be fundamental unit at the platform and explains the use case of the Coin.

In order to raise the necessary capital required for the project, the CargoCoin are offered to the public in a Token Sale.

### **The Term ICO vs. TGE**

The term “ICO” stands for Initial Coin Offering. This term is popular amongst the blockchain and cryptographic currency, and its meaning is known to be “new cryptographic token sale”. This term’s similarity to the term “IPO”, to our opinion, is only meant to serve as an easy explanation to this digital event, which is often misunderstood to the common people. It should be noted that in order to avoid confusion, a part of the blockchain community prefers to use the term “TGE”, which stands for “Token Generating Event”. Nevertheless, to be perfectly understood by the community, to avoid unfamiliar and misunderstood nomenclature, for the convenience of analysis the term ICO has been used in this document although it does not carry any special meaning in legal terms.

### **Three Kinds of Tokens**

Generally speaking, there are three kinds of tokens that can be issued to the public:

**Protocol token.** The first kind of token is the classic “cryptographic currency”. To put it simply, this token is called protocol token because what makes it special is the new or different protocol it uses. It is generally being used solely as an alternative currency, wholly digital. Its underlying blockchain serves nothing more than keeping a ledger of the transactions between token holders. It is usually mined or given away for free at issuance (either by creation of an entirely new network, either via a blockchain split event, a.k.a “airdrop”, or via some commercial sites that offer the token in exchange for some commercial participation, a.k.a “faucets”). In its initial digital issuance, this type of token is rarely exchanged for any valuable (sold), since initially it has no underlying or practical value at all.

**Utility token.** The second kind of token is being deemed by many as a coupon or a pre-paid gift card, or a coupon. This kind of token is basically a contract for provision of goods or services, to be redeemed by the token holder, once or continuously. In contrast with the protocol tokens which do not have any assets of any kind underlying them and their value is being based purely on mass psychology, the utility token has an actual underlying contractual right. Therefore, its value is determined not only by mass psychology but also by the value of the underlying right attached to it.

**Security token.** The third kind of token is a digital asset, the purchase of which entitled the owner with number of rights which is similar to securities such as stocks

or bonds. There are three major characteristics for an instrument to be deemed as a security: Voting rights in a general assembly or pertaining to important decisions of an entity, profit sharing such as distributions, and/or a right to claim against the Company to redeem the instrument in exchange for a value. Therefore, a security token, for example, might offer voting rights in the issuing entity, or rights in the profits of the issuing entity (or both). The issuing entity might also promise to redeem the tokens' value when there will be enough capital do to so. These are but examples of rights attached to such tokens, which can be deemed by many jurisdictions throughout the planet to be as securities per se, which therefore require to be compliant with the securities laws and regulations.

### Which Kind of Token is the **CargoCoin**?

The CargoCoin is an Ethereum blockchain ERC20 smart contract and therefore it is not meant to serve as a protocol token; no new protocol or network are being launched and therefore the CargoCoin is definitely not a protocol token by definition.

The CargoCoin does not grant any voting rights in the Company. Furthermore, the Company does not grant any pecuniary profits to the token holders, nor any rights to claim against the Company to redeem the token for pecuniary value. Therefore, at least at a preliminary review, the token will not be categorized as a security token. More on that in the next sections.

As per preliminary review it seems that The CargoCoin shall fall in the category of Utility token, There is furthermore discussion on this topic.

### **The Framework**

In this document, we will be focusing on analyzing the CargoCoin per the U.S Securities laws. In our opinion, the U.S is a substantial market for selling blockchain tokens, have extensive set of laws which govern these topics and concurrently holds fairly complicated set of laws which govern this area. Furthermore, these laws hold inclusive definitions of securities, but still distinguish tokens from one another by classifying some as securities and others as non-securities. Therefore, we will conduct an in-depth analysis which will also be relevant to defining the token in the subject matter for many other jurisdictions which are not all-permissive or all-forbidding.

### **U.S Securities Laws**

In the U.S, issuing, offering, or selling unregistered securities will be a violation of Section 5 of the Securities Act of 1933, and the issuer can face 5 years of prison. Furthermore, investors may initiate lawsuits under Section 5 and Section 12(a)(1) of the Securities Act of 1933 (or 15 Code § 77e and § 771 (a)(1)) for damages of selling non-exempted security without registering it. Moreover, the Securities Exchange Act of 1934 gives powers in section 10(b) to federally regulate fraudulent security

practices, wherein regulation 17 C.F.R. 240.10b-5 (c) gives investors the right to sue any issuer for fraud or deceit. It should be noted that similar laws apply in many other jurisdictions.

The Securities and Exchange Commission (hereinafter, the “SEC”), has issued the “Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO” (Release No. 81207 / July 25, 2017) wherein a few fundamentals were promulgated. Firstly, SEC has stated that the existing federal securities laws are sufficient to tackle the token issuance. Secondly, and more importantly, the SEC has pointed out that not all tokens are securities, and that such classification shall be determined on a case-by-case basis.

In order to define a token as a security, the SEC has stated that “Howey Test” shall be applied (defined hereinafter), which indeed was applied by the SEC in that particular DAO project token issuance SEC investigation on which its report was written. Finally, the SEC has treated DAO, an unincorporated, non-resident, virtual organization, definitely not situated in the U.S, as an entity for which the Securities laws also apply to, and by reference applying the U.S laws to whomever offers or sells securities to U.S persons, no matter in which jurisdiction the issuing entity is incorporated and/or located.

