Submission to the Token Mapping Consultation Paper

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Dear Committee,

1. Introduction

1.1. The *Token Mapping* Consultation Paper ('Consultation Paper') represents a foundational step in regulating crypto assets in Australia.[1] The purpose of this reform is twofold; to establish Australia as an economic hub for fintech, and to create a more robust regulatory framework to protect investors and ensure market integrity.[2] In order to achieve both of these goals, crypto assets must be subject to financial markets law based on the real level of risk which they pose to investors.[3] If the taxonomy is too narrow, certain tokens will not be regulated, and investors will be unprotected. If it is too broad, unrealistic demands will be placed on issuers, and innovation will take place overseas to the detriment of the Australian economy.[4]

1.2. In this context, this submission will address several general taxonomy issues with the Consultation Paper's proposal, as well as provide a response to Question 8(a). The main arguments can be summarised as follows:

1. The definition of 'crypto asset'

    a. A crypto asset should be defined as the combination of the token and the token system, rather than just the token system. This is because certain tokens are factually necessary in facilitating an asset's function, as opposed to types of intangible property where the asset exists only as rights enforceable by a court.

2. The definition of 'token system'

[1] Australian Treasury, *Token Mapping* (Consultation Paper, 13 February 2023) 17 ('Consultation Paper').
[2] Senate, *Select Committee on Australia as a Technology and Financial Centre* (Final Report, October 2021) ('*Senate Report*').
[3] Ibid 13, citing Aquilina et al., 'Addressing the risks in crypto: laying out the options', *Bank for International Settlements Bulletin*, 12 January 2023; see also Black, Julia and Baldwin, Robert, 'Really Responsive Risk-Based Regulation' (2010) 32(2) *Law and Policy* 18 for a discussion on the importance of designing financial markets law reforms around real risk levels.
[4] It has been argued that when seeking to regulate fintech, policy makers strive to balance the objectives of market integrity, innovation, and rule simplicity – however are only able to achieve two at once. See: Yesha Yadav and Chris Brummer, 'Fintech and the Innovation Trilemma' (2019) 107 *Georgetown Law Journal* 235.

a. Any definition should make apparent that token system protocols are generally made up of a combination of cryptographic mechanisms and legal arrangements.

3. In response to Question 8(a), applying the functional perimeter to certain types of 'Intermediated Crypto Assets' ('ICAs')

   a. In determining whether an ICA comes within the functional perimeter, the general test for financial product under s 763A must be met. The definition of ICA should be further distinguished into assets which meet this requirement and those which do not, referred to as 'Investment ICAs' and 'Utility ICAs' respectively;

   b. Investment ICAs are in themselves financial products, irrespective of whether they are sold through an Initial Coin Offering ('ICO');

   c. Utility ICAs are interests in a managed investment scheme when sold through an ICO, but may shed their status as a financial product once the scheme is wound up.

2. Definition of 'crypto asset'

2.1. The Consultation Paper states that:

> A crypto asset is a 'token system' that is intrinsically linked to a *specific* crypto token. The intrinsic link means the term 'crypto asset' is effectively an umbrella term for a crypto token and each of the benefits provided by its token systems.[5]

2.2. The Consultation Paper also notes the conceptual difficulty in classifying certain crypto-assets as intangible property, as they give the token-holder the factual ability to do something, rather than existing only as a bundle of rights enforceable by a court.[6]

2.3. This submission believes that while a token may not be a physical thing, it may still be useful to conceive of the token itself as an element of the property that a token-holder owns when they own a crypto-asset. Unlike a traditional security, such as a bond, where the bond paper is purely representative of the right to payment of the interest and principle,[7] the data contained within a token may actually be integral to receiving the function of the asset.

2.4. An example of this can be found within the Ethereum network, where the ether token ('ETH') can be used as gas in the Ethereum Virtual Machine ('EVM') to interact with smart contracts.[8] It is a matter of fact that token-holders cannot use the EVM's computational efforts to operate smart contracts without burning ETH as a transaction fee.[9] This right does not exist by virtue of a court.

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[5] *Consultation Paper* (n 1) 16.
[6] Ibid 28, 38.
[7] See: A Brealey, Stewart C Myers and Franklin Allen, Principles Of Corporate Finance (McGraw Hill Irwin, 10th ed, 2011) 353.
[8] Gavin Wood, 'Ethereum: A Secure Decentralised Generalised Transaction Ledger' *Gavwood.com* (Whitepaper, 2014) <https://gavwood.com/paper.pdf>; 'Ethereum Virtual Machine (EVM)' *Ethereum.org* (Web page, 12 April 2022) <https://ethereum.org/en/developers/docs/evm/>.
[9] 'Gas and Fees' *Ethereum.org* (Web page, 10 March 2022) <https://ethereum.org/en/developers/docs/gas/>.

