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May 2, 2018

Omar Syed
ULC Project
Murphy, TX

Dear Mr. Syed:

You have asked me to conduct a due diligence analysis of your proposed Unblocked Ledger Coin Project (the "Project"). Specifically, you have asked me to consider whether the Project's token distribution model would be subject to regulatory scrutiny by either the U.S. Securities & Exchange Commission ("SEC") or the U.S. Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN"). I will address each of these questions in turn after first summarizing the features of the Project's token distribution model that I believe are relevant to this analysis:

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Token Distribution Models

As described in your whitepaper (available at <https://ulcproject.com/>), the Project consists of a "novel distributed ledger technology that creates a self-governing, sustainable, peer-to-peer payment network which incorporates sharding and auto-scaling to provide high throughput, low latency, and immediate finality while maintaining the highest level of decentralization and security possible." Stated more simply, and for purposes of this analysis, the Project intends to develop and launch a new peer-to-peer payment network that solves all the speed and scaling limitations present in existing peer-to-peer payment networks (e.g., Bitcoin).

In order to launch the network and facilitate its development, the Project will issue two separate cryptographic tokens, as follows:

1. An ERC20-compliant "Unblocked Ledger Token," or "ULT," generated on the Ethereum network; and
2. An "Unblocked Ledger Coin," or "ULC," that will be generated on the Project's own peer-to-peer payment network, once deployed.

Each of these tokens has a specific purpose and function within the development and operational phases of the Project:

Unblocked Ledger Token ("ULT")

1. Purpose. ULT will be used as the primary means of supporting the Project throughout its entire development, deployment and testing phases. Instead of relying on venture capital funding or crowdfunding via a token sale, the Project will give away ULT as an incentive to volunteer developers and contributors.
2. Generation and Distribution. A maximum supply of 1,000,000,000 (one billion) ULT tokens will be created in an ERC20 contract on the Ethereum network. ULT will then be distributed to the Project's developers and



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contributors as a gratuity for their volunteer commitment. At no point will ULT ever be sold by the Project. ULT will be distributed to the Project's volunteers based on their efforts. At no point will ULT be redeemable for anything connected to the Project, and at no time will the Project ever take ULT out of circulation after it has been distributed.

3. Reimbursement. A total of 6,000,000 ULT will be specifically allocated to the six original founding Project volunteers as reimbursement for their sweat equity and out-of-pocket expenses to date. Each month no more than 2% of the total fund amount shall be distributed to the founding volunteers. Once the Project is complete, all the remaining ULT in the reimbursement allocation shall be distributed to the founding volunteers.
4. Community Development. To help generate awareness and encourage developers to volunteer for the project, up to a maximum of 10,000,000 ULT will be given freely as part of airdrops to members of cryptocurrency communities.
5. ULC Network Launch. Once the Project network is fully deployed and operational, all holders of ULT tokens will obtain an equivalent amount of ULC tokens directly on the network while still retaining their ULT. Shortly prior to this, any excess ULT still remaining in the ERC20 contract shall be burned. The maintenance fund from ULC will be then be used to provide future support for ULC and ULT.
6. Token Utility Post-Network Launch. Non-commercial projects using the ULC software will be asked to airdrop tokens for their project to ULT token holders. Commercial projects which want to use the ULC software can obtain a license token by burning a percentage of ULT tokens through the ULT smart contract. The percentage will be determined when the ULC software is released and may subsequently be adjusted based on market conditions.
7. Reporting Requirements. Each month the project will report the total amount of ULT distributed through the bounty program on its website. Also, any amount that is distributed as part of reimbursements and airdrops will be reported. The total circulating supply information can also be verified by examining the Ethereum blockchain for the ULT smart contract.
8. Open Source License Event. After 10 years (from the excess burn event), the ULC software will be licensed under a Creative Commons BY license. The ULT in circulation will be converted to ULC at a 1 ULC per 10 ULT ratio and the ULT smart contract will be frozen.

Unblocked Ledger Coin ("ULC")

1. Purpose. The primary function of ULC is to serve as the peer-to-peer payment network's native cryptocurrency. ULC will also provide the utility necessary to implement any User-Activated Software Forks (UASF).
2. Generation and Distribution. When the Project network is fully deployed and operational, all holders of ULT tokens will obtain an equivalent amount of ULC directly on the network while still retaining their ULT. Each node in the ULC network is also given a fixed amount of ULC daily for participating in the network.
3. Required Use. When the ULC software is released, the ULC peer-to-peer network is created by people around the world running the ULC node software. Each node in the ULC network will be required to hold a fixed amount of ULC in a bond account to participate in the network. The amount held in the bond account is at risk of being



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lost if the node misbehaves. The bond amount can be adjusted by the community via UASF. A fixed amount of ULC is also given to a maintenance fund daily.