### **Form Over Substance**

We have preliminary identified the CargoCoin as a utility token. Nevertheless, this determination is superficial. Firstly, determining whether a transaction involves a security does not turn on labelling; if we say it’s a utility token sale, it does not make the issued token a utility token. Secondly, even if the CargoCoin has a practical utility use, it does not necessarily preclude the token from being a security – but instead requires an assessment of “the economic realities underlying a transaction.” (United Housing Found., Inc. v. Forman, 421 U.S. 837, 849 (1975) (the “Forman” Case)).

The “test . . . is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect” (SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 352-53 (1943))

### *Analysis: Is **CargoCoin** Compliant with Securities Laws and Regulations?*

Securities must be registered per Section 5 of the Securities Act of 1933 as stated hereinabove. Of course, that instrument which is not security need not be registered. Therefore, one must first examine the definition of Security:

“(a) Definitions - When used in this subchapter, unless the context otherwise requires— (1) The term “security” means 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, collateral- trust certificate, preorganization certificate or subscription, transferable share, investment

contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, 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, or warrant or right to subscribe to or purchase, any of the foregoing.” 15 U.S. Code § 77b.

Similarly, the Securities Exchange Act of 1934 defines a security, in the following fashion: “The term “security” means any note, stock, treasury stock, security future, security-based swap, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a “security”; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker’s acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.” Section 3(a)(10) of the Securities Exchange Act of 1934.

The U.S Supreme Court has stated that the term “investment contract” in these two definitions is treated as being the same (SEC v. Edwards, 540 U.S. 398 (2004)).

So, we can see that the U.S term “security” includes also an “investment contract”. An investment contract is an "investment of money in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." (see SEC v. Edwards, 540 U.S. 389, 393 (2004); SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946); see also the Forman case, at 852-853) (in this work, the “Howey Test”). To be accurate, the Howey Test requires that the profits will be made solely from the efforts of others:

“... an investment contract for purposes of the Securities Act means 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.... Such a definition...permits the fulfillment of the statutory purpose of compelling full and fair disclosure relative to the issuance of the many types of instruments that in our commercial world fall within the ordinary concept of a security.... It 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.” (SEC v. W.J. Howey Co., 328 U.S. 293 (1946))

Therefore, according to the Howey Test, four prongs are to be met in order to declare of an investment contract as a security:

- a. *Investment of Money;*
- b. *[in a] A Common Enterprise;*
- c. *[with a reasonable] Expectation of Profits; and*
- d. *[to be derived from the entrepreneurial or managerial] Effort of Others;*

#### *Prong 1: Investment of Money*

The CargoCoin are being purchased by the public with Bitcoin, Ethereum and various other cryptocurrencies including fiat like USD/ Eur. These are money per se, but on August 6<sup>th</sup> 2013, the U.S. District Court for the

Eastern District of Texas held that Bitcoin is within the definition of “money” for purposes of the rules governing investment contracts – Bitcoin can purchase goods or services, and can be exchanged for conventional government-backed currencies (SEC v. Shavers, No. 4:13-CV-416, 2013 WL 4028182, (E.D. Tex. 2013), reconsideration aff’d, No. 4:13-CV-416, 2014 WL 12622292 (E.D. Tex. 2014)).

In the CargoCoin Token Sale, they will receive cryptocurrency/fiat currencies in exchange for the token. Therefore, his prong is met with the CargoCoin ICO.

#### *Prong 2: A Common Enterprise*

There are two sub-tests for the “Common Enterprise” prong – the horizontal commonality test, and the vertical commonality test, which is being divided into the narrow vertical and the broad vertical. The U.S courts have applied these two tests alternatively. The horizontal commonality test, which is the more common test, requires the pooling of assets from multiple investors so that all will share in the profits and risks of the enterprise. i.e., the profits of each investor are similar to those of the other investors.

Both vertical commonality tests require that the investor's fortunes will be tied to the issuer/promoter's success, rather than to the fortunes of its fellow investors; the broad vertical commonality test requires that the well-being of all investors be dependent upon the issuer/promoter's expertise. On the other hand, the narrow vertical commonality test requires that the investors' fortunes be "interwoven with and dependent upon the efforts and success of those seeking the investment ... of third parties" (SEC v. SG Ltd., 265 F.3d 42, sec. 31-35 (1st Cir. 2001)).

As for the horizontal commonality test, the CargoCoin is sold and the funds raised are being pooled together. Nevertheless, there is also the requirement for a mutual share in the profits and risks of the enterprise. Here, since the value of the token shall be based on user participation and mass adoption of the technology to which no single person is bearer to profits and losses of the same, Though, it might indicate towards common enterprise but its not the case. by purchasing the CargoCoin, the token owners merely possess the facility to use the Cargo Online Platform which would use CargoCoin as its currency. There is no advantage to buy the CargoCoin except for the purpose of using it at the Online Platform.

If one so desire, and therefore there is no correlation between all token holders' "profits" – the use of the token is discretionary. Furthermore, the token can be sold at exchanges so the user can at any time get out of the investment and the earnings from using the platform shall be based on each user's effort and doesn't have much to do with the common enterprise by that it seems that the horizontal commonality test's requirements are not met.

