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MEMORANDUM

From: Stephen H. Galebach

To: David Frohlich
Assistant Director, Division of Enforcement
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-5030
email: frohlichd@sec.gov

Re: Wells submission In the Matterof Sparkster Enterprise, Ltd. (HO-13851)

By letter of November 8, 2021, the Enforcement Division of the US Securities and Exchange Commission has informed the undersigned of its preliminary determination to recommend that the Commission file a civil enforcement action against the undersigned's client Mr. Ian Balina, under Sections 5(a) and 5(c) of the Securities Act of 1933 and under Section 17(b) of the Securities Act.

The Enforcement Division's proposed charges against Mr. Balina are an unfounded effort, based upon multiple misconceptions of fact and law, enumerated below, that would have the effect of barring or limiting Mr. Balina from personal involvement in a highly successful analytical and publishing cryptocurrency-focused business that he has built over the past two years.

At the height of the "ICO" boom of 2017-2018, Mr. Balina became internationally renowned as the person who parlayed a $20,000 initial cryptocurrency investment into a multi million dollar portfolio. His diligent disclosure of his investments in the digital assets that he spoke and wrote about led to his fame, so that by January 2018 his disclosure spreadsheet was viewed more than one million times per month. "He's a legend," said Peter Moores of the SEC's Boston office in a telephone conversation with the undersigned in early 2020; Mr. Moores was then leading an early stage of the Commission's scrutiny of Mr Balina (albeit the Commission-approved investigation was directed then, as again in 2021, toward another named entity, not Mr. Balina).

During 2018 Mr. Balina famously conducted a "World Tour," visiting offices of token issuers (typically ERC-20 tokens on the Ethereum network), interviewing founders and their team members, and publishing his views of what projects were real and valuable – in the midst of a wild west of questionable and often fraudulent projects. Mr. Balina invested his entire time and much of his resources in trying to separate wheat from chaff, an activity that regulators in the western world might have done but did not. (In a conference call on February 1, 2018 arranged by Keith Higgins, Dir. Corp. Fin. 2013-2017, for the undersigned and a partner of Mr. Higgins with three SEC staffers involved in the Commission's work on token offerings, Jonathan Ingram, Esq. stated, "we are not close to putting pen to paper" to identify with particularity what factors would make a token a security and what factors would not).

In the course of his World Tour, Mr. Balina was the master of ceremonies for a series of events similar to the well-known "Shark Tank" for startups, at which aspiring token-oriented startups pitched their projects to audiences of hundreds. Winners were chosen not by a small panel as in Shark Tank, but by the entire audience by voice vote and show of hands.

Mr. Balina approached undersigned counsel in May 2019, at the earliest public signs that the SEC was open to approving under Regulation A+ some qualified offerings of digital asset tokens deemed securities. He sought to develop an offering of such a token in a compliant manner. When, after months of developmental work for such an offering, it became doubtful that the Commission would approve more than the initial such pioneering offerings, Mr. Balina continued to work with undersigned counsel to find compliant ways to raise capital.

From fall 2019 to present, Mr. Balina has developed a business under the name Token Metrics, employing experts and utilizing their technical expertise and analytical methods similar to those used in major financial firms of the non-token economy. He successfully raised the necessary capital via private placement under Regulation D as well as a crowdfunding commencing in summer 2021 under Regulation CF, as his company successfully grew to a valuation of $80 million.

The charges. Now, after two years of scrutinizing Mr. Balina's activities in the course of two SEC investigations of other firms in the digital asset economy, and receiving more than 700 Gigabytes of data produced by Mr. Balina, the Enforcement Division has brought charges stemming from one particular event outside the United States on Mr. Balina's World Tour.

The event occurred in Amsterdam, Netherlands, on May 11, 2018. Approximately 600 people attended. Persons in Amsterdam other than Mr. Balina, in the course of organizing the event, chose eight contestant projects, with each project represented by a founder who spoke for one minute. The three top vote getters by acclamation then had three minutes each to give a more detailed presentation. The winner, Mr. Sajjad Daya as CEO of a project named Sparkster, then had five minutes to speak further and give what he purported to be a demonstration of an operational system. Mr. Balina surprised Mr. Daya by subjecting him on the spot to questions from the audience in the form of an "AMA" (Ask Me Anything). Mr. Balina hosted further questioning of Mr. Daya in a second AMA on May 25, 2018. Both the May 11 event and the

May 25 event are viewable on Youtube in the form of videos that Mr. Balina has produced to the Commission.

