



Legal Opinion: TENSET Token

TENSET token (“TENSET”) is a 100% pre-mined token that is designed to permit access to an automated investment and income generating platform with automated smart-contract payouts made directly to TENSET holders’ wallets. TENSET also entails a deflationary plan wherein 1% of any TENSET transaction will be instantly burned upon completion of any token transfer, and 30% of TENSET will be automatically repurchased by the issuer annually. The token offering has occurred in early 2021 and the platform appears to currently be in beta phase, with the intention to go live sometime in the second and third quarter of 2021.

Section 2(a)(1) of the Securities Act of 1933 defines “securities” as: “any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement ... investment contract ... 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.”

The seminal Supreme Court case for determining whether an instrument meets the definition of security is *SEC v. Howey*, 328 U.S. 293 (1946). The Supreme Court has reaffirmed the *Howey* analysis as recently as 2004. *Howey* focuses specifically on the term “investment contract” within the definition of security, noting that it has been used to classify those instruments that are of a “more variable character” that may be considered a form of “contract, transaction, or scheme whereby an investor lays out money in a way intended to secure income or profit from its employment.” Not every contract or agreement is an “investment contract” and the Supreme Court developed a four-part test to determine whether an agreement constitutes an investment contract and therefore a security.

The Court articulated the test as follows: A contract constitutes an investment contract that meets the definition of “security” if there is (i) an investment of money; (ii) in a common enterprise; (iii) with an expectation of profits; (iv) solely from the efforts of others (e.g., a promoter or third party), “regardless of whether the shares in the enterprise are evidenced by formal certificates or by nominal interest in the physical assets used by the enterprise.” In order to be considered a security, all four factors must be met.

1. Under *Howey*, and case law following it, an investment of money may include not only the provision of capital, assets and cash, but also goods, services or a promissory note. Given the broad definition of a money investment and the fact that TENSET is distributed by the issuer to buyers with the price set per token, even if payment is made in the form of cryptocurrency - ETH in this case - the first factor will likely be satisfied.
2. Various circuit courts use different tests to analyze whether a common enterprise exists. Three approaches predominate: (i) horizontal; (ii) narrow vertical and (iii) broad vertical.

- a. Under the horizontal approach, a common enterprise is deemed to exist where buyers pool funds into an investment and the profits of each buyer correlate with those of the *other buyers*. Whether funds are pooled appears to be the key question, and thus in cases where there is no sharing of profits or pooling of funds, a common enterprise may be deemed *not* to exist.
 - i. Under the horizontal approach, the TENSET project is likely to be deemed a common enterprise because the buyers of TENSET will pool their funds into the TENSET platform so that the funds may be utilized to oversee and manage the platform, as well as to provide for marketing and other operational costs. Furthermore, crypto assets received in exchange for TENSET will be used to purchase staked tokens to generate staking income for holders of TENSET which is a form of profit sharing. This test would likely be met for TENSET.
 - b. The narrow vertical approach looks to whether the profits of an investor are tied to a promoter and the analysis is similar to the next approach.
 - c. The broad vertical approach considers whether the success of the investor depends on the promoter's expertise. If there is such reliance, then a common enterprise may be deemed to exist.
 - i. The less of a reliance on the issuer's expertise, then the less chance the TENSET project would be viewed as a common enterprise. The TENSET token is presently in final development stages and ready to go live. There is some reliance on the development team to complete the platform and oversee its launch. Promoter's expertise is required to select the best assets for producing staking rewards for TENSET holders. It appears TENSET may also be a common enterprise under this test at this time, but not once the project goes live.
 - d. Given the diverging approaches, the law on the "common enterprise" element is somewhat unclear and not easily susceptible to analysis. In this case there seems to be proportional sharing of profits and pooling of funds. Whether there is pooling of funds also depends on the current stage of platform development. The TENSET platform runs on the ERC20 blockchain and is presently operational although not live, once it is fully live the embedded smart contracts will generally be responsible for operations and distribution of rewards. Until the platform is fully operational and decentralized it is likely this test would be met for TENSET.
3. Under the "expectation of profits" element, profit refers to the type of return or income an investor seeks on their investment (rather than the profits that the system or issuer might earn). Thus, for purposes of TENSET, this could refer to any type of return or income earned as a result of being a TENSET investor, which would be narrowed to the extent it is derived passively, i.e.,

from the efforts of others. Since courts consider this factor through the lens of the “efforts of others” factor, this prong is analyzed along with the fourth factor below. In other words, just because there is a return or profit, does not mean that the investment contract is a security. It is the essentially *passive nature of the return*, as determined by the “efforts of others” analysis that results in an “investment contract” and a “security” as opposed to a simple contract instrument. Because buyers of TENSET are most likely purchasing it for the purpose of generating passive returns in addition to potential capital gains from increase in value of the token, it is likely that this factor would be met. Additionally, the form of marketing of the token would have a significant effect on the determination regarding this test, discussed below.

