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Private Funds Regulatory
UPDATE

SEC Resolves Digital Token Offering Case

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On October 20, 2020, the SEC and Kik Interactive Inc. resolved a multi-year litigation regarding Kik's offer and sale of digital tokens called Kin. The SEC sued Kik, a Canadian company known for its instant messaging program, alleging that the Kin offering should have been registered with the SEC. Kik countered that the Kin token was not an offering of securities requiring registration under the securities laws. The case received significant press coverage because Kik was one of only a few companies to challenge the SEC's crackdown on initial coin offerings in federal court.

After extensive discovery, the U.S. District Court for the Southern District of New York granted summary judgment in the SEC's favor ruling that Kik violated Section 5 of the Securities Act by offering and selling securities without a registration statement or exemption from registration. In ruling for the SEC, the Court focused on the "economic realities" of the transaction at issue. According to the SEC, the Kin tokens were securities under Supreme Court precedent. The test of whether a transaction is an investment contract or security is whether it involves an (1) investment of money; (2) in a common enterprise; (3) with the expectation of earning profits; and (4) solely from the efforts of the promoter or a third party." The Court ruled in the SEC's favor, but left it up to the parties to negotiate a final judgment. The parties have proposed a $5-million fine and a requirement that Kik inform the SEC about any future transactions involving digital assets for a period of three years. The Court has not yet approved the final terms of the agreement.

This case, along with similar enforcement actions, makes clear to digital asset providers and purchasers that the SEC and federal courts will scrutinize the underlying economics of these asset sales to determine whether they comply with the registration requirements and antifraud provisions of the federal securities laws.

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