By applying the narrow vertical commonality test, we can clearly see that the investors' funds are not connected or dependent upon the success of the token issuer. The Online Platform where the earning of the token holder shall be based on much that person interacts at the platform and value of the token shall be based on various factors like adoption of the technology to which the token holders also contribute in their own way. That means the token holders don't benefit solely from the efforts of others.

And finally, as far as the broad vertical commonality test is concerned, it would be wrong to say that the well-being of all investors is dependent upon the issuer/promoter's expertise, because the Cargo Online Platform is to be used in an interactive manner and each token holder has an equal chance of making it successful. Therefore, the token holders' well-being is completely disconnected from the issuer's expertise, wherein the activation of the rights of the digital tokens will be an automated technicality, involving only the digital world. Therefore, we see these vertical commonality tests' requirements unmet.

To conclude, CargoCoin does not fully meet horizontal commonality test requirements, the token holders' pecuniary rights are not being accumulated, they are discretionary, Therefore, it only seems reasonable that this prong is not met.

*Prong 3: Expectation of Profits*

This prong does not merely require the customer who buys the token to expect profit, because it seems unreasonable that someone will purchase a service or a good without taking into account the probability that the purchased will increase in value. The expectation of profits from a purchase of any kind of valuable is almost always present. Therefore, it seems that the prong requires not only that there will be an expectation to profit, which is trivial, but also that the purchase of that valuable will

be primarily motivated by making profits (upon resale for example), rather than by consuming or using that which was purchased. The personal consumption is a vital part of considering whether this prong is met or not, wherein it should be examined if the primary motivation of purchasing the token is to profit upon resale, or to use the underlying rights of the token. There are several court cases where this differentiation was stipulated, for example see the Forman Case. Per Forman, it “is an investment where one parts with his money in the hope of receiving profits from the efforts of others, and not where he purchases a commodity for personal consumption or living quarters for personal use”.

Upon reviewing our matter, the CargoCoin will be sold to customers who will be able to use the token to participate at CargoCoin Online Platform where the primarily the CargoCoin shall be put to use, the token owner may hold it to a time where the value of the token in the market will increase, wherein the holder may sell the token with profit. Nevertheless, since the token provides a real consideration and functionality, it only seems reasonable that purchasers will use the token’s rights for consumption and participation at the platform. Therefore, for the personal users, this prong’s requirement seems not to be met, while for the secondary market investors, this prong can be deemed fulfilled.

*Prong 3A: Causal Connection Between the Investors’ Expectation of Profits and the Actions of the Issuer*

As this prong should be tested only after the offering of an instrument for actions done on the part of the issuer, to create expectation of profits in the potential buyers, i.e. promises or statements from the Company within or prior to the Token Sale, to spur expectation of profits in the Token Sale participants. It needs to be highlighted that CargoCoin has never identified/advertised their Token Sale as a quick money making opportunity and have well cautioned the investors about the risks they undertake while buying of the CargoCoin, The Token Sale was publicized as clearly as real life use case scenario where everyone is in a winning position. The incidental increase in the price (if any) of the token is secondary and not the primary purpose of conducting the Token Sale.

**Worldwide Token Sale**

CargoCoin ICO is being conducted worldwide and the buyers from all over the world participated in the ICO. Since the underlying project, Cargo Online Platform, and it has been stated in the white-paper that you will act to eventually obtain proper licenses and permits in jurisdictions in which the marketing efforts are being focused, we see the token’s smart contract relevant to purchasers worldwide and based on that information your marketing targets can spread worldwide without it being an indication of the token to be a security.

*Prong 4: From the Efforts of Others*



This prong is based on the fulfillment of the requirement of the previous prong – expectation of profits. Assuming that prong 3 is met (whereas to our opinion CargoCoin does not always meet its requirement for the above mentioned arguments), this prong “from the efforts of others” is examining the source of the profits - "whether the efforts made by those other than the investor are the undeniably 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.2d 476, sec. 28 (Feb. 1, 1973)). Therefore, this prong cannot, on its own, qualify any instrument (or token) as a security.

Why “significant” and not “solely”? Initially, in the Howey case, the phrase is stated “solely from the effort of others”. Nevertheless, the Forman case has construed the word “solely”, in that context, as requiring significant or essential managerial efforts necessary to the success of the investment (instead of being the “sole effort” as this phrasing means literally). Token users vs. Buyers for the Sake of Price Appreciation in the Secondary Market.

In reality, the general market for the CargoCoin is composed of two major kinds of purchasers. There is the purchaser which intends to use the token for its underlying rights for consumption, and there are those who will purchase the tokens for further secondary market appreciation. The latter will sell the tokens in the secondary market for a profit.

Prima facia, the purchasers who only purchase the token in the secondary market, are motivated by “expectation of profit”. The purchasers for the sake of future selling in the secondary market might make profit per se, and courts in Forman held that “Profits” can also mean "capital appreciation resulting from the development of the initial investment" (the Forman Case).