4. User-Activated Software Forks (UASF). The amount given to nodes, the amount given to the maintenance fund and other parameters can be changed by the community via UASF every 3 months. UASF outcome is determined by amount sent to the option addresses. The amounts sent to option addresses are burned after the software fork is activated.
5. Supply. The initial supply of ULC will be close to the supply of ULT in circulation after the excess ULT is burned. The total supply of ULC is not fixed and can gradually fluctuate based on what the community chooses for the miner rewards and any transaction fees.
6. Airdrops. Other projects using the ULC software that want to gain an immediate community of users can airdrop tokens for their project to ULC holders.
7. Open Source License Event. After 10 years (from the excess burn event), the ULC software will be licensed under a Creative Commons BY license.

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Legal Analysis

Given the two different token distribution models described above, it is possible to apply the relevant analyses under the U.S. Securities Act of 1933, the Bank Secrecy Act, and other related legislation applicable to the SEC and FinCEN.

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Securities Law Analysis

The starting point for a thorough securities law analysis of ULT and ULC tokens is asking whether either one of them qualifies as a “security” under the U.S. Securities Act of 1933. Under the Act, the term “security” means

any note, stock, treasury stock, security future, 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.C. §77b(a)(1).

As a rule, most cryptographic tokens do not fall within any of the specific enumerated categories provided in the statute and therefore are analyzed under the broad catch-all “investment contract” category. ULT and ULC are no exception to the rule, so it would also be appropriate to analyze them in the context of possible “investment contracts” under the statute. A securities law analysis of each token as a possible “investment contract” is provided below:



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Is ULT an Investment Contract?

In determining whether a cryptographic token qualifies as an “investment contract” (and therefore a “security”), U.S. courts have come to rely on something called the “Howey test,” which gets its name from a 1946 U.S. Supreme Court decision in which the court established that a security “involves an investment of money in a common enterprise with profits to come solely from the efforts of others.” *Sec. & Exch. Comm'n v. W.J. Howey Co.*, 328 U.S. 293, 300 (1946). Although the Howey test has never been applied directly to digital currency or cryptographic tokens in any United States court decisions, it is still considered the appropriate starting point for determining whether something qualifies as an “investment contract” as that term is defined in the Securities Act of 1933.

The analysis of ULT is performed using the following four elements based on the Howey test:

1. An Investment of Money;
2. In a Common Enterprise;
3. With [an Expectation of] Profits;
4. To Come Solely from the Efforts of Others

If ULT satisfies all four of these elements, it is likely that it will be deemed a security under the law. In contrast, if it fails any one of these four elements, it is unlikely to be deemed a security, and would thus qualify as a “utility token.”

Element 1: An Investment of Money

The first element of the Howey test considers whether there is an investment of money required to participate in the project or venture. Most cryptographic tokens undergo the Howey test analysis in the context of public token sales or “initial coin offerings,” where tokens are sold to participants in exchange for fiat or cryptocurrency.

However, instead of relying on venture capital funding or a token sale, the Project will incentivize its development by giving ULT away for free as a “thank you gift” to the Project’s volunteer developers and contributors. A maximum supply of 1,000,000,000 (one billion) ULT tokens will be created in an ERC20 contract on the Ethereum network. ULT will then be distributed for free to the Project’s volunteer developers and contributors. At no point will ULT ever be sold by the Project. Because there is no investment of money involved in acquiring ULT, it fails the first element of the Howey test.

By failing the first element of the Howey test, ULT is not an “investment contract” (or a “security”) as defined in the Securities Act of 1933. However, because the Howey test has not yet been directly applied by the courts to any digital currency or cryptographic token, it would be prudent to also briefly cover the remaining three elements.

Element 2: In a Common Enterprise

The second element of the Howey test considers the degree to which contributors are funding a “common enterprise.” The test for whether a “common enterprise” exists in any particular case varies widely depending upon which Federal Circuit Court of Appeals happens to be hearing the case, but the factors normally considered are whether: (a) there is a





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pooling of contributors' money in a common venture; (b) there is a correlation between the fortunes of the contributor and the founders; and (c) the success of a contributor depends on a the founders' expertise.

Because all of these definitions of a common enterprise require an investment of money, ULT also fails the second element of the Howey test.