2.5. It may therefore be more useful to define a crypto asset as the combination of the token and the token system.

3. Definition of 'token system'

3.1. The Consultation Paper states that:

> A token system is anything designed to ensure or facilitate a function. It could include:
>
> a) business protocols (e.g. a casino's internal procedure for facilitating casino chip redemptions)
>
> b) social protocols (e.g. the understanding between Monopoly game players on following the rules (including the meaning of each token))
>
> c) physical protocols (e.g. the mechanisms that ensure access to a subway through a token operated turnstile).
>
> Token systems used in the provision of products and services are typically the procedures used to create and meet contractual obligations to customers. These contractual obligations may be overlayed with other legal rights and obligations, including those created by legislation and regulation.[10]

3.2. It may be useful to consider the protocols which make up token systems as existing along a spectrum. On one end, the protocols may be purely cryptographic. This is the case with 'cryptocurrency network tokens', and some 'general network tokens.' The function of the asset is facilitated purely by the cryptographic mechanisms and economic incentives within the network.[11] On the other end of the spectrum are assets where the performance of the function is purely enabled by the legal arrangements between the asset-holder and the issuer. This is the case with traditional securities, where a debt, for instance, only exists as a bundle of legal rights pursuant to enforcement by a court.[12]

3.3. When defining a 'token system' it may therefore be useful to explicitly refer to these component pieces. Many crypto assets will involve a hybrid of both cryptographic and legal protocols used to facilitate their function.

4. Issues with applying the functional perimeter

4.1. For a crypto asset to be considered a financial product it must first be a 'facility.'[13] Under the *Corporations Act 2001* (Cth) ('Corporations Act') s 762C definition of 'facility' is very broad, and may involve intangible property, an arrangement, or any combination of the two.[14] An arrangement can be a contract, agreement, understanding or scheme.[15]

4.2. This submission does not believe that a crypto asset whose token system is comprised of purely cryptographic protocols, such as a cryptocurrency network token, should be considered 'intangible property.' It should therefore not be considered a facility, and will not be a financial product under s 763A.

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[10] *Consultation Paper* (n 1) 15–6.
[11] National Institute of Standards and Technology, *Blockchain Networks: Token Design and Management Overview* (NISTIR 8301, October 2018) 37 ('NISTIR 8301') 5.
[12] Australian Law Reform Commission, *Traditional Rights and Freedoms— Encroachments by Commonwealth Laws* (Final Report, 2016) ch 7.
[13] *Consultation Paper* (n 1) 54.
[14] *Corporations Act 2001* (Cth) s 762C.
[15] Ibid s 761A.

4.3. Only crypto assets whose token system protocols involve legal arrangements should be considered facilities. This effectively includes all ICAs, as they are by nature intermediated via a legal arrangement with the issuer.[16]

4.4. Considering the Consultation Paper's proposals together, the Government's suggestion is as follows: An ICA will be a financial product when the protocols within an ICA's token system perform one of the general financial functions under s 763A. For simplicity, this submission will refer to crypto assets who satisfy this requirement as 'Investment ICAs', and those which do not as 'Utility ICAs.'[17]

The problem

4.5. This framework has one major flaw. A Utility ICA is not subject to financial markets law because it does not by nature make a financial investment, manage financial risk, or act as a non-cash payment facility.[18] However, it is likely that a Utility ICA will be sold through a fundraising mechanism such as an Initial Coin Offering ('ICO').[19] This process will make it risky.[20]

4.6. ICOs have been the primary way in which tokens are distributed to the market.[21] At its simplest, an ICO is a fundraising event where buyers will purchase tokens offered by the issuer-developers.[22] A vast majority of ICOs are structured so that tokens are presold to finance the development of a blockchain project in which the tokens will have some utility.[23]

4.7. A consumer may purchase a Utility ICA with the genuine intent to consume it within the network. This entails no risk of financial loss. In contrast, when an investor participates in an ICO, they are not purchasing tokens for consumption. The tokens are generally not yet functional – nor is there any guarantee that they will be.[24] Investors only purchase these risky assets because they are compensated with the right for their tokens to appreciate in value. This is the type of transaction that financial markets law has traditionally sought to regulate.[25]

4.8. The proposal made by the Consultation Paper would thus create a gap in the regulator's net, as even though a Utility ICA on its own may not be considered a financial product, it may still be attached to financial risk.

