

PRACTICAL ASPECTS OF INITIAL TOKEN OFFERINGS (PART 2)

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In every Initial Token Offering (also known as Initial Coin Offering) we have to strive to create a token which will catch the interest of the community. This first of all requires forethought and an understanding of what is driving the community, but it also needs to focus on creating a sound legal basis for years to come, no matter how often the token has been transferred, be it online or through the transfer of an offline wallet. Token structuring therefore is also a task for the lawyers.

1. The Art of Creating Valuable Token-Economics

We are seeing Initial Token Offerings where tokens have been created by just mirroring the structures known to private equity investments, and in many cases even watered down in their economic effect to a marginal quota of both ownership and future profit participation without having any relation to decentralisation or the blockchain. These token sales are not doing the blockchain justice. They neither build on its potential, nor are they taking into account that many token-holders are not only investing because of revenues, but also because they want to be engaged ecologically, socially or politically.

The legal system has been built to be flexible and has sustained many changes and new technologies over the last decades. The idea of tokenization and of crowdfunding is exciting because it allows us as lawyers to advise on the basis of all the different tools the law offers. Token holders can co-own assets, receive portions of specific revenue streams, can hold membership rights, can form a simple partnership and can vote on specific subjects determined in the smart contract.

When choosing the right token structure lawyers need to support the clients in determining what should be tokenized and what the message behind the tokenization should be. In doing so, they should be open-minded - last, but not least, because old school investment structures come with a serious legal drawback.



2. The Issue of the Assignment

The assignment of claims under Swiss law is valid only if it is done in writing. This also applies to the transfer of uncertificated securities. The minimum requirement is a handwritten or, alternatively, qualified electronic signature under a machine-written text. The transfer of tokens on the blockchain does not fulfil this requirement. It is correct, that two parties can agree not to be bound by this formal requirement and such an agreement can be implemented in the initial terms and conditions between token issuer and the first token holder. But it will not automatically also be applicable to the second and the third token holder.

Therefore it is advisable to steer clear from any structure which has tokenized rights requiring transfer via assignment until the lawmaker has decided on a (hopefully technology neutral) new law instead of the existing need for written assignment.

3. Interesting Alternatives

In our discussions and workshops with clients we tend to first think about the business of the client, the interests token holders may have to see progress and how they can engage in the success of the company more visibly than only based on annual accounts. The following few examples may give a good starting point to think about what to offer the token holders:

Create asset tokens. This is not the same as an asset-backed token, where the assets only create an underlying security interest. Possession of an object may be acquired without physical delivery if a third party or the transferor himself retains possession of it in terms of a special legal relationship. In the case of an asset token the token holder has ownership rights and the token represents the instruction to the possessor of the asset to acknowledge ownership ("Besitzesanweisung"). Therefore the asset can remain with the issuer as possessor who accepts every token holder as partial owner of the asset. Similarly, certain IP rights can be tokenized.

Alternatively, create a limited ownership right on the revenues derived from of certain goods, assets or IP rights, rather than merely give a claim to revenues (so-called usufruct).

In the case of asset-backed tokens or similar contracts, there is a high probability that you will have rights and obligations on both the issuer and the token holder. In this case make sure that the entire contract between issuer and token holder is tokenized. Then the contractual rights and obligations will roll over from one token holder to the next, contrary to the situation created by the role-over of a mere claim (see section 2 above). Under Swiss law the transfer of an entire contract does not require a written agreement.

If you do want to give old-school equity rights (and there may be good reasons to take that decision) do not use uncertificated securities, but maybe think of creating a global certificate which you tokenize. Then you transfer ownership as set out in section 3(i) above by means of an in



struction to the possessor of the global certificate. However, do beware of the obligations to maintain shareholder and beneficial ownership registers and you will have to make sure you do not fall foul of prospectus requirements in the different jurisdictions.

Alternatively create a partnership of token holders similar to a shareholders' group and tokenize the partnership agreement. The shares of the company are then held by all token holders jointly and an escrow agent will act in accordance with the instructions of the majority of the shareholders.

Obviously there are many more options and all of these can be tweaked to suit the individual needs of the issuer. And whilst these options do not claim to solve all problems for a global distribution of the tokens and the token generally speaking will still remain a security under US laws, they at least come with the upside that the transfer of the token is valid if Swiss law applies to the token and its transfer.

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