The May 11, 2018 video shows Mr. Balina explaining at the outset of the event that he is part of an angel investor group that invests up to $10 million in projects. Youtube video, "Crypto World Tour: Amsterdam, Netherlands," May 11, 2018, at 1:11-1:23. The video also shows him, in response to a question, saying that he does not accept any payments from contestants. *Id*. at 1:05:54-1:06:31. While various celebrities less known than Mr. Balina in the crypto-focused universe took payments from token issuers, throughout his World Tour Mr. Balina did not accept payments from contestants. He repeatedly disclosed that he and investors in the angel investor group invested in token-based projects. For example, the May 25, 2018 video shows Mr. Balina stating at the outset of the AMA, "I have invested" – in reference to Sparkster's private pre-sale prior to public sale of Sparkster tokens. Youtube video, "Hangouts on Air: Sparkster ICO AMA and Demo," May 25, 2018, at 0:4:03-4:04.

The Enforcement Division now focuses on the Sparkster instance, out of Mr. Balina's hundreds of interactions with token-issuing projects, to charge him with touting, for allegedly not disclosing the fact and amount of a 30% volume-based discount from the public sale price, which applied to the private pre-sale purchase of Sparkster tokens by Mr. Balina and dozens of other angel investors. Additionally, Mr. Balina is charged with offering and selling unregistered non-exempt securities in the form of Sparkster tokens.

This is the first time, to the undersigned's knowledge, that a private pre-sale purchase of a digital asset token, with a discount/bonus typical for such purchases, has been accused of being "compensation" in exchange for publicity. As explained below, this is a particularly inapt set of facts for such a pioneering case. Nor is there a legal basis for enforcement against Mr. Balina under Section 5(a),(c) of the Securities Act of 1933.

The charges proposed by the Enforcement Division rest on the following misconceptions:

1. Factual misconception. The Enforcement Division explained in a conference call with the undersigned on Friday, October 29, 2021 why they believe that Mr. Balina invested the amount of US $1.2 million in Sparkster tokens in May 2018: They cite evidence that $5 million was invested in total by Mr. Balina and the other angel investors (approximately 60 persons in total), pursuant to a SAFT (simple agreement for future tokens) that was signed by Mr. Balina. They further aver to having found evidence of only $3.8 million going into the investment pool by the angel investors other than Mr. Balina. Subtraction yields a difference of $1.2 million, which they presume to be invested by Mr. Balina.

The Enforcement Division's number is off by a factor of more than 10. Mr. Balina has evidence that he invested $106,915.50 on May 21, 2021 in the form of 150 ETH (Ethereum digital assets). That he invested no more than that amount is confirmed by his blockchain-embedded record of how many Sparkster tokens he received. Nor did he receive any compensation from any of the other angel investors.

2. Legal/factual misconception about disgorgement. It is axiomatic that disgorgement applies to ill-gotten gains causally related to wrongdoing. *SEC v. First City Financial Corp.* 890 F.2d 1215, 1230-32 (D.C. Cir. 1989). Disgorgement must be "a reasonable approximation of *profits* causally connected to the violation." *SEC v. Patel*, 61 F.3d 137 (2d Cir. 1995), *quoting SEC v. First City Financial Corp.*, *id*. at 1231 (emphasis added). In this case, Mr. Balina received no profits, no net value whatsoever. On the contrary, he lost virtually all the value of his investment.

At the time when Mr. Balina invested, May 21, 2018, there was no market value of Sparkster tokens against which to compare the discount price that Mr. Balina and others paid. Sparkster tokens were not issued to Mr. Balina and the other angel investors until more than a year later. For more than a year, until June 2018, Sparkster tokens did not exist, and thus there was naturally no market value for them before then.

The first transmission of Sparkster tokens to the angel investors including Mr. Balina did not occur until August 2019. The Onchain data from Mr. Balina's Sparkster wallet show him receiving a first transmission of Sparkster tokens, in numbers consistent with his investment of 150 ETH, on or about August 28, 2018. As of August 28, 2018 there was no secondary market and no market value of the Sparkster tokens. When trading on an exchange later began in September 2019, the price of Sparkster tokens fluctuated between 2/10 and 3/10 of one US cent, on a daily trading volume that averaged mostly in the hundreds of dollars and occasionally in the low thousands. *See* www.nomics.com, last accessed Nov. 16, 2021 (historical price data for SPRK token)

Thus any value that Mr. Balina received from Sparkster was at most a small percentage of the value of his investment in Sparkster tokens. Given the low trading volume in SPRK tokens, it was impossible for Mr. Balina to realize any significant value from the SPRK tokens he received; any effort to sell more than a handful of tokens would have driven the price immediately toward zero.