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[16] *Consultation Paper* (n 1) 20.
[17] These terms are based on a broad tradition in the literature to use three functional classes of tokens, 'utility', 'investment' and payment. See: Philipp Hacker and Chris Thomale, 'Crypto-Securities Regulation: ICOs, Token Sales and Cryptocurrencies under EU Financial Law' (2018) 15 *European Company and Financial Law Review* 645.
[18] The three branches of the general test for a financial product under s 763A of the *Corporations Act 2001* (Cth).
[19] Lewis Rinaudo Cohen, '*Ain't Misbehavin'*: An Examination of Broadway Tickets and Blockchain Tokens' (2019) 65(1) *Wayne Law Review* 81, 99.
[20] Iris M Barsan, 'Legal Challenges of Initial Coin Offerings (ICO)' (2017) 3 *Revue Trimestrielle de Droit Financier* 54, 55.
[21] Jin Enyi and Ngoc Dang Yen Le, 'Regulating Initial Coin Offerings ("Crypto-Crowdfunding")', (2017) 8 *Journal of International Banking and Finance Law* 495.
[22] Jean Bacon et al, 'Blockchain Demystified: A Technical and Legal Introduction to Distributed and Centralized Ledgers' (2018) 25 *Richmond Journal of Law & Technology* 1, 79, citing Nathaniel Popper, 'An Explanation of Initial Coin Offerings' *New York Times* (online, 27 October 2018) <https://www.nytimes.com/2017/10/27/technology/what-is-an-initial-coinoffering.html>.
[23] Collomb, Alexis, Primavera De Filippi and Klara Sok, 'Blockchain Technology and Financial Regulation: A Principle-Based Approach to the Regulation of ICOs' (2019) 10(2) *European Journal of Risk Regulation* 263, 271.
[24] Guido Ferrarini and Paolo Giudici, 'Blockchain Startups and Prospectus Regulation' (2019) 20 *European Business Organisation Law Review* 665.
[25] It has been acknowledged as a basic principle of ICOs that investors only take on this level of risk if they believe they can profit: Cohen (n 19) 99.

ASIC's solution in INFO 225

4.9. The Government's existing solution to this problem is provided by *Information Sheet 225: Initial coin offerings and crypto-assets* ('INFO 225'). Here the *Australian Securities and Investment Commission* ('ASIC') suggests that crypto assets are most likely to be classified under the *Corporations Act* as either securities, or interests in a managed investment scheme ('MIS'). INFO 225 states that the 'production of financial benefits' required under the s 9 definition of an MIS would include the benefit a token holder would receive if their tokens appreciated in value.[26] This is followed by the statement that:

> In some cases, crypto-asset or ICO issuers may frame the entitlements received by contributors as a receipt for a purchased service. If the value of the crypto-assets acquired is affected by the pooling of funds from contributors, or the use of those funds under the arrangement, then the crypto-asset is likely to involve a managed investment scheme.[27]

4.10. Reading between the lines, ASIC's reference to a 'receipt for a purchased service' strongly implies that Utility ICAs are the class of crypto asset which will be issued under an MIS.[28] INFO 225 therefore insinuates the following: A Utility ICA will be an interest in an MIS if it is sold through an ICO, and this arrangement affects its value.

4.11. Per INFO 225, a majority of Utility ICAs must therefore be operated pursuant to Ch 5C of the *Corporations Act*. This has practical consequences. Under s 601ED an MIS must be registered by ASIC if, amongst other things, it has over 20 members.[29] One of the key requirements for registration is that a scheme be operated by a responsible entity,[30] whom must be a public company and Australian Financial Services Licence Holder.[31] If a token can only exist under the guide of a central, controlling body, then legally it cannot become decentralised. Above all else, decentralisation has been the core promise of blockchain projects.[32] The requirement for a responsible entity to oversee the scheme is therefore antithetical to innovation. If Australian laws make this practically illegal, developers will simply relocate to more favourable jurisdictions overseas.

4.12. Where the Consultation Paper underregulates Utility ICAs, INFO 225 therefore overregulates them. The issue in both instances stems from a misunderstanding of the nature of the relationship between a Utility ICA and the ICO it is sold under.