Nevertheless, this profit will not be generated from “the effort of others”. In reality, every valuable can be expected to appreciate due to secondary market factors which are not related to any continuing effort of the issuer. For example, there could be a purchase of a real estate, or gems, that could appreciate later, and be sold in a profit. The purchase agreement of a real estate cannot be considered as an investment contract solely due to the fact that the real estate will almost certainly appreciate. Therefore, mere appreciation in the second market cannot be perceived as made by “the effort of others”. To support this argument, it has been held by number of cases that mere secondary market appreciation cannot at all be construed or perceived as derived from “the effort of others”, e.g: “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 acts. In a sense anyone who buys or sells a horse or an automobile hopes to realize a profitable "investment." But the expected return is not contingent upon the continuing efforts of another.” *Sinva v. Merrill Lynch*, 253 F. Supp. 359, 367 (S.D.N.Y. 1966)

Therefore, the fact that a person might purchase the token solely in order to sell it in the secondary market for profit, does not constitute on its own the prong 4, the “effort of others”.

### **The Undeveloped Project, and the Pre-sale**

There are two common definitions for a pre-sale. The first is receiving orders of future tokens prior to their issuance. The second definition is selling tokens in a discount, but in a limited quantity, and only in exchange for large orders. These are common acts amongst the blockchain community and it is meant to serve as an incentive to participate in the Token Sale. As for the differentiation between Token Sale and their Pre-sales, it goes without saying, that presales to Token Sales, like Token Sales themselves, should likewise undergo an examination per the Howey Test (or other securities laws in case of other jurisdictions).

The Pre-sale occurs, and often the Token Sale occurs, prior to the development of the project. Since the development of the project is being made by the issuer, this act might be considered as “essential managerial efforts of others”. If this is the case, then the token might be deemed a security.

There are two approaches to address the pre-sale issue, two schools to treat the undeveloped project’s token sale, as far as prong 4: “the effort of others” is concerned.

The first approach can be considered, to our opinion, as a “technical approach”. This school argues that if the project is undeveloped, then the tokens’ value is almost utterly dependent on the managerial efforts of the issuer. Therefore, in case a token is sold when the project is undeveloped, then the tokens meet the requirement of prong 4 and along with the analysis of the previous prongs as well, the tokens might be deemed as a security. Here in the case of CargoCoin the project will be developed at a later stage as stated in the roadmap.

This school has conceived the “SAFT”. The acronym stands for “Simple Agreement for Future Tokens”. This is a legal document which is based on the SAFE, a “Simple Agreement for Future Equity”. The SAFT is an instrument which is meant to serve as a way to bypass the technical issue of undeveloped project being dependent upon the essential managerial efforts of others.

The SAFT is an investment contract, to receive tokens in a future date. The SAFT itself is meant to serve as “investment agreement” in the U.S securities laws federal meaning as previously discussed. Therefore, the SAFT should be sold only under the exemption from registration of rule 506 (C) of Regulation D of the Securities Act, which limits the offer of the SAFT only to 35 people, and to unlimited “Accredited Investors”, one definition of whom is “Any natural person whose individual net worth, or joint net worth with that person's spouse, exceeds \$1,000,000” (Rule 501(a)(5)).

The SAFT project has conducted a thorough analysis, is very interesting and instructive, and on top it may offer some theoretical tax benefits, which we shall not cover in this work.

Nevertheless, so far as the U.S securities laws are concerned, per this technical approach, we see no material difference between selling the SAFT, and selling actual tokens – so long as the project is still undeveloped. In both cases, per the technical approach, the securities laws are to apply, and therefore only 35 people and unlimited “accredited investors” may enjoy from the benefits of the Token Sale or its pre-sale, whether by Token Sale or without it.

The second approach look past the technicalities of whether the project is fully developed or there is still work to be done, utilizing the funds raised or regardless. We may name this approach “the material approach” as it prefers substance over form. Per this approach, a token shall be a security, or non-security, regardless of the fact that the project is not fully developed yet. i.e., the token sale does not change its legal nature or character completely due to the mere fact that the project is completed or nearly complete.

From the two approaches, we favor the second “material approach”. We believe that the thought that a token sale is a security merely because the underlying project is not fully deployed or completed, is a legal error as far as cooperative Token Sale are concerned. Though by reviewing common policies and considerations regarding investors protection we can clearly understand that a purchaser’s risk in buying a token of an undeveloped project is larger than if the project was developed, it is nevertheless limited still, and understood due to the cooperative nature of many of the Token Sale projects.

The Forman Case turned on a cooperative housing project. The court stated that “people who intend to acquire only a residential apartment in a state-subsidized cooperative, for their personal use, are not likely to believe that, in reality they are purchasing investment securities simply because the transaction is evidenced by something called a share of stock ... the inducement to purchase was solely to acquire subsidized low-cost living space; it was not to invest for profit...when a purchaser is motivated by a desire to use or consume the item purchased ... the securities laws do not apply”. So, we can clearly see that the Forman Case explains that cooperative initiatives, where a purchaser is likely to purchase a share in the project itself (not in the legal entity), will generally not be treated as securities offerings.

As most Token Sales hold an underlying cooperative ideal, in case such exists, it must be taken into account in considering whether the “essential effort of others” prong is met or not. Therefore, as far as cooperative Token Sales are concerned, we must state our opinion that a token should not be viewed as if it has changed its nature or legal status merely because it is sold prior to the system’s launch, the

project's completion or the code's development.

Moreover, and to support the view of the second "material approach", we wish to indicate that the first "technical approach" disregard the development stage of the project, and classifies it's token sale as a potential security. It is possible that the very last steps are missing and the Token Sale is being conducted and completed concurrent or just prior to the completion of the development of the project. Still, this "technical approach" shall deem such a project as utterly dependent on the essential managerial efforts of others, and as such – a security.