A second transmission of tokens from Sparkster to the angel investors including Mr. Balina occurred on or about August 8, 2020. During August 2020 the historical prices of the SPRK token fluctuated between 1/10 and 4/10 of one US cent, on trading volume that averaged well under $1,000 per day.

A third and final transmission of tokens to the angel investors including Mr. Balina occurred on or about October 27, 2020. The price of SPRK tokens in the ensuing days was consistently under 3/10 of one US cent, with average daily trading volume well under $1,000.

These figures compare to a purchase price of $0.105 paid by Mr. Balina and the angel investors. In short, the value they received – with considerable delay after investment – was a small fraction of what they invested. Given the low trading volumes of the SPRK tokens, the tokens they received were essentially worthless.

Mr. Balina has never sold any of the tokens he received from Sparkster. There is no prospect of future value, as there are no longer any exchanges listing the SPRK token.

The only thing Mr. Balina has to disgorge – if he could – is a $106k loss.

As a matter of law, there being no ill-gotten gain, there is nothing to disgorge. By the same token, there is no evidence that Mr. Balina received any profit, compensation or consideration in connection with Sparkster's offer and sale of an alleged unregistered security.

3. Misconception about legal precedents. When undersigned counsel asked three lawyers of the Enforcement Division, in a conference call on September 24, 2021, what precedent they can cite for treating a discount purchase of tokens as compensation, they had no answer. When undersigned counsel then asked what precedent they can cite for treating a discount purchase of any type of alleged security as compensation in a 17(b) context, they said they would get back to me. Several days later one of the Enforcement Division lawyers sent this response:

> Pursuant to our conversation last week, I am providing a few decisions in response to your request for case law that we believe supports the proposition that a bonus or discount received by a promoter qualifies as "consideration" for purposes of Section 17(b) of the Securities Act of 1933. The following decisions reflect that the receipt of shares of stock itself qualifies as such consideration: *SEC v. Thompson*, 238 F.Supp.3d 575, 595-596 (S.D.N.Y. 2017); *SEC v. Friedland*, 2019 WL 688054, *3-*4 (D. Colo. Feb. 19, 2019); *SEC v. Corp. Relations Grp*., 2003 WL 25570113, *2 (M.D. Fla. March 28, 2003); *SEC v. Huttoe*, 1998 WL 24078092, *2, *9 (D.D.C. Sept. 14, 1998).

None of these cases involved a discount purchase of the securities in question: *Cf. SEC v. Thompson*, 238 F.Supp.3d 575, 595-96 (S.D.N.Y. 2017) (defendant touted Recycle Tech stock in exchange for a free grant of 2,325,000 shares of Recycle Tech stock); *SEC v. Friedland*, 2019 WL 688054, *3-*4 (D. Colo., Feb. 19, 2019) (defendant promoted OSC stock in exchange for free grants of OWC stock); *SEC v. Corp. Relations Group*, 2003 WL 25570113, *2 (M.D. Fla., March 28, 2003) (defendants, after receiving shares as compensation, promoted the stock in their publications); *SEC v. Huttoe*, 1998 WL 24078092, *2, *9 (D.D.C., Sept. 14, 1998) (defendants received shares of stock for promotions of said stock).

A fortiori, none of these cases remotely supports the idea of treating as compensation a discount purchase of a commodity that has no market price at the time, that has no secondary market in which the theoretical value of a discount can be realized, and that in fact does not even exist until more than a year later when the commodity is created and conferred on purchasers.

While the terms discount and bonus are often used interchangeably in token sales, and were used interchangeably in this case as well, there is no ground for confusion: The only way Mr. Balina or any other angel investor was able to receive "bonus tokens" from Sparkster was by purchasing tokens at a discount price of $0.105. The economic reality is not changed by using the term bonus or the term discount. In contrast to all four of the Enforcement Division's above-cited precedents, nothing was given for free.

4. Implication of the misconception about precedents. If the above four cases are the best precedents that three lawyers in the Enforcement Division can cite after several days of research opportunity, how can Mr. Balina be expected to have divined in May 2018 that a volume

discount offered to others as well as him in a private presale of a to-be-created digital asset could be deemed compensation that he needed to disclose in the course of his ongoing efforts to disclose his investments in and compensation from token issuers that he was evaluating and reporting on in the course of his World Tour?

5. Further implications of SEC pronouncements before May 11, 2018 about disclosure obligations of token promoters:

On November 1, 2017 the SEC issued an official pronouncement detailing the obligations of celebrities and other persons who promote token offerings. This statement was explicit and clear about the obligation to state the nature and amount of compensation received. It said nothing about an obligation to disclose discount purchases of tokens, even though it was common practice for the numerous ICOs of the time to hold private presales; private presale purchases were typically at a discount rate when compared to the future planned public token sale price; and promoters at the time were naturally inclined to invest in the private presales (just as those with good contacts with traditional share offerors and underwriters are naturally inclined to invest in IPOs).