The separability of ICO rights within a managed investment scheme

4.13. The solution to this issue rests on the fact that an ICO is an MIS. An MIS is a collective investment arrangement open to passive investors that offers returns on the basis of the schemes' best-endeavours, as opposed to a capital-backed basis.[33] Under the s 9 test

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[26] Australian Securities Investment Commission, *Information Sheet 225: Initial coin offerings and crypto-assets* (INFO 225, October 2021) ('INFO 225').
[27] Ibid.
[28] The government has acknowledged the prevalence of the three-class model which groups tokens into 'utility', 'investment', and 'payment' classes: *Senate Report* (n 2) 56, citing Organisation for Economic Coordination and Development, *Taxing Virtual Currencies: An Overview of Tax Treatments and Emerging Policy Issues* (October 2020) 12.
[29] This paper will assume that most a majority of ICOs have over 20 members for the sake of confining its scope. It is therefore unnecessary to explore the other instances which cause schemes to be registered under s 601 of the *Corporations Act*.
[30] *Corporations Act 2001* (Cth) s 601EA(4).
[31] Ibid s 601FA.
[32] Cohen (n 19) 93, citing Vitalik Buterin, 'The Meaning of Decentralization' *Medium* (Blog post, 6 February 2017) <https://medium.com/@VitalikButerin/themeaning-of-decentralization-a0c92b76a274>.
[33] *Australian Securities and Investments Commission v Great Northern Developments Pty Ltd* (2010) 79 ACSR 684; [2010] NSWSC 1087, [63]–[65].

for an MIS, a 'scheme' can constitute virtually any programme or plan of action.[34] If the other requirements are satisfied, it is uncontentious that an ICO is a such an arrangement.[35]

4.14. The s 9 test for an MIS also requires an investor to purchase 'interests.' As noted by ASIC, the acquisition of 'rights to benefits produced by the scheme' has been interpreted broadly,[36] with 'benefit' having a much wider meaning than merely profit or gain.[37]

4.15. This principle was established in *Australian Softwood Forests Pty Ltd v Attorney-General for NSW*.[38] Here the Softwood company entered into agreements with investors, whereby the investors bought trees to be planted and maintained by the company on the company's land.[39] Upon maturity investors were to fell the trees and sell them for a profit. The High Court found that if there had been no such arrangement between the parties, the investors would simply have been purchasing trees.[40] But they were not. Through the scheme they were purchasing trees, as well as the right to have the trees managed by the company, and for the value of the trees to appreciate through the company's managerial efforts.[41]

4.16. Similarly, in *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd*, an arrangement created to fund litigation was taken to be a managed investment scheme.[42] The scheme's benefits included the provision of legal services and the absence of exposure to adverse costs orders – not just the contractual rights to profit upon a successful judgement.[43] The 'interest' in the MIS was made up of a bundle of various rights.[44] In this case the right to profits from the judgement could not have been 'produced by the scheme', and therefore an interest, without being bundled together with the right to legal services necessary to bring about the successful judgement.[45]

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[34] *Australian Securities and Investments Commission v Takaran Pty Ltd* (2002) (2002) 170 FLR 388; (2002) 43 ACSR 46; [2002] NSWSC 834, [15] Barrett J observed that 'the essence of a 'scheme' is a coherent and defined purpose, in the form of a 'programme' or 'plan of action', coupled with a series of steps or course of conduct to effectuate the purpose and pursue the programme or plan.'

[35] The next limb of s 9 requires the contribution of money or money's worth to acquire rights to benefits produced by the scheme. As the purpose of an ICO is to raise capital in exchange for tokens, the 'contribution' element will also be satisfied. To 'contribute' has been interpreted as to 'make available' or 'supply' money. This is straightforward during an ICO: *Crocombe v Pine Forests of Australia Pty Ltd* (2005) 219 ALR 692; [2005] NSWSC 15, [52]–[53].

[36] This accords with the approach that has consistently been taken by the courts, led by Mason J in *Australian Softwood Forests Pty Ltd v Attorney-General for NSW* (1981) 148 CLR 121; 6 ACLR 45; [1981] HCA 49 ('*Softwood*'), where it was reasoned that a very wide meaning should be given to the word 'interest' in light of the provision's investor protection context, and the nature and scope of the exemptions from it. Although this judgement dealt with 'prescribed interests' under the old *Companies Act 1961* (NSW), courts have consistently decided not to read the words down: *Australian Securities and Investments Commission v Enterprise Solutions 2000 Pty Ltd* (2000) 18 ACLC 130; [199] QSC 387.

[37] *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* (2009) 180 FCR 11, 79 ('*Brookfield*').

[38] *Softwood* (n 36).

[39] *Softwood* (n 36).

[40] *Softwood* (n 36) per Mason J.

