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# INSIGHT: What SEC's Lawsuit Against Kik Teaches Us About Token Presale Agreements

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*Token presale agreements are a popular type of financing instrument among start-ups in the blockchain space. Latham & Watkins attorneys explore the initial impact of SEC v. Kik on the use of token presale agreements and discuss an approach the law firm developed to overcome challenges like the "single plan of financing" issue.*

By now, many gallons of virtual ink have been spilled over [SEC v. Kik Interactive Inc. \(Kik\)](#). The SEC alleges that Kik conducted an illegal securities offering when it raised \$100 million in its Kin token offering in September 2017.

Moving beyond the arguments proffered by each side, we briefly highlight the SEC's view of the token presale agreement that Kik used for its private sale of tokens and discuss how this issue can be avoided.

### SAFT Problems

Starting in May 2017—prior to Kin's public sale—Kik offered and sold Kin to investment funds and wealthy individuals (Accredited Investors) using a type of token presale agreement that Kik described as a Simple Agreement for Future Tokens (SAFT).



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The SAFT stated that the Accredited Investors would purchase Kin at 70% of the public sale price, with Kik delivering the first half of the purchased Kin at the same time it delivered Kin to the general public, following completion of a public sale. The second half of the purchased Kin would be delivered a year later.

The SAFT also stipulated that if Kik failed to conduct the Kin public offer and sale by Sept. 30, 2017, it would be required to return 70% of the funds raised under the SAFT. In late August 2017, Kik announced the details of its public sale, which ran from September 12-26, following which the tokens were delivered to all investors.

In its complaint, the SEC staff raised a number of issues in relation to Kik's SAFT. A key issue was that "Kik sold the Kin as part of a single plan of financing, for the same general purpose, at about the same time, without creating different classes of Kin." The SEC concluded that the private and public sales of Kin should be viewed as one non-exempt offering of securities. That is, the "public" sale included non-Accredited Investors, and when those persons are integrated into the "private sale," the "private sale" can no longer qualify for the private placement exemption from registration under U.S. securities laws.

## **The Automated Convertible Note**

In collaboration with ConsenSys and OpenLaw, we have developed an approach that seeks to overcome the challenges raised by token presale agreements, including the "single plan of financing" issue. This approach is encapsulated in the [Automated Convertible Note \(ACN\)](#), a free-to-use tool that addresses future token sales in a manner compliant with U.S. securities and commodities regulations.

As discussed above, a key issue with Kik's SAFT is that it did not sufficiently distinguish the private sale from the public sale, and thus the SEC viewed the two sales as one integrated financing (Kik objected to that characterization). The ACN is designed to avoid this issue entirely by providing clearer differentiation between the instruments being sold.

First, the ACN starts with an entirely different instrument, a convertible note. The convertible note operates in a way similar to those used in typical venture financings, and is convertible into equity securities instead of tokens. The ACN is clearly a security and would have very different attributes as compared to any subsequently issued token.

Second, instead of including the conversion and exchange rights of traditional token presale agreements, the ACN includes a Token Purchase Option, which provides noteholders with a limited right to participate in a future token sale, typically at the best price offered by the issuer in such sale.

In addition, upon the occurrence of a token sale, the noteholder is entitled to elect for the convertible note to: (i) be repaid at a pre-negotiated multiple of the convertible note's aggregate principal amount; (ii) remain outstanding; or (iii) be converted into preferred stock of the issuer.

Consequently, the noteholder could elect at the time of a token sale to receive their original investment back (potentially at a premium) and then exercise their Token Purchase Option to participate in the token sale. This structural adjustment helps distinguish the subsequent token purchase from the convertible note securities offering.

To the extent the token sale occurs after the launch of the network and is not otherwise part of the same plan of financing, we believe the various distinguishing characteristics between the ACN and the token should be sufficient to distinguish the two sales such that the future token sale should not be integrated with the original offering or considered part of the same plan of financing.

Accordingly, we hope the ACN assists in permitting innovators to move forward with these projects in a way that does not run afoul of U.S. securities laws.

*This column does not necessarily reflect the opinion of The Bureau of National Affairs, Inc. or its owners.*

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