Element 3: With [an Expectation of] Profits

The third element of the Howey test considers the degree to which investors have an "expectation of profit" when they purchase the token. The simple answer to the question is "no," for the following reasons:

- a) ULT tokens do not confer any sort of ownership or equity interest in a legal entity, entitlement to a share of profits or losses, status as a creditor or lender, claim in bankruptcy as an equity interest holder or creditor, or a right to repayment of purchase price or payment of interest;
- b) ULT tokens are not being sold via token sale or in any manner whatsoever;
- c) Nothing in the Project's whitepaper or marketing materials would give any prospective recipient of ULT tokens the impression that ULT will increase in value or appear on any secondary exchanges.

For all the foregoing reasons, ULT also fails the third element of the Howey test.

Element 4: To Come Solely from the Efforts of Others

The fourth and final element of the Howey test depends on whether token holders' own efforts can affect the returns they receive, and whether the returns can vary depending on the amount of effort put in. If the answer to both of those is in the affirmative, then it cannot be said that any profits realized by token holders rely solely on the efforts of others.

ULT will be used as the primary means of "incentivizing" the Project throughout its entire development, deployment and testing phases. The amount of ULT distributed to each of the Project volunteers will be based on the efforts put into the Project, as solely determined by the Project Association. Thus, there is a possibility of varying returns between token holders, based on their participation or use of the network. For that reason, ULT also fails the fourth and final element of the Howey test.

Conclusion

As stated at the beginning of this analysis, if ULT failed any one of the four elements described above, it is unlikely to be deemed a security. In the case of ULT, it failed all four elements, so there is no reason to think that it would be considered an "investment contract" (and therefore a "security") under the U.S. Securities Act of 1933.

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Is ULC an Investment Contract?

Just like ULT, ULC does not fall under any of the specific enumerated categories of "securities" provided in the Securities Act of 1933, so it must be analyzed under the broad catch-all "investment contract" category. As a result, the analytical framework of the four elements of the Howey test also apply to ULT as follows:



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1. An Investment of Money;
2. In a Common Enterprise;
3. With [an Expectation of] Profits;
4. To Come Solely from the Efforts of Others

If ULC fails any of these four elements, it is unlikely to be considered an “investment contract” (thus not a “security”).

Element 1: An Investment of Money

The first element of the Howey test is whether there is an investment of money required to participate in the project or venture. In the case of ULC, when the Project network is fully deployed and operational, all holders of ULT tokens will obtain an equivalent amount of ULC directly on the network while still retaining their ULT. Additional ULC tokens on the network will be primarily distributed through mining or as a reward for contributing resources to the network (e.g., each node in the ULC network will be given a fixed amount of ULC on a daily basis for participating in the network). In each of these examples, no money is being paid for the tokens received, so there is no purchase *per se*. Instead, rewards are being given in return for labor contributed to the network. Because there is no investment of money involved in acquiring ULC, it clearly fails the first element of the Howey test.

Element 2: In a Common Enterprise

The second element of the Howey test considers the degree to which contributors or participants are funding a “common enterprise.” As with ULT, discussed in the previous section, ULC cannot involve a common enterprise because there is no investment of money. As a result, ULC also fails the second element of the Howey test.

Element 3: With [an Expectation of] Profits

The third element of the Howey test considers the degree to which investors have an “expectation of profit” when they purchase the token. As with ULT tokens, the answer is “no,” because:

- a) ULC tokens do not confer any sort of ownership or equity interest in a legal entity, entitlement to a share of profits or losses, status as a creditor or lender, claim in bankruptcy as an equity interest holder or creditor, or a right to repayment of purchase price or payment of interest;
- b) ULC tokens are not being sold via token sale or being sold by the Project in any manner whatsoever;
- c) Nothing in the Project’s whitepaper or marketing materials would give any prospective recipient of ULC tokens the impression that ULC will increase in value or appear on any secondary exchanges.

For all the foregoing reasons, ULC also fails the third element of the Howey test.





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Element 4: To Come Solely from the Efforts of Others

The fourth and final element of the Howey test depends on whether token holders' own efforts can affect the returns they receive, and whether the returns can vary depending on the amount of effort put in. If the answer to both of those is in the affirmative, then it cannot be said that any profits realized by token holders rely solely on the efforts of others.

Unlike ULT, which is merely an "incentivizing" mechanism for development of the overall Project, the purpose of ULC is to serve as the native cryptocurrency of the Project's peer-to-peer payment network. Because the network is completely decentralized, as is the case with Bitcoin, there is no single entity or even collection of entities whose efforts will have any more impact on the overall profitability of ULC than anyone else. Because there are no "others" upon whose efforts token holders can rely to expect profits, ULC also fails the fourth and final element of the Howey test.

