

## ADDENDUM “C”

### Unintended Applications: Why Utility Tokens shouldn't be regulated as securities.

Number three of the “Howey Test,” while perfectly functional for legacy asset classes, tends toward preventing the functioning of utility tokens. It creates such a narrow use case to effectively ban the issuance and usage of true utility tokens. Frankly, it takes away their “Utility”. To emphasize this point, it is important to cover the prohibitions mentioned in **Framework for “Investment Contract” Analysis of Digital Assets II**, C, 2, bullet points 1, 3, 4, 6, 8, 9, and 10 respectively.

<https://www.sec.gov/about/divisions-offices/division-corporation-finance/framework-investment-contract-analysis-digital-assets>.

#1. Prohibition against *gains from capital appreciation of the digital asset*: i.e. Issuers cannot protect or increase the purchasing power of the consumer.

While this is reasonable for legacy assets, it directly places a “Utility Token” issuer at odds with the Consumer Financial Protection Bureau. Any planned decrease in value of rewards on the part of the issuer has been deemed harmful to the consumer by The CFPB. It is next to impossible for a utility token issuer to manage token value to a neutral state. Therefore, the most healthy protection for the consumer is for the issuer to manage toward an increase in utility token value, even if gradual or minutely small. Also, the spirit of the 1934 Securities and Exchange Act was to protect the consumer from loss, not gain. It is difficult to reconcile this prohibition on token value increase, against the Congressional intent upon which the SEC was founded.

#3. Prohibition against the *expectation of asset value increases*:

Blockchain technology is neutral to transactions and makes no determinations or representations about intent either on the part of the buyer or seller. Purchaser and seller identity are required during Know Your Customer Checks performed by exchanges selling to United States citizens. However, once inside the marketplace the buyers and sellers do not exchange personally identifiable information. It becomes impossible for the issuer of utility tokens to know the identity of the purchaser, let alone their intent at time of transaction. The time and place for influencing purchaser “intent” is outside the digital transaction and can be found in the directly promoted materials of the issuer.

#4. Prohibition against *marketing broadly*:

In the digital age it is possible for businesses to use social media to build a tribe of loyal supporters and followers. However, the business does not usually have access or control of the algorithms on the social media platforms. These algorithms control who receives the business content within their digital feed. It is not uncommon for promotional videos, texts, and digital newsletters to reach across the nation and bridge socio-economic classifications. Certainly this would be marketing broadly, and the token issuer would have limited to no control over who receives their material. Furthermore, a “Security” is supposed to be marketed to “Accredited Investors”. Does this mean a utility token must

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be marketed solely to non-accredited non-investors, in order to maintain non-security status? Such a thing is impossible enough to be ridiculous.

#6. Prohibition against *large token sales in relation to value of goods available for purchase*:

Utility tokens can be purchased by businesses as a means to give gifts to employees or donate charitably. Blockchain technology does not automatically allow an issuer of tokens to ascertain if the volume of transaction by one purchaser is for the purchaser’s own usage or otherwise. Alternately, purchasers can have legitimate reasons to buy and hold large volumes of utility tokens. Examples include waiting for a new product to reach market and redemption of multiple goods and services across multiple affiliated businesses.

#8. Prohibition against, *the AP(issuer) [benefiting] from its efforts as a result of holding the same class of digital assets as those being distributed to the public*: i.e. No issuer should hold reserves of their token centrally.

Because a “Utility Token” issuer cannot know intent, it is valuable they centrally control their token issuance to protect it against speculation. This allows them to sell their tokens into an inflating scenario and buy their tokens back within a deflating scenario. Businesses desire to have stability as a means of gaining customer trust, and making a profit. This self-preservation desire drives an issuer of true “Utility Tokens” to regulate the prices of their token as best as possible. The most stable form of token regulation by an issuer is to mint, store, and release tokens in a centrally controlled manner. It provides defense against speculators and their “reasonable expectation of profit”. If speculators attempt to drive up prices, they will quickly find a token that rises gradually. If speculators attempt to short sell they will find a token that does not yield much to downward pressure. This is especially true as the business can modify its acceptance ratio of tokens at anytime and with every purchase remove tokens from the system by not issuing more. In fact there are more options for a utility token to be protected against downward pressure than upward. This should be welcomed, as the SEC and CFTC were created to protect the consumer from loss in value not gain in value. Also, previously stated was the fact that decreasing the value of redemption points often comes under scrutiny by the Consumer Financial Protection Bureau. Therefore, issuers have numerous incentives to protect against price swings, but they likely need to hold a reserve of their own token regardless of whether it benefits them or not.