Nevertheless, we wish to note that we have not found any conclusive law or case law on the subject to prefer either view on the subject matter. Hence, we do not further inquire on this subject further.

In the case at hand, the development of the underlying project is not yet complete and the funds will be used to serve as a capital to further the objectives of the project and nothing and the developers and other team members interest in tokens is locked in for 24 months with 6 months cliff.

Therefore, as per our view, in case of the CargoCoin, considering the fact that the system is already developed by the time of the offering, and considering its participative characteristics, this prong cannot be met fully.

#### Interim conclusion – the Howey Test

By concluding all the variants on the CargoCoin, we can safely assume that the CargoCoin will not be deemed as a security per the Howey Test. It takes all four prongs to be fulfilled in order to see an instrument as a security. Although "investment of money" is met, the "common enterprise" with the horizontal commonality test might not be, since the rewards for holding the token are based on participation at the CargoCoin Online Platform and users/token holders will be rewarded on the basis of their participation and the tokens serve a purpose for using the platform and not just by holding the tokens. Furthermore, the interested users of the CargoCoin Online Platform can buy the tokens from the secondary markets once they are listed at exchange and can use them at the platform. According to our analysis, also the two vertical commonality tests are not met.

Furthermore, the "expectations of profit" prong will not be fulfilled as far as the personal consumers are concerned, but will definitely be fulfilled for the purchasers with the intent to sell the tokens in the secondary market for profits.

And eventually, for the "effort of others" component, the schools are divided between the technical approach and the material approach, wherein per the technical

approach the “efforts of others” component is met because the Cargo Online Platform project has not started yet and the profits of the investors are dependent upon the efforts of the participants, whilst the material approach, which we support, claims that that the “efforts of others” component is not fulfilled because an instrument does not utterly changes its legal status just because the underlying project has not been completed yet. So, the overall risk score is quite minimal and we are positive that CargoCoin shall not be considered as 'Security'.

Therefore, per our legal view, CargoCoin should not be deemed as a security per the U.S federal securities laws. Nevertheless, it should be noted that the Howey Test has not yet been directly applied by courts to any utility token before.

### **The Risk Capital Test**

The U.S securities laws are both federal and state. State laws are called “blue sky laws”. A Token Sale or any other instrument must comply with both, each time it is offered to the public. It may be possible that under federal laws the instrument will not be considered as a security, but under state law it will. Therefore, it is necessary also to point out that some U.S states use an entirely different test to determine whether an instrument is being a security or not. The test is “the risk capital test”.

Generally, courts in states that apply this test will apply it alongside with the Howey Test, alternatively; If either test is met, then the instrument shall be deemed as a security (State v. Consumer Business Systems, Inc., 5 Or. App. 19, 482 P.2d 549 (1971)).

As opposed to the Howey Test, the Risk Capital Test ignores the “profit” component of the Howey test, which were a pecuniary benefit, with any kind of valuable benefit one might be induced to purchase (the “act extends even to transactions where capital is placed without expectation of any material benefits” - Silver Hills Country Club v. Sobieski, 55 Cal. 2d 811 (1961) (hereinafter, “Silver Hills”)).

Simply put, the Risk Capital Test, examines whether there was a contributed risk capital, subject to the entrepreneurial or managerial efforts of others (Amfac Mortgage Corp. v. Arizona Mall of Tempe, Inc., 583 F.2d 426 (9th Cir. 1978)). If the contribution is secured in some way, it will not be deemed as a risk capital and therefore the instrument will not be deemed as a security.

In the constitutive Silver Hills case, the Risk Capital Test stipulated that an investment contract exists when four prongs are met:

1. funds are being raised for a business venture or enterprise (the risk capital);an indiscriminate offering to the public at large;
2. a passive position on the part of the investors, i.e. investors do not affect the

success of the initiative;

3. the conduct of the enterprise by the issuer with other people's money;

The Risk Capital Test was also applied to cooperative initiatives (Silver Hills; Jet Set Travels Club v. Corporation Com'r, 21 Or. App. 362 (1975) (hereinafter, "Jet Set")), wherein under the federal courts definition these cooperatives were not to be deemed as securities because the members joined the club to get the benefits of membership, and not for a financial return. Nevertheless, the court in Silver Hills held that the sale of membership to a country club was a security because the initiative utilized risk capital. the investors were risking their capital in expectation or receiving the benefits of membership.

It should be noted that in Silver Hill, the court also addressed the fact that there were no existing facilities for which the right to use could be sold to purchasers. In the subsequent case, Jet Set, the Oregon Court of Appeals limited the risk capital test, applying it only to undeveloped enterprises. Jet Set, too, was about a cooperative initiative - a mutual purchase of jet plane for the use of the members. The membership was nothing more than a sale of right to use the existing facilities.

Therefore, for our purposes, we see that on one hand the Risk Capital Test expands the "benefit" component of investment to non-pecuniary benefits, making also cooperative Token Sale initiatives exposed to be deemed as securities, and on the other hand, if the Token Sale's underlying project is already completely developed, the token will unlikely be deemed as such. i.e., the test reviews whether the funds were used to establish the business or the business was already established when the funds were raised. In our case the CargoCoin did not completely developed therefore this Risk Capital Test is not fully met.