Conclusion

As with ULT, ULC fails all four elements of the Howey test, so there is no reason to think that it would be considered an "investment contract" (and therefore a "security") under the U.S. Securities Act of 1933.

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The SEC's Take on Bitcoin (and ULC) as a Security

In closing the securities analysis of ULC, it is worth emphasizing that whereas ULT (and most cryptographic tokens being scrutinized by securities regulators) are being created in an ERC20 contract on the Ethereum network, ULC is a brand-new cryptocurrency being developed and issued on the Unblocked Ledger Coin peer-to-peer payment network. This makes ULC much more akin to something like Bitcoin as opposed to the sorts of tokens that typically capture the attention of the SEC and other international securities regulators.

Although the SEC hasn't issued an official opinion as to whether Bitcoin itself can be regulated as a security, they have restated the CFTC's position that Bitcoin can be regulated as a commodity. This does not preclude the SEC from treating Bitcoin as a security, but they go on to state that "products linked to the value of underlying digital assets, including bitcoin and other cryptocurrencies, may be structured as securities products subject to registration under the Securities Act of 1933 or the Investment Company Act of 1940." Although not conclusive, by distinguishing "products linked to [Bitcoin]" as securities, this suggests that the SEC does not consider Bitcoin itself to be a security under the Securities Act of 1933. By extension, given the similarities between Bitcoin and ULC, the same approach should be taken towards ULC, i.e., it is not a security.

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Money Services Business Analysis

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Unblocked Ledger Coin Project

The Project intends to develop and launch a new peer-to-peer payment network that solves all the speed and scaling limitations present in existing peer-to-peer payment networks (e.g., Bitcoin). Because of this, it is necessary to consider the possible application of the Bank Secrecy Act of 1970 ("BSA") to the Project, and whether the Project needs to register as a "Money Services Business" ("MSB") with FinCEN.



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Although the definition of an MSB is found at 31 CFR § 1010.100(ff)(5), there is nothing in that regulation which makes any specific reference to cryptocurrency. In fact, the first official reference to cryptocurrency, or “convertible virtual currency” as it is called by FinCEN, appears in a letter of interpretive guidance issued by them on March 18, 2013, entitled “Application of FinCEN’s Regulations to Persons Administering, Exchanging, or Using Virtual Currencies” (FIN-2013-G001). That guidance classifies three different types of participants in generic virtual currency arrangements—users, exchangers and administrators—and states that any participants who qualify as either exchangers or administrators of convertible virtual currency are considered “money transmitters” as defined in 31 CFR § 1010.100(ff)(5)(ii)(A)–(F), which provides as follows:

§1010.100 General definitions.

(ff) Money services business. A person wherever located doing business, whether or not on a regular basis or as an organized or licensed business concern, wholly or in substantial part within the United States, in one or more of the capacities listed in paragraphs (ff)(1) through (ff)(7) of this section. This includes but is not limited to maintenance of any agent, agency, branch, or office within the United States.

...

(5) Money transmitter—

(i) In general.

(A) A person that provides money transmission services. The term “money transmission services” means the acceptance of currency, funds, or other value that substitutes for currency from one person and the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means. “Any means” includes, but is not limited to, through a financial agency or institution; a Federal Reserve Bank or other facility of one or more Federal Reserve Banks, the Board of Governors of the Federal Reserve System, or both; an electronic funds transfer network; or an informal value transfer system; or

(B) Any other person engaged in the transfer of funds.

(ii) Facts and circumstances; Limitations. Whether a person is a money transmitter as described in this section is a matter of facts and circumstances. The term “money transmitter” shall not include a person that only:

(A) Provides the delivery, communication, or network access services used by a money transmitter to support money transmission services;

(B) Acts as a payment processor to facilitate the purchase of, or payment of a bill for, a good or service through a clearance and settlement system by agreement with the creditor or seller;

(C) Operates a clearance and settlement system or otherwise acts as an intermediary solely between BSA regulated institutions. This includes but is not limited to the Fedwire system, electronic funds transfer networks, certain registered clearing agencies regulated by the Securities and Exchange Commission (“SEC”), and derivatives clearing organizations, or other clearinghouse arrangements established by a financial agency or institution;

(D) Physically transports currency, other monetary instruments, other commercial paper, or other value that substitutes for currency as a person primarily engaged in such business, such as an armored car, from one person to the same person at another location or to an account belonging to the same person at a financial institution, provided that the person engaged in physical transportation has no more than a custodial interest in the currency, other monetary instruments, other commercial paper, or other value at any point during the transportation;



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(E) Provides prepaid access; or

(F) Accepts and transmits funds only integral to the sale of goods or the provision of services, other than money transmission services, by the person who is accepting and transmitting the funds.

