

312-19-1739

REPORT

**REGARDING THE APPLICABILITY OF THE "INVESTMENT CONTRACT TEST"  
TO CERTAIN INVESTMENTS TIED TO CRYPTOCURRENCIES**

Joseph Rotunda, Director of Enforcement, Texas State Securities Board

**STATEMENT OF ENFORCEMENT DIRECTOR JOSEPH ROTUNDA FILED IN CONNECTION WITH  
DISCLOSURE OF INTENT TO DESIGNATE AND DIRECTOR JOSEPH ROTUNDA AS AN EXPERT WITNESS**

1. My name is Joseph Jason Rotunda. I am of sound mind and capable of preparing this statement. I voluntarily agree to appear and testify at any hearing held at the State Office of Administrative Hearings (hereinafter referred to as *SOAH*) in connection with Emergency Cease and Desist Order No. ENF-18-CDO-1765 (hereinafter referred to as the *Emergency Order*) to defend the statements set forth herein.
2. The facts stated herein are within my personal knowledge and/or are based on documents, tangible things, reports, models, and data compilations that have been provided to, reviewed by, or prepared by or for me in anticipation of my testimony. The statements herein are true and correct.
3. I have prepared this statement with the understanding it will be disclosed to Symatri, LLC FKA Sivas, LLC, Mintage Mining, LLC, BC Holdings and Investments LLC DBA Mintage Mining, Social Membership Network Holding, LLC, NUI Social, LLC, and Mr. Olayan (hereinafter referred to individually as a *Respondent* and collectively as the *Respondents*) and filed in connection with a contested case to affirm, modify, or set aside the Emergency Order.
4. This statement includes my name, address, telephone number, current resume, and bibliography. It also identifies the subject matter on which I will testify, summarizes the general substance of my mental impressions and opinions, and summarizes the basis for my mental impressions and opinions.
5. This statement references documents, tangible things, reports, models, and data compilations that have been provided to, reviewed by, or prepared by or for me in anticipation of my testimony. All such records are attached hereto and incorporated herein.
6. For the convenience of the parties, I have organized this statement using a table of contents to divide the statement into eight sections. The table of contents appears on the next page.

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## EDUCATION AND WORK EXPERIENCE

7. I attended Trinity University in San Antonio, Texas, from the fall of 1993 through the spring of 1997. I graduated from Trinity University and was conferred a bachelor's degree in Political Science.
8. I attended the University of Kansas School of Law in Lawrence, Kansas, from the fall of 1997 through the spring of 2000. I graduated from the University of Kansas School of Law and was conferred a Doctor of Jurisprudence.
9. I am an attorney and I have been continuously licensed to practice law in Texas since May 2001.
10. I was employed as a staff attorney assigned to the Enforcement Division of the State Securities Board from October 2001 through October 2004. As a staff attorney, I was responsible for investigating complex investment offerings, determining whether these investments constituted securities regulated by the Securities Act,<sup>1</sup> and recommending and pursuing appropriate administrative, civil, and criminal enforcement actions against persons who violated the statute. In or around 2013, while serving as a staff attorney, I was appointed as a special prosecutor by the Travis County District Attorney and successfully prosecuted defendants accused of operating a nationwide Ponzi scheme through the sale of securities tied to scrip-dispensing automated teller machines.
11. I was employed as an Assistant District Attorney by the Travis County District Attorney's Office from October 2004 through March 2007, and I was assigned to both the Trial Court Division and the Insurance Fraud Division of the Public Integrity Unit. While assigned to the Trial Court Division, I was responsible for prosecuting general felony offenses such as robbery, burglary, kidnapping, and sexual assault. While assigned to the Insurance Fraud Division of the Public Integrity Unit, I was responsible for prosecuting felony offenses committed by persons engaged in the business of insurance throughout Texas.
12. While employed as an Assistant District Attorney, I also served as a faculty advisor for the *Prosecutor Trial Skills Course*, an immersive training session for new county and state prosecutors hosted by the Texas District & County Attorney's Association.
13. I am now employed as the Director of the Enforcement Division of the State Securities Board (hereinafter referred to as the *Enforcement Division*), and I have been continuously employed in this capacity since March 2007. I am assigned to the office of the State Securities Board located at 208 E. 10th Street, 5th Floor, Austin, Texas 78701.
14. I am responsible for the operation and management of the Enforcement Division. I supervise approximately thirty attorneys, financial examiners, and other employees assigned to offices in Austin, Corpus Christi, Dallas, Houston, and Lubbock. I am largely responsible for directing their

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<sup>1</sup> TEX. REV. CIV. STAT. ANN. Arts. 581-1 to 581-45 (West 2010 & Supp. 2017).

investigation of suspected violations of the Securities Act. The Enforcement Division has opened more than 4,700 investigations tied to suspect securities offerings during my tenure as the Director of Enforcement.