[41] *Softwood* (n 36) per Mason J.

[42] *Brookfield* (n 37).

[43] *Brookfield* (n 37) 71.

[44] The High Court has unanimously stated that it may be more helpful to speak of property as a 'bundle of rights' rather than just the underlying subject matter to which those rights attach: *Telstra Corporation Ltd v Commonwealth* (2008) 234 CLR 210, 230–1 [44] (Gleeson CJ, Gummow, Kirby, Hayne, Heydon, Crennan and Kiefel JJ), quoting Kevin Gray, 'Property in Thin Air' (1991) 50(2) *Cambridge Law Journal* 252, 299.

[45] *Brookfield* (n 37) 71.

4.17. It is therefore appropriate to say that an ICO does not just involve the sale of tokens. The 'interest' that investors are really purchasing is a bundle of several distinct rights.[46] The Utility ICA can be considered a digital representation of the property rights to certain services within the completed network.[47] Along with this, an investor in the ICO is also purchasing the right to benefit from the expertise and labour of the developers in building the network, which will ultimately result in an appreciation of the token's value.[48] This paper will refer to this latter bundle of rights as 'ICO rights.'

4.18. ICO rights should be conceived of as separate from the token. Afterall, a token does not have to be sold through an ICO. This point has been argued by scholar Lewis Cohen in relation to tokens that are subject to the equivalent test for investment contracts in the US.[49] He distinguishes that, but for the scheme, these assets have no inherent security-like characteristics.[50] This concept is referred to as the 'separability' of the asset from the investment scheme it is sold under.[51]

4.19. As mentioned above, Utility ICAs may be purchased either with the genuine intent to be consumed within the network, or by an investor in the ICO. Outside of the scheme the token is just a token – a bundle of innocuous rights to a service. When it is wrapped in the rights sold through an ICO it becomes risky. Only then is it appropriate to regulate the collective bundle as an interest in an MIS and a financial product.[52]

5. Proposal for applying the functional perimeter

5.1. This submission will proceed to propose a framework for classifying Utility ICAs as financial products. It will combine a two-stage model developed by US scholar Yuliya Guseva with the Australian law concept of property as a separable bundle of rights.

Guseva's Two-Stage Bond Token Model

5.2. Blockchain based projects go through two discrete stages. In the first stage tokens are sold to investors through an ICO. The second stage begins with the launch of a decentralized platform, DAO, or Dapp and the delivery of fully functional digital assets.[53]

5.3. In Yuliya Guseva's paper *'A Conceptual Framework for Digital-Asset Securities: Tokens and Coins as Debt and Equity'* she develops what this submission will refer to as a 'two-stage bond token' model.[54] She reasons that tokens sold through an ICO resemble debt

[46] The concept of property as a 'bundle of rights' is considered by groups of scholars as a more nuanced approach for the purposes of legal analysis. See; Denise R Johnson, 'Reflections on the Bundle of Rights' (2007) 32 *Vermont Law Review* 247; J E Penner, 'The Bundle of Rights Picture of Property' (1996) 43(3) *UCLA Law Review* 711.
[47] Hacker and Thomale (n 17) 28.
[48] The right to a developer's management of the project is analogous to the right to financial management within a traditional fund. For a discussion on the nature of this contractual relationship between the responsible entity as an investment manager, and the investor, see: Charles Zhen Qu, 'Australia's Managed Investment Schemes: The Nature of Relationships among Scheme Participants' (2004) 12(1) *Asia Pacific Law Review* 69.
[49] Cohen (n 19).
[50] Cohen (n 19) 93.
[51] Cohen (n 19) 106.
[52] The principle that 'when a purchaser is motivated by a desire to use or consume the item purchased . . . the securities laws do not apply' has been upheld by foreign courts: Cohen (n 19) 94, quoting *United Housing Foundation, Inc. v Forman*, 421 US 837 (1975), 848.
[53] National Institute of Standards and Technology, *Blockchain Technology Overview* (NISTIR 8202, October 2018) ('NISTIR 8202').
[54] Yuliya Guseva, 'A Conceptual Framework for Digital-Asset Securities: Tokens and Coins as Debt and Equity' (2021) 80(1) *Maryland Law Review* 166.

securities under the US *Howey* test.[55] When a traditional bond is sold, the issuer is essentially borrowing money from the investor, who in return receives the right to coupon payments and the face value of the bond at the maturity date.[56] During an ICO, the issuer-developer has similarly borrowed from the investors, and will eventually repay this indenture through the provision of functioning tokens.