Furthermore, the SEC's high profile enforcement actions in the weeks and months following the November 1, 2017 pronouncement – against such well-known persons as boxer Floyd Mayweather and anti-virus impresario John McAfee – mentioned only objectionable payments they received from issuers, not objectionable discount purchases. *Cf. In the Matter of Floyd Mayweather, Jr.*, SEC Administrative Proceeding, File No. 3-18906, Order Instituting Cease-and-Desist Proceedings, Nov. 29, 2018, at 2-3 (payment of $100,000 each by three ICOs to respondent without disclosure); *In the Matter of Steven Seagal*, SEC Administrative Proceeding, File No. 3-19712, Feb. 27, 2020, at 2 (promotion of ICO in exchange for undisclosed payments from the ICO issuer); *SEC v. McAfee et al*., Complaint, 20 Civ. 8281 (S.D.N.Y. Oct. 5, 2020), at 2 ("Promoting a security without disclosing that you are being paid to do so is unlawful").

6. Misconception about the nature of "in exchange for." The nature of the Amsterdam event, captured on video, is far removed from a *quid pro quo* grant of value in exchange for touting. The role that Mr. Balina played in Amsterdam, as throughout his World Tour, was as master of ceremonies for a competition that was decided by a voting process among hundreds of persons. His role was to make sure that all contestants had an equal and fair chance to compete for the voting acclamation of the audience. His sincere fairness in this role is evident in the Amsterdam event video of May 11, 2018. There is no allegation that Mr. Balina received any payment or inducement to favor Sparkster. It was other persons, organizing the event in Amsterdam, who allowed Sparkster into the competition. The video shows the Sparkster CEO, Mr. Daya, saying that he pursued Mr. Balina at the London UK World Tour event – and that Mr. Balina did not follow up with him. Video, May 11, 2018, *supra*, at 45:10-45:25.

Once the Amsterdam audience voted Sparkster the winner of the competition, publicity involving Mr. Balina for Sparkster followed as a matter of course, in the nature of the event. The

sequence of events militates against any finding that there was an exchange of promotion in return for a discount.

7. Misconception about the discount purchase by Mr. Balina as a unique compensation or consideration for promoting Sparkster. Not only was the discount purchase well after the Amsterdam event and unrelated to the promotion that followed inevitably from Sparkster's winning the contest; it was a discount that dozens of other angel investors received who had no role in the contest and no connection with Sparkster. Mr. Balina paid the same price as the other angel investors who received the 30% discount from the then-planned future public sale price of the Sparkster token. The discount was offered by the CEO of Sparkster as a volume-based discount/bonus with multiple tiers; the angel investors qualified by volume for the 30% tier and thus a per-token price of $0.105. WhatsApp message of May 21, 2018, at 11:26, from Daya to Balina (Bates IB-001-003-004-001-000031).

8. Misconception about the adequacy of Mr. Balina's disclosures. The adequacy of Mr. Balina's disclosures is apparent in light of the policy underlying Section 17(b), as expressed by the Commission in its November 1, 1917 Statement Urging Caution Around Celebrity Backed ICOs: "Investors should note that celebrity endorsements may appear unbiased, but instead may be part of a paid promotion." Mr. Balina made ample disclosures, even if they were not legally necessary, for persons considering the purchase of Sparkster tokens to evaluate the nature of his involvement in the May 11 and 25, 2018 events.

a. The "amount of any compensation paid" by Sparkster Enterprises Limited to Mr. Balina was disclosed by him as zero in the video of the May 11, 2018 Amsterdam ICO Pitch event, when Mr. Balina was asked if he was shilling for ICOs that pay him. He answered: "No, I am not shilling paid ICOs. I've been transparent . . . sharing every single entry and exit of my position, the amount, when I got in. . . In America, for an American, it is illegal to take money for an ICO and not disclose that." Youtube video, "Crypto World Tour: Amsterdam, Netherlands," May 11, 2018, at 1:05:54 – 1:06:31 (Bates IB-002-004\Youtube-001\Videos-001\Daya-May\2018\Amsterdam). Mr. Balina further described how he was taking counsel from his securities lawyer, who was in touch with the SEC (not the undersigned, who was engaged considerably later). *Id*. at 1:06:53– 1:07:12.