15. I am also responsible for reviewing referrals for prosecution of criminal offenses, considering referrals for civil receiverships, and civil injunctive and equitable relief, directing the litigation of administrative actions before the SOAH, and approving applications for the issuance of administrative subpoenas that compel witnesses to appear and testify or produce documents and records. I am further responsible for acting as a liaison between the State Securities Board and representatives of other state and federal regulatory and law enforcement agencies, administering the division's budget, preparing administrative reports, and performing other duties as assigned by the Securities Commissioner and the Securities Board.
16. I have testified as an expert witness in criminal cases brought in state district court, administrative proceeding in the State Office of Administrative Hearings, and a federal bankruptcy case before a federal bankruptcy court. These legal proceedings include the following:
  - a. I testified before a jury as an expert witness in *State v. Digges*, a criminal case brought against a promoter who sold investments in revenue purportedly generated from point-of-sale terminals used by merchants to process credit and debit transactions. I testified, in part, that these investments constituted investment contracts regulated as securities by the Securities Act. The jury found these investments constituted securities, the defendant was convicted of securities fraud, and he was sentenced to serve 99 years in prison. The conviction was affirmed by the Texas Court of Appeals for the Fifth District and the Texas Court of Criminal Appeals refused a petition for discretionary review.<sup>2</sup>
  - b. I testified in a contested case as an expert witness in *In the Matter of AGAP Life Offerings, LLC, Charles D. Madden and Matthew Searle*.<sup>3</sup> The contested case was brought after the named respondents filed a challenge to an administrative action that found they were offering investments in the proceeds of life insurance policies that were purportedly secured by a bond issued by a third party. I testified that these investments constituted securities regulated by the Securities Act. The Honorable Administrative Law Judge Michael J. O'Malley handed up a proposal for decision that agreed with my testimony, finding that the investments constituted securities regulated by the Securities Act. The Securities Commissioner later entered Order No. ENF-11-CDO-1697, adopting the opinion set forth in my testimony and the conclusion set forth in the proposal for decision, finding the investments in the proceeds of the life insurance policies constituted securities regulated by the Securities Act.

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<sup>2</sup> *Digges v. State*, 2012 Tex. App. Lexis 5195 (Tex. App.-Dallas 2012, no pet.), cert. denied, 133 S. Ct. 2801 (2013).

<sup>3</sup> SOAH Docket No. 312-10-4169.

17. I have served and continue to serve as a speaker and moderator at various events that explore the regulation of securities. These events include the University of Texas Conference on Securities Regulation and Business Law, the Annual Life Settlement Conference hosted by the Life Insurance Settlement Association, the Annual Conference hosted by the Fraud Investigators Association of Texas, the Advanced Business Law Course hosted by the State Bar of Texas, and the Annual Southwest Securities Conference hosted by the State Securities Board, the United States Securities and Exchange Commission, and the Financial Industry Regulatory Authority.
18. I authored an article that described the Enforcement Division's work in investigating and assisting in the prosecution of William Seelye, a white-collar criminal sentenced to serve 99 years in state prison for defrauding victims through the sale of interests in an illegal oil and gas investment program. The article was published in *The Prosecutor*,<sup>4</sup> a publication of the Texas District & County Attorney's Association available to every prosecutor in Texas.
19. I have served and continue to serve as a source for the media and have been and continue to be quoted by the media in articles that report on the regulation of securities. These articles include articles published by national media such as the Wall Street Journal, the Washington Post and Bloomberg, as well as articles published by local media such as the Houston Chronicle, Austin American-Statesman, the Ft. Worth Star-Telegram, the San Antonio Express-News, and the Dallas Morning News.

PROFESSIONAL EXPERIENCE  
IN THE REGULATION OF SECURITIES TIED TO CRYPTOCURRENCIES

20. Based on my experience and training, I understand that bad actors are often drawn to new markets and often attempt to capitalize on interest in these new markets to defraud the investing public. In December 2017, I grew concerned that bad actors may be drawn to the new market for cryptocurrencies and that they may attempt to capitalize on interest in the new market for cryptocurrencies to defraud the investing public. Therefore, on December 15, 2017, I circulated an internal memorandum that announced the Enforcement Division would conduct a cryptocurrency sweep by committing resources to the identification and investigation of promoters attempting to illegally and fraudulently offer securities tied to cryptocurrencies to Texas residents.
21. My suspicions proved correct. The cryptocurrency sweep lasted from December 18, 2017 through January 19, 2018, and during that time the Enforcement Division opened 32 investigations tied to suspected illegal and/or fraudulent securities offerings predicated on cryptocurrencies.
22. The Enforcement Division has not simply investigated suspected illegal and/or fraudulent securities offerings tied to cryptocurrencies. The Enforcement Division has also pursued numerous enforcement actions against promoters found to have illegally and/or fraudulently offered securities tied to cryptocurrencies to Texas residents.