The main question, then, is whether the Project should be classified as a “user,” “administrator,” or “exchanger” or convertible virtual currency.

Unfortunately, there is no published guidance to date from FinCEN that answers this question in the context of a brand-new per-to-peer payment network like the one being developed by the Project. As a result, it is necessary to apply several different letters of interpretive guidance published by FinCEN between 2013 and 2016 that refer to convertible virtual currency. I have personally reviewed all of the relevant guidance but an excellent summary of everything issued by FinCEN entitled “The Bank Secrecy Act, Cryptocurrencies, and New Tokens: What is Known and What Remains Ambiguous” and published by Coin Center is available at <https://coincenter.org/entry/aml-kyc-tokens>.

According to Coin Center’s summary of the Bank Secrecy Act, “[a] new protocol developer *who does not sell* tokens to others but, instead, gives them away or distributes them through mining (e.g. Bitcoin’s release schedule) is likely not an exchanger or a money transmitter.” I believe this analysis is most relevant to the Project as currently described. However, Coin Center goes on to state that “A new protocol developer *who also sells* their protocol’s tokens may or may not be an exchanger under the Guidance. This area is extremely uncertain and warrants further analysis.” The distinction between new protocol developers who do not sell tokens versus those that do is based on a 2015 settlement between FinCEN and Ripple Labs, Inc. relating to its virtual currency known as XRP. Even though the XRP sold by Ripple Labs was sold from its own account (and would therefore qualify as a “user” and not a “money transmitter” under FinCEN’s own guidance), the specific facts of that settlement make it an important distinction.

In conclusion, as long as the Project only gives away ULC or distributes them through mining, it is unlikely to have to register with FinCEN as an MSB. However, if the Project gets into the business of selling ULC, it may very well have to register with FinCEN as an MSB.

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Unblocked Ledger Tokens

Whereas the previous section focused on the issue of whether the Project qualified as a money transmitter under the Bank Secrecy Act because of the creation and distribution of its native ULC cryptocurrency, it is also important to consider whether the Project’s planned use of ULT might also qualify it as a money transmitter. The relevant characteristics and uses of ULT for purposes of this analysis are as follows:

- ULT will be distributed to the Project’s developers, contributors and founding volunteers as a gratuity for their volunteer commitment;
- At no point will ULT ever be sold by the Project;
- ULT will be distributed to the Project’s volunteers based on their efforts;



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- At no point will ULT be redeemable for anything connected to the Project, and at no time will the Project ever take ULT out of circulation after it has been distributed; and
- Up to 10,000,000 ULT will be given freely as part of airdrops to members of cryptocurrency communities.

Given how ULT will be used solely to incentivize the development of the Project, and that at no point is the Project ever giving or receiving currency (whether fiat currency or virtual currency) in exchange for ULT, I don't believe that the Project would qualify as an exchanger of ULT for the same reasons as given in the previous section. However, the question remains as to whether it would qualify as an "administrator."

According to the following guidance from FIN-2013-G001, "Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies:"

An administrator 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."
<https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf>

The Project does not possess the authority to redeem ULT, so it is not an "administrator." Because it is also not an "exchanger" of ULT, it is unlikely to have to register with FinCEN as an MSB.

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Conclusion

Having conducted the due diligence analysis of your proposed Unblocked Ledger Coin Project (the "Project"), I have concluded the following:

- ULT should not be considered an "investment contract" (or a "security") as that term is defined in the Securities Act of 1933;
- ULC should not be considered an "investment contract" (or a "security") as that term is defined in the Securities Act of 1933;
- As long as the Project only gives away ULC or distributes them through mining, it is unlikely to have to register with FinCEN as an MSB. *However*, if the Project gets into the business of selling ULC, it may have to register with FinCEN as an MSB; and, finally,
- The Project's planned use of ULT as stated in its whitepaper does not trigger the MSB registration requirements per FinCEN.

I hope this analysis will prove useful to you and I appreciate the opportunity to have performed it. Feel free to email me directly at gulovsen@gmail.com if you have any questions. Thank you.



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Sincerely,

A handwritten signature in blue ink, appearing to read 'Grant R. Gulovsen', with a long horizontal flourish extending to the right.

Grant Gulovsen
Gulovsen Law Office



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