**As written, the Market Structure Bill prevents issuers from engaging in the very activities necessary to protect consumers.**

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### #9. Prohibitions against *network improvement*:

Utility token issuers need to re-use some of the funds raised from token sales to help expand their network quickly. It costs money to be listed on exchanges, and the more exchanges an issuer can list on the more facility purchasers have to find the token. Purchasers tend toward using exchanges that they are already registered and comfortable with. If a purchaser cannot find a utility token at time of checkout, the issuer will likely lose the sale. Conversion very much matters to vendors and they want to make check-out as smooth as possible.

Typically, an issuer will fund the first exchange listing with company finances and then list on additional exchanges using some of the proceeds from the first exchanges sales. This allows the smaller and medium sized businesses to gain visibility and adoption within the marketplace. Such rapid growth can be the difference between a hung start and successful launch. Additionally, it is possible for utility token issuers to manage the outstanding claims against their goods and services while concurrently using funds raised from the sale of their token to expand their network. Specifically, discounts can be honored down to the purchase cost of the item, after which cash is paid to complete the transaction. This selling at cost allows a business to give up profit on their products in the near term in order to expand their network for the long term. If the existing prohibition is continued, it will limit utility tokens to large companies with access to large amounts of capital: capital necessary for launching expansive, fully functional networks, across multiple exchanges on day one. This will limit the ability of small and medium sized businesses to compete. Knock on effects will be to slow the velocity of commerce and restrict consumer choice.

### #10. Sub-point #1

Prohibition against *marketing directly or indirectly the expertise of the issuer to build or grow the value of the network or asset*. i.e. Don't build trust with customers by stating your intentions to genuinely increase token usefulness. (Effectively this is the result, despite the intention being otherwise.)

Meadowlark would argue that statements about our expertise are needed for purchasers to adequately assess whether to use our utility token. Statements regarding when the token was launched, how many are in circulation, what affiliates accept it, what ongoing efforts are being made to expand the affiliate network etc... can be unobtrusively listed on our website's back pages. Unfortunately, current SEC interpretations would consider this to be indirect marketing of our expertise and immediate grounds to sue us for operating as an un-registered “Security” or “Ancillary Asset”. How is a consumer to decide to purchase a utility token if they aren't even allowed to know what affiliates accept it? This is especially true regarding “coming soon” statements about affiliates who are working toward on-boarding with our network.

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### #10. Sub-point #5

Prohibition against *marketing directly or indirectly the promise (implied or explicit) to build a business or operation as opposed to delivering currently available goods or services for use on an existing network.* i.e. Don't allow your followers to engage in helping you bring additional products to market.

That is not the original intent, but the statement is certainly subject to such future ambiguous interpretations. This prevents an issuer from sharing any information about scaling their business, token exchange listings, affiliate network, and product offerings. “Utility Tokens” are not “Securities”, “Digital Commodities”, or “Ancillary Assets” and have different needs. One of those “needs” is the ability to share business news. Information thus conveyed allows purchasers to know what “Utility” is available to them when using the issuer’s token. It is very difficult to justify purchasing a utility token if there is not reassurance it will be accepted for new products in development.

Our company will have products for purchase on day one of our token launch, but how are we to treat products in development? Adding new products often requires marketing, and expanding operations is part of building a business. As written, the proposed legislation would prevent us from doing many of the functions necessary for our utility token to operate. It would require us to register with additional government enforcement agencies when we are already regulated by FinCen and CFPB.

### **Outcomes and Material Harm**

It should be evident at this point that material harm will affect businesses—especially medium to small businesses—if changes to this bill are not made.

Meadowlark Manufacturing, LLC, cannot afford litigation against one Federal enforcement agency, let alone multiples. This is especially true when the average legal action takes between four to five years before reaching resolution. If an injunction is placed against trading of a specific utility token, all customer trust will likely be destroyed. Furthermore, should that business be vindicated in the courts, the damage to customer perception will already be done. In business, it can be difficult if not impossible to regain this broken customer trust.

If the language in the Senate Market Structure Bill is maintained as written, it will subject our business to material harm through surprise litigation. Our status as a utility token could rapidly change without our prior knowledge and without any connection to our direct efforts. The likelihood that a business of our size would fail from such strain is incredibly high. We are of the opinion that the material harm would equate to the destruction of our reputation and entire business. We need to have explicit language stating what a “Utility Token” is and what it isn’t. This is the only way to prevent numerous government enforcement agencies from perceiving these types of assets as being within their purview.

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### Summation

**Our argument: “Utility Tokens” can be effectively regulated, provided four conditions are met.**

**#1. The effort to determine utility token classification shifts the focus to the issuer and away from the purchaser.**

**#2. Utility token classification is determined by the *directly promoted intent* of the issuer.**

**#3. Utility token classification shows no preference for decentralized vs centralized governance structure. (GSA, Governance Structure Agnostic)**

**#4. Existing regulatory requirements and agencies overseeing crowdfunding, credit card points, airline miles etc... are used.**