4. “Solely from the efforts of others”: typically, courts have been flexible with the word “solely,” such that, in addition to the literal meaning, it also will include significant or essential managerial or other efforts by the issuer necessary to the success of the investment.
 - a. The expectation of profits resulting from the purchase of TENSET would primarily relate to whether a buyer receives rights and/or investment interests. While non-security token holders may receive money, capital gains, or other forms of financial incentives by virtue of merely owning the token, any such incentives should be derived through their own efforts, rather than through a passive investment. There are such interests or incentives granted to buyers in the case of TENSET; however, the substantial involvement in the governance and management of the platform by TENSET holders would likely negate the passivity element since voting rights granted to TENSET holders may be deemed to possess the significant or essential managerial powers to ensure the success or failure of the platform.
 - b. Assets held by TENSET are managed by automated smart contracts which control the distribution of rewards to TENSET holders. During the asset holding period any oversight by the management team may be deemed non-essential.
 - c. The capital gains aspect of TENSET, wherein the buyers would expect an increase in value of the TENSET from the purchase price of the token, would not be dispositive towards either security or non-security status of TENSET because the capital gains would occur through the buyers’ own efforts and because of the TENSET decentralized platform, in addition to the efforts of the issuer. Therefore, the efforts of the issuer would not predominate this reliance factor, and are unlikely to be deemed “essential”.
 - d. The manner in which the sale of TENSET occurs, particularly the promotion and marketing, may also affect the “expectation of profits” analysis. For example, if the language used to promote TENSET includes words like “investment,” “returns” or “profits,” the purchasers of TENSET may be more likely to expect passive profits from the efforts of others than if TENSET is promoted on the basis of the usefulness of the functionality attaching to it.

- e. With respect to voting rights, courts have also analyzed the existence of voting rights through this Howey factor. Whether voting rights are determinative of a security will be based on the facts at hand. For example, where (i) the holder is provided with rights that provide it with significant managerial control— i.e., the ability to participate in decisions that will affect the success of the enterprise; (ii) the holder has the resources and expertise to make a meaningful contribution; and (iii) the holder does, in fact, participate in management decisions, the instrument is *less* likely to be considered a security, due to the active nature of engaging in an informed and significant voting process. At present, there are substantial voting rights granted to holders of TENSET with respect to control and management of the TENSET platform. This factor as well as the non-reliance on the management team but on the platform itself militate toward TENSET not being deemed a ‘security’.
5. Based on the above analysis of the unique nature of TENSET, the security/non-security scale leans slightly towards TENSET **not** being a security due to its failure of the 4th factor. The active nature of the voting and other forms of governance input rights received by all TENSET holders would likely not be sufficiently passive to declare TENSET a security. There likely exists an expectation of passive profits by means of merely holding TENSET; however, the determination of this factor would also depend on the nature of the reliance on the management/development team. The following will provide a summary of the above factors used in the analysis.
- a. TENSET will be sold for value to investors thereby satisfying the first factor of the test.
 - b. TENSET has functionality which may not be accessed by anyone other than specific TENSET holders; this factor moves the scale toward the TENSET not being a security.
 - c. TENSET provides voting, management, and control rights over the TENSET platform; therefore, this factor tends to shift the balance toward the investment being less passive by not requiring the reliance by buyers on the essential managerial efforts of the founders. Because the platform is nearly fully operational and will be automated and decentralized there is not likely to be significant reliance on the development/management team, whose oversight efforts would not likely be deemed essential to the continued successful operations of the platform. There would likely be greater reliance on the TENSET platform itself and the underlying assets being held by the platform, than the management team.
 - d. TENSET marketing does not appear to use investment correlated terms such as “ROI” “profit” or “returns,” therefore this tends to push the scale toward TENSET not being deemed a security regardless of the actual expectation of profit by buyers of the token.