In the course of the undersigned's review and work on this matter I have found no evidence that Mr. Balina received any payment from Sparkster Enterprises.

b. To the extent a discounted purchase price might be deemed in some circumstances to be indirect compensation (*but see* sections 2 thru 6 above), Mr. Balina made the following relevant disclosures:

> At the outset of the ICO Pitch competition on May 11, 2018 in Amsterdam, Mr. Balina disclosed: "I'm a blockchain angel investor. . . . I'm also part of an angel investor group that invests up to ten million dollars in ICOs." *Id*. at 0:1:11 – 1:23.

In context of the event as recorded on video, Mr. Balina's statement effectively disclosed to the audience of approximately 600 persons at the ICO Pitch contest that Mr. Balina and the

investor group he mentioned would likely invest in whatever ICO was vetted by the audience and voted as the winner of the competition.

Mr. Balina made a further disclosure at the AMA ("Ask Me Anything") session of May 25, 2018, which was broadcast live on Youtube, and which occurred prior to Sparkster's ICO crowdsale:

"I have invested."

Youtube video, "Hangouts on Air: Sparkster ICO AMA and Demo," May 25, 2018, at 0:4:03 – 04 (Bates IB-002-004\Youtube-001\Videos-May\25\2018).

This disclosure had an understandable meaning to persons involved in ICOs in 2018, as it still has today:

-- Investor groups and large individual investors typically purchase in private sales and presales prior to the crowdsale.

-- Mr. Balina's disclosure that he invested was prior to the crowdsale and thus understood by those considering the crowdsale to be a private sale prior to the crowdsale.

-- Purchasers in private sales and presales typically receive discounts or bonuses.

-- Thus Mr. Balina's disclosure effectively gave notice that he likely received a discount.

c. Context of the disclosure: The typicality of discounts in private sales and presales prior to ICO crowdsales is evident from materials readily available online and widely known to those knowledgeable about ICOs, both in 2018 and today.

A Google search for the terms "ICO + private + pre + sale" yields dozens of results that mention discount or bonus as a prominent feature of private sales and presales, in online content published at various times from 2018 to the present. Indeed, the first five listed results of this Google search all mention discount or bonus as an aspect of private sales or presales.

Two of the search results dating from 2018, for example, explain the discount-bonus feature as follows:

> ICO presale is a phase carried out before the main crowdsale. It is advertised on different websites, social media platforms, and (possibly) through advertising. In general, an ICO presale is a great possibility to get a higher discount or bonus compared to a crowdsale, and avoid experiencing drawbacks or risks that might happen during a private sale. Bonuses and discounts depend upon the level of contribution.
>
> *See* Applicature, "Private Sale or Public Sale?" Nov. 8, 2018, online at: https://medium.com/applicature/private-sale-or-public-sale-b515476718a3 (last accessed July 10, 2021).

And:

> Private sales are considered to be riskier than a crowdsale as they are done without the scrutiny of the general public, so it is more difficult to gauge their actual value. However, the risks to the investment are often paid off as compensation tokens, or 'bonus' tokens."
>
> ***See*** My Krypto Law, Crypto Currency and the Law, "Everything You Need to Know About ICO Private Sales, Presales and Crowdsales," Oct. 5, 2018, online at: https://myklaw.wordpress.com/2018/10/03/everything-you-need-to-know-about-ico-private-sales-presales-and-crowdsales/ (last accessed July 10, 2021).

In context, Mr. Balina's disclosures on May 11 and May 25, 2018 were relevant to informing anyone familiar with ICOs that he and/or his investor group would likely receive a discount in the course of investing in Sparkster tokens.

9. Misconception about applicability of Section 5(a),(c) – and Section 17(b) - of 1933 Act. The Enforcement Division's investigation has not focused, so far as apparent to the undersigned, on establishing that the transactions in question occurred within the United States. SEC regulations state explicitly that Section 5 of the Securities Act of 1933 applies only to offers and sales that occur within the United States:

> For the purposes only of section 5 of the Act (15 U.S.C. sec. 77e), the terms *offer, offer to sell, sell, sale,* and *offer to buy* shall be deemed to include offers and sales that occur within the United States and shall be deemed not to include offers and sales that occur outside the United States.

17 C.F.R. sec 230.901 (2020) (emphasis in original).

Sparkster was a United Kingdom offering by a company in the United Kingdom. The Amsterdam event was in the Netherlands, and the events following upon Sparkster's contest win took place outside the United States as well. Mr. Balina never met with any Sparkster persons in the United States in connection with their sale or his purchase of Sparkster tokens. His World Tour had Mr. Balina outside the United States continuously from the events in May 2018 until a brief trip to the US that commenced on July 18, 2018, followed by resumption of his World Tour abroad through August and September 2018. The Sparkster public token sale concluded on July 8, 2018.