5.4. In comparison, the subsequent token-holders who purchase tokens during the second stage will not be party to this bilateral relationship between the initial investor and the issuer-developer.[57] They will have no expectation of profit, as they have received a token which is fully functioning. Guseva therefore argues that the initial investors' tokens are securities, while the subsequent token-holders' are not.[58]

5.5. The point at which the debt-securities would cease to carry rights enforceable against the issuer, and convert to Utility ICAs, can be conceptualised of as their maturity date.[59] Guseva argues the maturity date can be found by applying the third and fourth limbs of the *Howey* test, being the 'expectation' of the 'efforts of others', as well as by asking the question of when these expectations occur.[60] Even though a platform is operational and decentralised, the initial investor may still expect the developer to continue to improve the ecosystem and thereby appreciate the value of their tokens.[61] Instead maturity occurs when the investor no longer *expects* the developer to provide services to promote the ecosystem.[62]

5.6. Guseva's theory can be summarised as such: Where developers raise capital through an ICO they are distributing bond-like securities to initial investors, entailing a right to profit from the developer's efforts in building the platform as set out in any offering documents.[63] These bonds will convert to Utility ICAs either at the maturity date (which occurs when the developer has discharged their contractual obligation to service the project), or when they are sold to subsequent token-holders post platform launch.[64] As the bonds may change hands before the maturity date, these two distinct assets may exist concurrently.[65] A bond attaches rights under securities law. A token does not.

5.7. Guseva's proposal has its drawbacks. Namely, the model does not specify the exact difference in nature, nor rights entailed, which are material when distinguishing between a bond and a Utility ICA.[66] Simply stating that the transformation occurs where there is no

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[55] The test is the functional equivalent to the s 9 test for a managed investment scheme under the *Corporations Act*. In order to come within the SEC's jurisdiction a transaction must involve a 'security', defined broadly to include transactions under 'investment contracts' per *Securities Act* 15 USC § 77b(a)(1); *SEC v WJ Howey Co*, 328 US 293 (1946), [20] establishes the test for an investment contract. An investment contract exists where there is the 1) investment of money into 2) a common enterprise with 3) the reasonable expectation of profits derived 4) from the entrepreneurial or managerial efforts of others.
[56] It should be noted that in reality, utility tokens more closely resemble 'zero-coupon bonds', as they do not entail the right to regular interest payments; Stewart M Robertson, 'Debenture Holders and the Indenture Trustee: Controlling Managerial Discretion in the Solvent Enterprise', (1988) 11 *Harvard Journal of Law and Public Policy* 461, 463.
[57] Guseva (n 54) 186.
[58] Guseva (54) 186.
[59] Guseva (54) 186.
[60] Guseva (54) 184, citing M Todd Henderson and Max Raskin, 'A Regulatory Classification of Digital Assets: Toward an Operational Howey Test for Cryptocurrencies, ICOs, and Other Digital Assets' (2019) 2 *Columbus Business Law Review* 443, 461.
[61] Guseva (54) 186.
[62] It is suggested that this is a matter for courts to determine based on the offering materials provided during the ICO, and whether or not they effectively disclaim any responsibility for postlaunch and postdelivery services: Guseva (54) 196.
[63] Guseva (54) 171.
[64] Guseva (54) 186.
[65] Guseva (54) 187.
[66] See above Ch IV(B) for a discussion on the consequences of failing to distinguish between a token and the scheme under which it is sold.

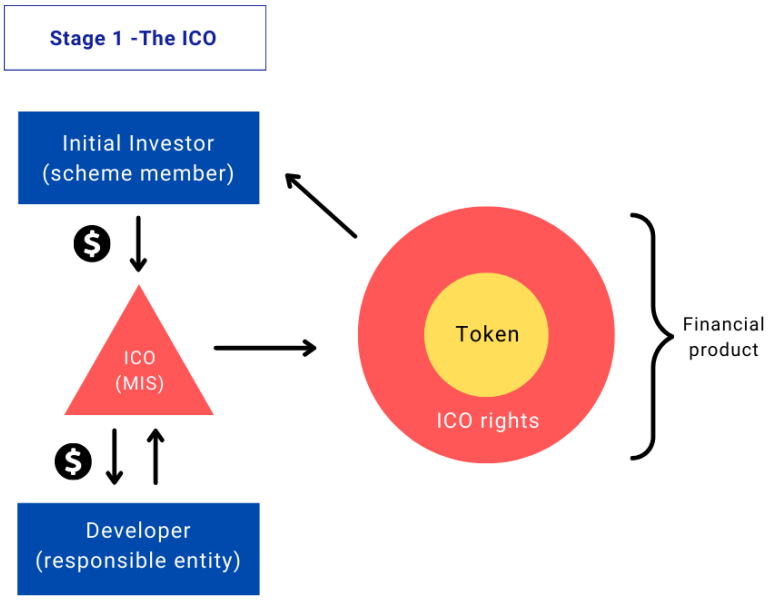
longer an 'expectation' for the developer to generate value is ambiguous.[67] It is therefore uncertain exactly how or when such an asset will shed its security status. Although this model provides a useful basis for token classification, certain elements of it can be improved.

