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What entrepreneurs should know about raising capital in the age of blockchain



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Blockchain technology has attracted an enormous amount of attention – and capital – over the past year.

According to data from CB Insights, blockchain-focused startups raised more than \$5 billion in 2017. Notably, a majority of that funding was raised through blockchain token sales

rather than traditional venture capital financing transactions. Already in the first few weeks of 2018, token sales and pre-sales have raised more than \$1 billion, according to a recent report by TechCrunch.

If you are a technology entrepreneur whose company is looking to raise capital soon, you have likely considered whether to do so via traditional methods such as an equity or debt financing, or you may be considering a token sale.

In this article, we highlight three key business and legal considerations to keep in mind as you consider whether a token offering is the right fundraising strategy for your company.

Consider Product-Market Fit

The first and most important question to answer about whether a token offering might be the right fundraising strategy for you is: Why sell tokens rather than debt or equity securities?

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If your answer is that the former are subject to little or no regulation, expect to be quickly dissuaded from that notion after speaking with your legal advisor and reading up on recent legal developments, including numerous inquiries and enforcement proceedings initiated by federal, state, and foreign regulators. Likewise, if you are motivated by a desire to seize on recent hype around blockchain and token sales, do not be surprised when sophisticated investors identify that motivation and decline to participate.

Be prepared to show how selling tokens can help you not only raise money, but also tackle a problem you were already trying to solve. If, for example, you find a token sale appealing because your business leverages blockchain technology and tokens could help drive growth by engaging a dispersed group of contributors or customers, you may have an easier time establishing the bona fides of your token offering.

Keep Existing (and Future) Stakeholders Happy

Be mindful of the interests of your company's investors, lenders, employees, directors, customers, and other stakeholders. If you have raised money from angel or venture capital investors or borrowed money from a bank, for example, you may find that your company's financing agreements require you to obtain certain approvals before conducting a token sale.

Indeed, the National Venture Capital Association's recently revised Model

Legal Documents now include provisions requiring board or stockholder approval of token sales. And if you are an officer or director, you will want to make sure to keep your company's board of directors informed about your fundraising strategy, whether or not it involves tokens.

Even if you are able to satisfy these formal approval requirements, remember that not all investors and lenders feel the same about token sales. Some think of them as "found money" for companies that are fortunate enough to complete a successful token sale, while others view them as an unnecessary distraction or unreasonably risky.

Canvas your company's current and potential future stakeholders and your advisors to gather their views about a potential token sale. Those discussions may reveal important tradeoffs – such as creating obstacles for a potential acquisition – that you are not ready to make.

Keep Up with Regulatory Developments

Even if you, your stakeholders, and advisors are comfortable with pursuing a token sale, remember that the regulatory environment can change rapidly and that federal, state, and non-U.S. regulators are afforded broad enforcement discretion to fulfill their respective mandates, notwithstanding the absence of major court decisions or changes in statutes.

Many regulators who previously viewed token sales as niche transactions are now focused on them. The chairman of the U.S. Securities and Exchange

Commission, for example, recently declared in congressional testimony that, in his view, token offerings generally "involve the offer and sale of securities and directly implicate the securities registration requirements and other investor protection provisions of our federal securities laws." He also noted in a recent speech that he has instructed the SEC staff to be on "high alert for approaches to [token offerings] that may be contrary to the spirit of our securities laws."

Even where no public precedent exists to suggest that a regulator might seek action today, the prognosis could be very different days, months, or years from now.

In the face of this uncertainty, failure to consider other potentially applicable regulatory regimes and developments – including, but not limited to, federal, state, and non-U.S. laws relating to taxation, commodities, money transmission, consumer protection, and intellectual property – could stop a fundraising process in its tracks or result in an unexpected dialogue with regulators.

Lawyers who regularly advise emerging companies and their investors are increasingly fielding questions about regulatory risks related to token sales. Speak with experienced legal advisors sooner rather than later to identify salient risks and avoid spending too much of your most precious resource – your time – pursuing a token sale strategy before understanding and developing a plan to address those risks.

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