The Supreme Court has made clear that the application of Section 5 turns on the location of *transactions, i.e.,* whether the transactions in question occurred within the US or outside the US. *Morrison v. National Australia Bank Ltd*., 561 U.S. 247, 268, 130 S.Ct. 2869, 177 L.Ed.2d 535 (2010) (citing 17 C.F.R. sec. 230.901) (emphasis on *transactions* in the original). Under the holding of *Morrison* and the Court's affirmation therein of the presumption that federal laws are not intended to have extraterritorial effect, any United States contact of Mr. Balina in connection with the Sparkster offering was *de minimis* and insufficient to bring Sparkster's UK-based offering into the category of "offers and sales that occur within the United States."

That same presumption likewise undermines the Enforcement Division's proposal to assert jurisdiction as to the Section 17(b) issue in this case.

10. The overarching misconception as to Section 5(a),(c) and 17(b) charges: the legal standard for determining what is a security in this context. Throughout the SEC's scrutiny of Mr. Balina, there has been an assumption without explanation that the Sparkster token is a security, and that Mr. Balina had a responsibility to treat the Sparkster token as a security. That assumption, in light of the Supreme Court's jurisprudence, SEC pronouncements before the transactions in question, and the facts of this case, is highly questionable.

a. The first SEC pronouncement about offerings of digital asset tokens, in July 2017, stated that analysis of tokens under the Supreme Court's "*Howey* test" is a case-by-case matter, quite the opposite of a blanket statement that all tokens are securities. *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO,* Release No. 81207, 117 S.E.C. Docket 745, 2017 WL 7184670 (July 25, 2017), citing *SEC v. W.J. Howey Co*., 328 U.S. 293, 66 S.Ct. 1100 (1946).

b. On November 8, 2017, SEC Chairman Jay Clayton said in the midst of a speech on various topics that he hadn't yet seen a token that wasn't a security. But his speech was caveated with the explanation that he was giving his personal views, not the view of the Commission. And he gave no hint of how many or few tokens he had seen and analyzed.

c. On December 11, 2017, Chairman Clayton addressed the same issue in greater detail and with significantly more nuance. He contrasted a token for using an existing system, which may well not be a security, with a token sold for the sole purpose of financing the development of a planned future system, which would be a security. His words were as follows:

> For example, a token that represents a participation interest in a book-of-the-month club may not implicate our securities laws, and may well be an efficient way for the club's operators to fund the future acquisition of books and facilitate the distribution of those books to token holders. In contrast, many token offerings appear to have gone beyond this construct and are more analogous to interests in a yet-to-be-built publishing house with the authors, books and distribution networks all to come.

SEC Chairman Jay Clayton, "Statement on Cryptocurrencies and Initial Coin Offerings," Dec. 11, 2017.

d. Chairman Clayton's distinction between tokens for participation rights in an existing system and tokens marketed on the basis of a yet-to-be-built system, while again caveated as his personal view, was particularly significant because (i) it corresponded with the guidance in the July 2017 Section 21(a) Report that called for a case-by-case analysis, and (ii) it corresponded with a distinction the Supreme Court itself has made.

e. The Supreme Court's decision paralleling Chairman Clayton's December 11, 2017 statement was *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 95 S.Ct. 2051 (1975). The Court's opinion drew a distinction similar to Clayton's: On the one hand, per *Forman,* are cases in which "the investor is 'attracted solely by the prospects of a return' on his investment." *Id*. 421 U.S. at 852-53, *quoting Howey,* 328 U.S. at 300, 66 S.Ct. at 1103.

On the other hand, per *Forman*, are non-security cases involving an already-existing product, service or system usable and developable by the purchaser, such as the instance Clayton described in December 2017. In the *Forman* Court's words:

> By contrast, when a purchaser is motivated by a desire to use or consume the item purchased – "to occupy the land or to develop it themselves," as the *Howey* Court put it, *ibid.* – the securities laws do not apply.

421 U.S. at 853.

f. The first more detailed presentation by an SEC official of factors that militate in favor of finding a token to be a security, and factors that militate against, did not occur until June 2018. In a speech by the Director of the Corporation Finance Division, again caveated as a personal view rather than the view of the Commission, the *Forman*-Clayton distinction appeared among other factors that tend to make a token not a security: "Is the application fully functioning or in early stages of development?" William Hinman, Speech, "Digital Asset Transactions: When Howey Met Gary (Plastic)," June 14, 2018.

g. Lower federal court cases finding tokens to be securities have been in the context of tokens marketed based on their investment value and appreciation potential, to raise money for the building of a future product, service or network that was only an idea in a whitepaper or similar ideational plan. In the *Kik* case involving the Kin token, for example, the Southern District of New York found a predominant marketing emphasis on factors of supply and demand, secondary market trading and prospects of future token appreciation. *SEC v. Kik Interactive Inc*., 492 F.Supp.3d 169, 179 (S.D.N.Y. 2020) ("In public statements and at public events promoting Kin [tokens], Kik extolled Kin's profit-making potential.")