The Two-Stage ICO Rights Model

5.8. This submission proposes that ASIC regulate Australian ICOs using a two-stage rights model. In the first stage under this model, Utility ICAs and their respective ICO rights will initially be sold as interests in an MIS. Although the Consultation Paper suggests using the general test for a financial product to classify tokens under s 763A, this paper believes that it is more practical to use the classes of financial product specifically included under s 764A. This is because it is the fundraising scheme of the ICO which is the operative element in determining whether financial markets law attaches to a Utility ICA, not the nature of the asset itself. In contrast, security tokens are likely to be financial products of their own accord. It is more appropriate to use the general test for these types of assets.

5.9. This reasoning grows out of the shortcomings in Guseva's two-stage bond token model. While Guseva notes the existence of a bilateral relationship between the initial investor and the developer as the main source of the token's security status, she stops short of specifying the exact nature of this right, nor how it terminates.[68] This paper's two-stage rights model therefore builds upon Guseva's theory by distinguishing between the bundle of rights that is the token, and the separate ICO rights that attach to it when sold through an ICO.[69] Under Guseva's model, the token is the security.[70] Under this model, the token can be separated from the ICO rights. A visual representation of this can be seen below:

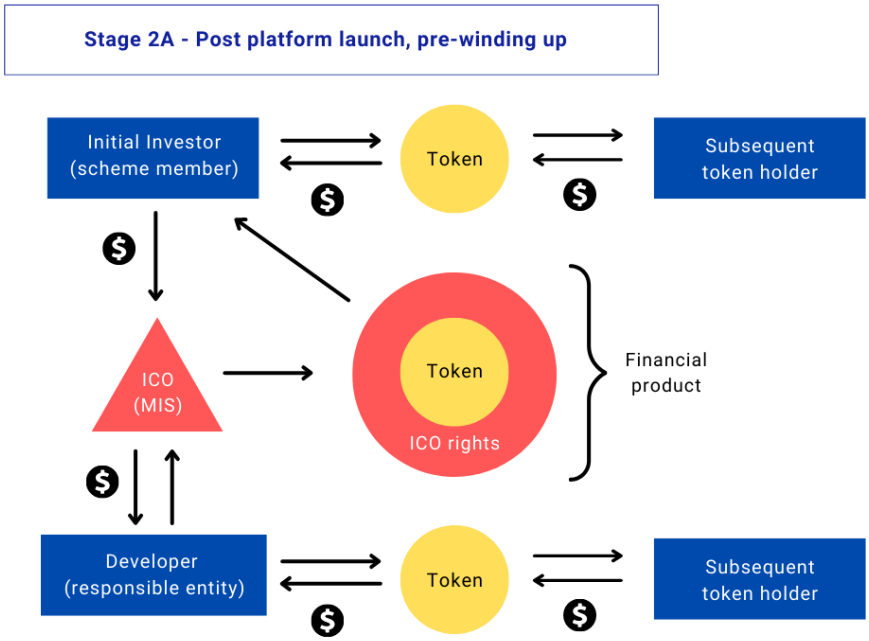
Figure 1: Stage 1 – The ICO



[67] Guseva (54) 186.
[68] Guseva (54)
[69] See above [4.16]–[4.19], citing Cohen (n 19); Gray (n 44); *Brookfield* (n 37) 71.
[70] Guseva (54) 180.