To the best of our research, The risk-capital test has been adopted in in several jurisdictions, whether by courts or by blue sky laws and regulations:

- ✚ Alaska (Act of July 2, 1975, ch. 217, 1975 Alaska Sess. Laws (codified at ALASKA STAT. §45.55.130(12) (Supp. 1979)))
- ✚ California (the Silver Hills case);
- ✚ Idaho (State ex rel. Park v. Glenn W. Turner Ents., [1971-1978 Transfer Binder] BLUE SKY L. REP. (CCH) 71,023 (Idaho Dist. Ct. 1972));
- ✚ Oregon (the Jet Set case)
- ✚ Arkansas (Smith v. State, 266 Ark. 861, 587 S.W.2d 50 (ct. App. 1979))
- ✚ Michigan (MICH. STAT. ANN. § 19.776(401) (I) (Supp. 1980));
- ✚ Oklahoma (OKLA. STAT. tit. 71, § 2(20)(P) (Supp. 1980);
- ✚ Ohio (State v. George, 362 N.E.2d 1223 (Ohio Ct. App. 1973));

- ✚ Hawaii (State v. Hawaii Market Center, Inc., 52 Hawaii 642, 485 P.2d 105 (1971));
- ✚ Guam (Securities Admin. v. College Assistance Plan, Inc., 533 F. Supp. 118 (D. Guam 1981), aff'd, 700 F.2d 548 (9th Cir. 1983);
- ✚ Washington (WASH. REV. CODE § 21.20.005(17)(a) (1979))
- ✚ North Dakota (N.D.C.C. 10-04-02 (1951));
- ✚ Wisconsin (Wisconsin Uniform Securities Law 551.102 (28)(d)2.);

Therefore, in these jurisdictions, there is some risk that the use of funds raised by tokens to develop a project, even if it is a cooperative project, may be deemed as a security. In our case the CargoCoin does not steer clear of the test.

Nevertheless, and similar to the Howey Test, it should be noted that the Risk Capital Test has not yet been directly applied to cryptographic tokens in the U.S. As opposed to the Howey Test being applied on the DAO, the Risk Capital Test has not been ever applied to any blockchain instrument.

### **Final Conclusion**

Based on that definition and our reading of relevant case law, as well as on our understanding of the facts and our review of the materials provided to us as regards the structure of the CargoCoin, we conclude that the Token Sale conducted by you, the CargoCoin should not be deemed as a security by federal securities laws. Accordingly, the federal securities laws would not apply to the initial distribution and subsequent trading of those tokens.

### **Excluded and Forbidden Jurisdictions**

As far as we are aware of, currently you are forbidden from offering the CargoCoin in the following countries: New Zealand, Russia and China. This is due to government standing against Token Sales, statute act against them, the consideration of Token Sales as securities offerings, or otherwise.

### **Further Allowed Jurisdictions**

Many jurisdictions share a very similar view of how to define a security. A security is generally being defined as a collection of rights relating to a company. There is a

range of types of securities, but they mainly divide into equity securities (shares) or debt securities (bonds, ETNs, ETFs).

In the case of the CargoCoin, we can clearly see that it holds no “share” right in the Company such as voting, profits, liquidation rights. Therefore, as far as we’re aware of, offering the CargoCoin to the rest of the jurisdictions will not deem as local infringement of securities laws.

### **Additional Notes**

Financial Crimes Enforcement Network (“FinCEN”)

FinCEN is a bureau in the U.S department of Treasury, with a mission to safeguard the U.S financial system from illicit use, combat money laundering and promote national security through the collection, analysis, and dissemination of financial intelligence and strategic use of financial authorities.

FinCEN regulates money transmitting businesses. The U.S code stipulates that anyone who knowingly conducts, controls, manages, supervises, directs, or owns all or part of an unlicensed money transmitting business, shall be fined or imprisoned not more than 5 years, or both (18 U.S. Code § 1960). Per the regulations, a “money transmitter” is either a person that provides money transmission services, or any other person engaged in the transfer of funds.

FinCEN has treated cryptocurrency (convertible virtual currency) as money for the purpose of the law (FIN-2013-G001) and therefore anyone who “(1) accepts and transmits a convertible virtual currency or (2) buys or sells convertible virtual currency for any reason is a money transmitter under FinCEN’s regulations, unless a limitation to or exemption from the definition applies to the person”.

In a later guidance, FinCEN stipulates that:

“How a user obtains a virtual currency may be described using any number of other terms, such as “earning,” “harvesting,” “mining,” “creating,” “auto- generating,” “manufacturing,” or “purchasing,” depending on the details of the specific virtual



currency model involved ... What is material to the conclusion that a person is not an MSB [Money Services Business] is not the mechanism by which a person obtains the convertible virtual currency, but what the person uses the convertible virtual currency for, and for whose benefit.” (FIN-2014-R001).

In our view, since the Token Sale is being conducted for getting capital for establishing Cargo Online Platform and not for the purpose of converting cryptocurrency into fiat or other cryptocurrency, therefore the CargoCoin Sale cannot and should not be deemed as a money transmitter and therefore is not a money services business.

Moreover, per the above excerpt, the Token Sale is indeed a “creation” or “manufacturing” of convertible virtual currency, in a very similar way to mining, and so its issuance has been explicitly excluded from the definition of money transmittance.