In contrast to the *Forman* case, the *SEC v. Kik* decision found that "none of the 'consumptive use' was available at the time of the distribution. It would materialize only if the enterprise advertised by Kik turned out to be successful." *Id*. at 180.

h. The *Forman*-Clayton distinction comports with the plain language of the *Howey* test, which requires, for an instrument to be an investment contract and thus a security, that it be marketed based on expectations of profits *solely* from the efforts of others. *Howey*, 328 U.S. at 298, 300, 66 S.Ct. at 1103. If there is a developed product, service or network for which any token holder can use the token, then the profit or value flowing from the token is not solely from the efforts of others; it is also from the value or profit of using the product, service or network.

i. The Supreme Court in *Forman* noted that the 9th Circuit has effectively eliminated the word "solely" – or watered it down – so as to make it easier to find an instrument to be a security. The *Forman* opinion notes that the issue of "solely" *vel non* was not presented in the *Forman* case, and accordingly expressed no view as to the 9th Circuit's revision of the *Howey* test. 421 U.S. at 852 n.16, 95 S. Ct. at 2060 n.16.

j. More recently, in 2004, the Supreme Court explained that the *Howey* test – with the word "solely" intact – derived from state court decisions applying blue sky laws before 1933. *SEC v. Edwards*, 450 U.S. 389, 394, 124 S.Ct. 892, 897 (2004).

k. The SEC, while diluting if not eliminating the term "solely" from the *Howey* test in some of the Commission's actions, has never used rulemaking to modify or further particularize the *Howey* test in a manner that would be entitled to *Chevron* deference.

l. The term "solely" is particularly important for ensuring that useful technology developments, which enable the use of a novel product, service or network, are not prohibited or unduly impeded because the value of the novel technology development gives rise to trading and even speculation.

m. As a result, it is likely the Supreme Court, if given the opportunity to apply the Howey test to an instance of a developed product, service or network, which operates in conjunction with a blockchain-based token or digital asset, would reaffirm the importance of the term "solely" in the *Howey* test. In the ongoing legal controversy over constitutional and statutory interpretation, one element of common ground is the importance of stare decisis in the interpretation of statutory language. See William N. Eskridge, Jr., "Reading Law: The Interpretation of Legal Texts," 113 Colum. L. Rev. 531, 542 (2013).

Given that the *Howey* test is based on the meaning of "investment contract" at the time of enactment of the 1933 Act, combined with the fact that Congress has seen no need to change the wording of the *Howey* Court's definition of investment contract in the 75 intervening years, there is no reason for the Supreme Court today to delete the word "solely" from the test. On the contrary, there are strong policy reasons to apply the *Howey* test unchanged so as to enable unhindered growth of actual new technology developments – while protecting against unregulated capital raising efforts based merely on whitepapers and abstract ideas.

11. The key fact relevant to applying the legal standard for determining what is a security in this context. The key fact is that Sparkster CEO Sajad Daya presented a developed and usable product, service and network. It was a product/service enabling persons to do computer programming – to develop code – using natural language, and without knowing any particular programming language. He also described the Sparkster network as able to handle 10,000 transactions per second. These were descriptions of a product, service, network and system *that anyone could use.* Details are readily viewable in the Youtube videos of the May 11 and 25, 2018 events that Mr. Balina produced to the Commission.

a. In Sparkster's initial one-minute presentation as the seventh of eight contestants at the May 11, 2018 event in Amsterdam, CEO Daya claimed Sparkster had already developed a high-speed network, a decentralized cloud, and with them a product for natural language code development: "Now all of you can build decentralized software with no code, a hundred times faster than traditional software development." Youtube video at 21:36 to 23:00, Bates no. 004\YouTube-001 Daya. The audience responded by voting Sparkster into the next round of three finalists.

b. In the next round, during his three-minute presentation, the Sparkster CEO was questioned by Mr. Balina about the stage of development of Sparkster's technology. Daya responded as follows:

Mr. Balina: Do you have a prototype?

Mr. Daya: No, we have a finished product. Not an MVP, but a finished product. We've been building it for over four years. I've spent eight million dollars of my own money to do it. … So I've built companies for the last fifteen years that generate over fifty million dollars a year in revenue . . . That product, to be able to build software without writing any code, firstly it's finished today and it's blockchain-integrated, meaning that you can build Ethereum smart contracts, plain English, right now today … What we're building today is a blockchain to run the software that you build . . ."