5.10. The next stage occurs once the platform which is funded by the ICO is operational, but before the agreement contemplated by the ICO rights has been fulfilled. Tokens that were sold to initial investors through the ICO will still be financial products. However, if these same assets are subsequently sold to a new party during this stage, they will not be subject to the bilateral agreement between the developer and the initial investor.[71] The subsequent token-holders do not possess any contractual ICO rights for the developer to appreciate their tokens.[72] These assets will therefore revert to simple Utility ICAs and shed their status as financial products. This can be seen below:

Figure 2: Stage 2A – Post platform launch, pre-winding up



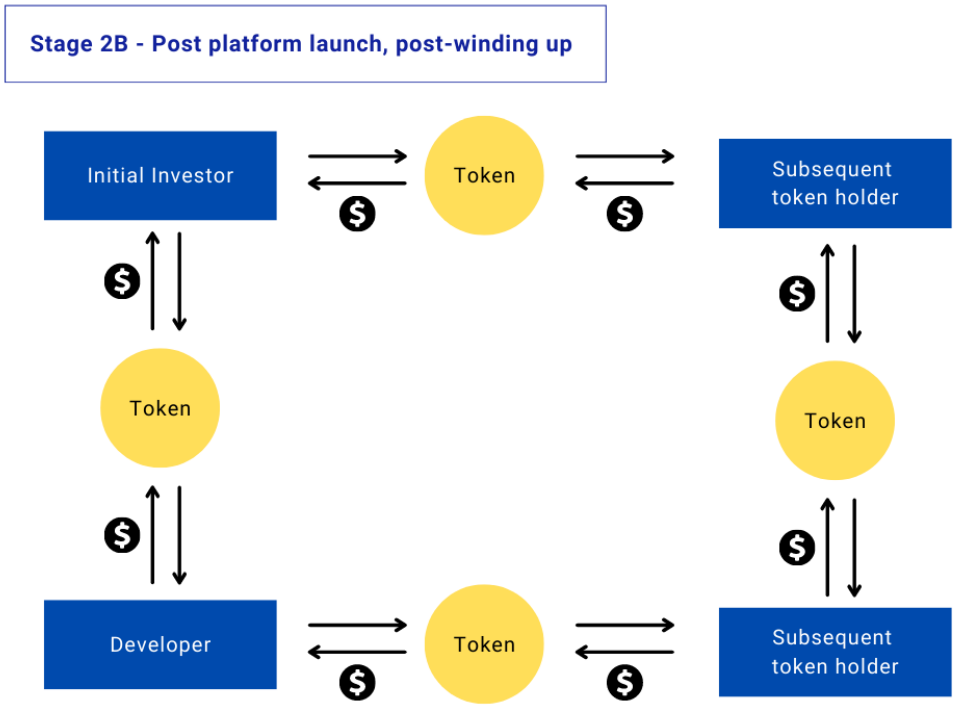
5.11. Finally, once the contractual obligations for the developer to produce benefits under the scheme have been fulfilled, all remaining ICO rights will cease to exist, and the eco-system of tokens will no longer include financial products. In Guseva's model an ambiguous 'maturity date' acts as the mechanism through which tokens are separated from the indenture.[73] Instead of this, the two-stage rights model relies on the statutory basis for winding up an MIS contained in Part 5C.9 of the *Corporations Act*.

5.12. An MIS will cease to exist when it is wound up.[74] Under s 601NC, a responsible entity may elect to wind up the scheme if they consider that the purpose of the scheme has been accomplished or cannot be accomplished. The purpose of an ICO is to raise capital to assist in the financing of the development of a blockchain project.[75] When this project is complete, the developer will have fulfilled their contractual obligations parceled within the ICO rights to appreciate the value of the initial investor's tokens, and they may therefore

[71] See above [4.16]–[4.19], citing Cohen (n 19); Gray (n 44); *Brookfield* (n 37) 71; above [5.4], citing Guseva (54) 186.
[72] See above [4.16]–[4.19], citing Cohen (n 19) 106.
[73] Guseva (54) 170.
[74] *Australian Securities and Investments Commission, in the matter of GDK Financial Solutions Pty Ltd v GDK Financial Solutions Pty Ltd* (2006) 24 ACLC 1, 364 ('*GDK*').
[75] Bacon et al (n 22) 79.

wind up the MIS and all of the interests with it.[76] All ICO rights will dissolve, and the tokens will no longer be regulated as financial products.[77] This final stage can be visualized below:

Figure 3: Stage 2B – Post platform launch, post-winding up



6. Conclusion

6.1. As Australia seeks to leverage the economic opportunities presented by crypto-assets, the framework with which financial markets law is applied to tokens must distinguish where financial risk truly stems from. In isolation a Utility ICA is merely a consumptive product. It is only when Utility ICAs are sold through an ICO that they should be subject to Ch 5C and 7 of the *Corporations Act*.

[76] *Corporations Act* s 601NC.
[77] The token will no longer be considered part of an interest in a managed investment scheme under s 9 of the *Corporations Act*, therefore Ch 7 will no longer apply.