And lastly, the issuer does not purchase back the issued CargoCoin, as a business nor as a dividend, and therefore only “transmits” but not “accepts” the CargoCoin. Thus, this activity is insufficient for “exchanger” status.

FinCEN Guidance (FIN-2013-G001) also defines an “administrator”, who is a person engaged as a business in issuing (putting into circulation) a virtual currency, and who has the authority to redeem (to withdraw from circulation) such virtual currency. Such “administrator” requires a license of a money services business.

To address the “administrator” definition, per the data provided us, you do not possess the authority nor the power to remove or eliminate the CargoCoin from the digital existence, which do not constitute a “redeem “, and therefore you are not being an “administrator” per FinCEN’s definition.

Thus, being constructed as it is and in the ICO purposed configuration as described to us, we see no relevance of obtaining a FinCEN money services business license for the CargoCoin ICO.

Needless to say, CargoCoin does not claim that the Company utilizes the Virtual Currency for investment purposes, but rather to sell its tokens to develop the Cargo Online Platform. Additionally, in general, and as a secondary consideration, the “customers” (the CargoCoin purchasers), of course, may or may not utilize the Virtual Currency for investment purposes, or buy the token to use the platform.

This opinion is made for your benefit, written in good faith, and does not consist a guarantee or obligation on behalf of the undersigned.

# A Securities Law Framework for Blockchain CargoCoin.

To estimate how likely a particular blockchain token is to be a security under US federal securities law

[Refer to: full legal analysis](#)

## Instructions

**Step 1: Copy to a new google sheet (File > Make a copy) or download as .xls**

Step 2: Review each characteristic and determine whether or not it applies to the token

Step 3: Select Y or N for each characteristic from the drop down menu

Step 4: Review results at the bottom of this page

## Element 1: Investment of Money

Is there an investment of money?

Characteristic	Points	Explanation	Examples	Y or N
There is no crowdsale. New tokens are given away for free, or are earned through mining	<b>0</b>	Tokens which are not sold for value do not involve an investment of money.  For example, if all tokens are distributed for free, or are only produced through mining, then there is no sale for value.	There was never any token sale for Bitcoin. The only way to acquire new bitcoin is via mining.  A token which is randomly distributed for free	
Tokens are sold for value (crowdsale)	<b>100</b>	Tokens which are sold in a crowdsale, at any time, regardless of whether sold for fiat or digital currency (or anything else of value) involve an investment of money	CargoCoin was sold for Ethereum/BTC and Fiat in a crowdsale.	<b>Y</b>

Total for Element 1 **100**

## Element 2: Common Enterprise

What is the timing of the sale?

Characteristic	Points	Explanation	Examples	Y or N
Pre-deployment	<b>70</b>	A sale of tokens before any code has been deployed on a blockchain is more likely to result in a common enterprise where the profits arise from the efforts of others. This is because the buyers are completely dependent on the actions of the developers, and the buyers cannot actually participate in the network until a later time.	A developer has an idea for a new protocol, writes a white paper and does a crowdsale.	
The protocol is operational on a test network	<b>60</b>	If there is a functioning network there is less likely there is to be a common enterprise where the profits arise from the efforts of others. The closer the sale is to launch of the network, the less likely there is to be a common enterprise.	A developer has an idea for a new protocol, writes a white paper and deploys a working test network before doing a crowdsale.	<b>Y</b>
Live network is operational	<b>50</b>	If the token is sold once there is an operational network using the token, or sold immediately before the network goes live, it is again less likely to result in a common enterprise	The tokensale was done when the both the Web and App platform was developed	

## What do token holders have to do in order to get economic benefits from the network?

Characteristic	Points	Explanation	Examples	Y or N
All token holders will always receive the same returns	<b>25</b>	If returns are paid to all token holders equally (or in proportion to their token holdings) regardless of any action on the part of the token holder, then their interests are more likely aligned in a common enterprise	<p>'HodlToken' holders are automatically paid an amount of ETH each week, based on fees generated by other users of the network</p> <p>'FoldToken' does not pay any return, and there is no way to earn more tokens within the network (but they can be bought, sold or traded)</p>	
There is a possibility of varying returns between token holders, based on their participation or use of the network	<b>-20</b>	If token holders' returns depend on their own efforts, and can vary depending on the amount of effort they each put in, then there is less likely to be a common enterprise	Cargo Coin Holders will earn reward based on their participation at Cargo Online Platform and the token's designated use is to use at the platform	<b>Y</b>



**Total for Element 2** **40**

### Element 3: Expectation of Profit

#### What function does the token have?

Characteristic	Points	Explanation	Examples	Y or N
Ownership or equity interest in a legal entity, including a general partnership	100	<p>Tokens which give, or purport to give, traditional equity, debt or other investor rights are almost certainly securities.</p> <p><i>If one or more of these characteristics apply, the token is almost certainly a security, notwithstanding the results of the other elements</i></p>	A developer releases and sells 100 'BakerShares' tokens. Each token entitles the holder to 1 share in Baker, Inc.	
Entitlement to a share of profits and/or losses, or assets and/or liabilities	100		A developer releases and sells 100 'BakerProfit' tokens. Each token entitles the holder to 1% of the profits of Baker, Inc. for the next year.	
Gives holder status as a creditor or lender	100		A developer releases and sells 100 'BakerDebt' tokens. Each token entitles the holder to principal and interest repayments based on the initial token sale price.	
A claim in bankruptcy as equity interest holder or creditor	100			
A right to repayment of purchase price and/or payment of interest	100			
No function other than mere existence	100	<p>A token which does not have any real function, or is used in a network with no real function, is very likely to be bought with an expectation of profit from the efforts of others, because no real use or participation by token holders is possible.</p> <p>Voting rights alone do not constitute real functionality.</p>	A developer releases and sells 100,000 'SocialCoin' tokens to fund the development of a new Social Network. However, SocialCoin is not required to access the network and has no real function after the sale.	
Specific functionality that is only available to token holders	0	A token which has a specific function that is only available to token holders is more likely to be purchased in order to access that function and less likely to be purchased with an expectation of profit.	To access the Cargo Online Platform the user must have CargoCoin in order to use the platform effectively, So basically it's a utility token.	Y