Id., Youtube video at 32:14 to 35:25.

Daya's claim of a "finished product" in contrast to an MVP was particularly significant, since "minimally viable product" (MVP) is an important stage in software and system development, especially in the widely used Agile/Scrum project management methodology. Successfully creating an MVP often opens the way to funding rounds at favorable company valuations. Very few ICO projects in 2017-2018 had an MVP; most had only a Whitepaper, very few had a fully developed product.

In terms of the Clayton-*Forman* distinction, Daya's presentation placed Sparkster at the "book of the month club" end of the spectrum, uniquely different from other ICO projects offering tokens to fund the development of an idea from a whitepaper. The Amsterdam audience responded to Daya's presentation by acclaiming Sparkster the winner.

c. In his five-minute winner's presentation, Mr. Daya gave what appeared to be a demonstration of the system developed by Sparkster. Daya said he had approached Mr. Balina at the London UK event of Balina's World Tour and tried to pursue him to other events, but Mr. Balina did not follow up with him. *Id.,* Youtube video at 40:00 to 46:30 This confirms that the decision to include Mr. Daya in the Amsterdam event was made by the organizers, led by Etienne vantKruys, not by Mr. Balina.

d. At the conclusion of Mr. Daya's five minute winner's presentation, Mr. Balina said the two of them would now jointly do an AMA (Ask Me Anything). Daya, obviously surprised, said, "Right now?" The result was an opportunity for members of the audience to ask Daya challenging questions. Daya continued to give additional details of Sparkster's purportedly developed system and product. *Id.*, Youtube video at 46:30 and following.

e. The May 25, 2018 video shows Mr. Daya continuing to give the impression of a developed and usable Sparkster system.

f. Mr. Balina can only be held accountable for the status of the Sparkster token as a security *vel non* as of the time of the relevant events in May 2018 that gave rise to his purchase of Sparkster tokens and his publicity for the winner of the Amsterdam contest. To the extent Mr. Daya's representations of a developed system later proved overstated, those are grounds for assessing whether he committed fraud, not grounds for holding Mr. Balina more responsible than the hundreds of others at the time who were induced by Mr. Daya's presentations to purchase Sparkster tokens.

12. Mr. Balina was not a "substantial factor" or a "significant participant" in the sale of Sparkster tokens. On the contrary, the roles in which he appears in the fully recorded key events are (a) master of ceremonies at a contest, (b) host of two AMAs on May 11 and 25, 2018, and (c) publisher of his own opinions about token offerings.

In the extensive case law applying the terms "sell such security" and "offer to sell or offer to buy" in Sections 5(a) and 5(c) of the Securities Act of 1933, the undersigned has been unable to find any case targeting a person acting as master of ceremonies of a contest, or host of a question and answer session for an offeror, such as the AMAs hosted by Mr. Balina.

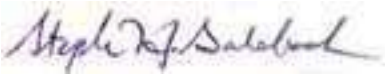
Mr. Balina was in fact a buyer of Sparkster tokens. The term "buy" in Section 5(c) of the 1933 Act does not apply to offers and sales that occur outside the United States. *See* section 9 above.

13. The proposed enforcement action threatens to chill First Amendment activities in the categories of: (a) Shark Tank-type contest hosting and promotion; (b) hosting of informative question and answer sessions that give the public opportunities to question and challenge offerors; (c) well-known purchasers whose publicized purchasers influence others to purchase not because of improper conduct but because of their widespread popularity; and (d) publishers acting within the scope of the First Amendment-protected publishers exemption to the Investment Advisers Act pursuant to *Lowe v. SEC*, 472 U.S. 181, 105 S.Ct. 2557 (1985).

Mr. Balina acted neither as an offeror, nor as a broker, but as a master of ceremonies whose function was to conduct a fair and unbiased contest – which he demonstrably did, as recorded in the May 11, 2018 Youtube video – and to give the May 11 audience and the May 25, 2018 participants in the AMA opportunities to question and challenge the contest winner. Is the panel of Shark Tank a "substantial factor" in a contestant's subsequent offer of securities? Is the host of Shark Tank liable for any subsequent offering of unregistered securities that a contestant might make? Or an AMA host? Or a widely followed publisher of his opinions of token offerings?

Conclusion. For the reasons stated above, the proposed enforcement action against Mr. Balina should not go forward. On his behalf, the undersigned respectfully requests notice that the proposed enforcement action will not go forward and that the investigation as concerns him has been terminated.

Respectfully submitted,



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