Does the holder rely on manual, off-blockchain action to realize the benefit of the token?				
Characteristic	Points	Explanation	Examples	Y or N
Manual action is required outside of the network (e.g. off-blockchain) in order for the holder to get the benefit of the token	80	A token whose value depends on someone taking specific manual action outside of the network means that the token is not functional in and of itself. Instead, the token relies on a level of trust in a third party taking action off-blockchain. This sort of token is more likely to be bought for speculation - i.e. the expectation of profits.	A developer releases and sells 'FreightCoin', which will allow the holder to pay FreightCoin to access capacity on a new real-world freight network. The network relies on legal contractual relationships and manual actions. (This alone does not make FreightCoin a security)	
All functionality is inherent in the token and occurs programmatically	0	A token which is built with all the necessary technical permissions means that the token holder does not rely on manual actions of any third party. This means that the buyers are more likely to purchase the token for use rather than with the expectation of profit from the efforts of others.	The CargoCoin is based on technical permissions and no manual actions are required from the end of Token issuers.	Y

What is the timing of the sale?				
Characteristic	Points	Explanation	Examples	Y or N
Pre-deployment	20	A sale of tokens before any code has been deployed on a blockchain is more likely to result in buyers purchasing for speculative reasons with the expectation of profit, rather than practical use cases.	A developer has an idea for a new protocol, writes a white paper and does a crowdsale.	
The protocol is operational on a test network	10	If the sale occurs after code has been deployed and tested, the token is closer to being able to be used	A developer has an idea for a new protocol, writes a white paper and develops a working test network before doing a crowdsale.	Y
Live network is operational	0	If the token is sold once there is an operational network using the token, or immediately before the network goes live, it is more likely to be purchased with the intention of use rather than profit.	The website as well as application was complete before the tokensale.	

### Can the token holders exercise real and significant control via voting?

Characteristic	Points	Explanation	Examples	Y or N
Token holders as a whole are able to control the development team's access to funds	-20	If the collective approval of token holders is required in order for the development team to access the funds raised in the crowdsale, then any value realized by the token holders is more closely tied to their own decisions, and less reliant on the efforts of others.	A development team sells 100,000 Tokens for a total of 100,000 ETH.  50,000 ETH will be released from the token contract to the development team immediately, but the remainder is only released once milestones are met, which requires approval of a majority of the token holders each time. If the milestones are never met, the remaining ETH will be returned to the token holders.	Y or N
Token holders as a whole are able to vote on significant decisions for the protocol	-10	If the collective approval of token holders is required in order to make significant changes to the protocol, then any value realized by the token holders is more closely tied to their own decisions, and less reliant on the efforts of others.	The Token holders will have a say in the decision making process	Y

**Note: Voting rights must be in addition to functionality. A token with voting rights alone and no other real functionality is very likely to satisfy**

### How is the token sale marketed?

Characteristic	Points	Explanation	Examples	Y or N
Marketed as an 'Initial Coin Offering' or similar	50	It is not possible to prevent some buyers from buying a token purely for speculation. However, marketing the token as an investment leads buyers to believe they can profit from holding or trading the token, rather than from using the token in the network.  Using terms like 'Initial Coin Offering' or 'ICO', and investment-related language like 'returns' and 'profits' encourages buyers to buy a token for speculation, rather than use.	'ProfitCoin' includes potential of 'high ROI' and 'investor profits' in its marketing material.	Y or N
Marketed as a Token Sale	0	Marketed as a sale of tokens which give the right to access and use the network	The token sale was conducted and it was never marketed as an ICO for high returns	Y
There is no economic return possible from using the network	-100	If there is genuinely no economic return possible for the token holders, then there is unlikely to be a common enterprise. This will be rare.	Backers contribute to a cause and receive a 'thank you' token which has no economic value.	

# Results

Guide		Your results	
<b>Total Points</b>	<b>How likely is the element to be satisfied?</b>		
0 or less	Very unlikely	Total for Element 1	100
1 - 33	Unlikely	Total for Element 2	40
34 - 66	Equally likely and unlikely	Total for Element 3	0
67 - 99	Likely		
100 or more	Very likely	<b>Overall Risk Score</b>	<b>46</b>

A token will only be a security if it satisfies all three elements. The higher the point score for each element, the more likely the element is to be satisfied.

## Important notes

*Please remember that this methodology produces nothing more than an estimate. The Overall Risk Score and the categories of likelihood are a guide only.*

*The Howey test has not yet been directly applied by the courts to any digital currency or blockchain token. The Howey test as applied by the courts does*