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<sup>4</sup> Joseph J. Rotunda, *Cleaning Up After a Slick, Fraudulent "Oil Man,"* *The Prosecutor*, Volume 40, No. 1, (January-February 2010)

23. On December 20, 2017, just days after the commencement of the aforementioned cryptocurrency sweep, the Enforcement Division secured Emergency Cease and Desist Order No. ENF-17-CDO-1753, its first enforcement action involving investments tied to cryptocurrencies. This action found investments tied to bitcoin mining contracts constituted securities regulated by the Securities Act and the parties were engaging in illegal, fraudulent, deceptive, and/or misleading practices in connection with the offer of these securities in Texas. To the best of my knowledge, Emergency Cease and Desist Order No. ENF-17-CDO-1753 was the first enforcement action filed by a state securities regulator against promoters of investments tied to cryptocurrencies.
24. The Enforcement Division has now secured 19 enforcement actions against 57 promoters of securities tied to cryptocurrencies who have engaged in illegal, fraudulent, deceptive, and/or misleading practices. To the best of my knowledge, the Enforcement Division has secured more enforcement actions involving securities tied to cryptocurrencies than any other state securities regulator. To the best of my knowledge, the Enforcement Division has also secured more enforcement actions against promoters of securities tied to cryptocurrencies than any other state securities regulator.
25. The 19 enforcement actions referenced in the aforementioned paragraph include eight enforcement actions against 35 parties offering investments tied to cryptocurrency mining, nine enforcement actions against 20 parties engaged in cryptocurrency trading, two enforcement actions against five parties offering cryptocurrencies in an initial coin offering or pre-initial coin offering, and one enforcement action against four parties selling shares to raise capital to develop a cryptocurrency wallet. In every case, the investments tied to cryptocurrency mining, cryptocurrency trading, initial coin offerings and pre-initial coin offerings, cryptocurrency staking, cryptocurrency pools or portfolios, and shares were found, as a matter of law, to constitute securities regulated by the Securities Act.
26. The Enforcement Division has now opened more than 100 investigations to formally review suspected illegal, fraudulent, deceptive, and/or misleading offerings of investments tied to cryptocurrencies in or from Texas. To the best of my knowledge, the Enforcement Division has now opened more investigations to review suspected illegal, fraudulent, deceptive and/or misleading offerings of investments tied to cryptocurrencies than any other state securities regulator.
27. I have been and continue to be responsible for managing and directing these investigations, and I have been and continue to be responsible for determining whether the underlying investments tied to cryptocurrencies constitute securities regulated by the Securities Act.
28. Although all information received during the course of these investigations is confidential as a matter of law, the Enforcement Division has taken steps to inform the public and the industry

about its work and the regulation of securities tied to cryptocurrencies in Texas.<sup>5</sup> For example, the State Securities Board publishes all of its enforcement actions on its website, including all enforcement actions brought against promoters of securities tied to cryptocurrencies. The public can access its website, review the enforcement actions, and contact the agency to present any questions or comments.<sup>6</sup>

29. Additionally, on or around April 10, 2018, the State Securities Board published a public report titled *Widespread Fraud Found in Cryptocurrency Offerings*. The public report detailed the Enforcement Division's investigation of suspect cryptocurrency offerings and described the enforcement actions brought against promoters fraudulently, deceptively, and/or misleadingly offering securities tied to cryptocurrencies in Texas. The report is hosted on the agency's website and is accessible by the public.
30. The State Securities Board also maintains a webpage on its website dedicated to providing information about securities offerings tied to cryptocurrencies. The agency regularly edits this webpage to ensure the currency of its contents. The webpage is accessible by the public and the agency's website permits the public to contact the agency to present any questions or comments.

THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION AND MY WORK  
IN ADDRESSING CRYPTOCURRENCY INVESTMENTS AS VICE-CHAIR OF ITS ENFORCEMENT SECTION

31. I am familiar with the North American Securities Administrators Association, an organization often referred to as NASAA. This organization was formed in 1919 and is the oldest international organization devoted to investor protection. Its membership consists of 67 state, provincial and territorial securities agencies from the 50 states, the District of Columbia, Puerto Rico, the US Virgin Islands, Canada, and Mexico.
32. NASAA conducts its affairs through standing committees, referred to as "sections," and specialized groups of regulators, referred to as "project groups," which report to the sections. I was appointed and currently serve as the Vice-Chair of NASAA's Enforcement Section, which oversees the operations of the Commodities & Derivatives Project Group, the Deposition & Litigation Skills Training Project Group, the Enforcement Publications and Manuals Project Group, the Enforcement Technology Project Group, the Enforcement Training Project Group, and the

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<sup>5</sup> Section 28.A of the Securities Act requires the Enforcement Division to maintain the confidentiality of investigative information. It provides, in part, that, "all information of every kind and nature received in connection with an investigation and all internal notes, memoranda, reports, or communications made in connection with an investigation shall be treated as confidential... and shall not be disclosed to the public except under order of the court for good cause shown." Section 28.A of the Securities Act does, however, permit the Enforcement Division to disclose this information as part of an administrative proceeding to enforce the statute.

<sup>6</sup> The publishing of this information, as well as the information described in subsequent paragraphs, appears to comply with Texas Gov't Code § 2001.007, and as such the Honorable Administrative Law Judge may consider it as agency policy purchase to SOAH Rule § 155.419(b).



Enforcement Zones Project Group. These project groups are composed of approximately 50 to 60 securities regulators and liaisons from the United States and Canada.

33. In addition to supervising the work of the aforementioned project groups, as Vice-Chair of NASAA's Enforcement Section I am also responsible for assisting in the identification of trends and developments related to the violation of state, provincial, and territorial securities fraud statutes, overseeing and assisting in the planning of training conferences for securities regulators, participating in an annual meeting with the United States Securities and Exchange Commission, preparing an annual report summarizing state enforcement actions and current regulatory issues, and drafting an annual publication that identifies emerging and persistent threats to the investing public. As Vice-Chair of NASAA's Enforcement Section, I am further responsible for assisting in the coordination of multijurisdictional investigations and enforcement actions.
34. In 2013, as part of NASAA's Enforcement Section, I drafted the relevant part of a public warning that recognized the risks digital currencies pose to the investing public. To the best of my knowledge, this warning marked the first time state securities regulators publicly acknowledged bitcoin and other digital currencies, as well as the risk that bad actors may attempt to capitalize on interest in bitcoin and other digital currencies.
35. On or around April 8, 2014, I spoke about Bitcoin and issues relating to digital currencies at NASAA's Annual Public Policy Conference in Washington, DC. To the best of my knowledge, this panel marked the first time state securities regulators formally presented information about bitcoin and other digital currencies at an event hosted or sponsored by NASAA.
36. Contemporaneously with my participation in the 2014 NASAA Public Policy Conference, I also drafted a detailed, annotated memorandum titled *Digital Currencies: A Memorandum of Securities Regulators* that described Bitcoin and the legal and regulatory issues associated therewith. The memorandum was circulated among state securities regulators. To the best of my knowledge, this was the first time a state securities regulator prepared an analysis of Bitcoin and the legal and regulatory issues associated with investments tied to Bitcoin that was disseminated among state securities regulators.
37. Beginning in or around April 2018, while acting as the Vice-Chair of NASAA's Enforcement Section, I led an international multijurisdictional "sweep" of promoters of suspect securities offerings tied to cryptocurrencies. During this international multijurisdictional sweep, more than 40 securities regulatory offices from the United States and Canada opened more than 200 investigations and brought more than 46 enforcement actions relating to offers of suspect illegal and/or fraudulent securities offerings predicated on cryptocurrencies. To the best of my knowledge, this sweep was the first time securities regulators participated in a multijurisdictional enforcement effort relating to securities offerings predicated on cryptocurrencies.
38. I was awarded NASAA's 2018 Distinguished Service Award for my work in leading the international multijurisdictional sweep of promoters of suspect securities offerings predicated on cryptocurrencies.

**PRESENTATIONS, PUBLICATIONS, AND THE DISSEMINATION OF  
INFORMATION RELATING TO CRYPTOCURRENCIES TO THE PUBLIC AND PEERS**

39. I have conducted and continue to conduct internal training sessions for employees of the State Securities Board that relate to the regulation of investments tied to cryptocurrencies. Also, in addition to participating on a panel exploring cryptocurrencies at NASAA's 2014 Public Policy Conference, I presented information about securities and cryptocurrencies to other securities regulators, as well financial professionals from the private industry, at NASAA's 2017 Enforcement Section Forum and NASAA's 2018 Enforcement Section Forum.
40. I have served and continue to serve on numerous panels and served and continue to serve as a presenter at various events, and in my capacity as a panelist or presenter I have publicly discussed cryptocurrencies and the regulation of securities tied to cryptocurrencies. I have recently served as a panelist or presenter at the 2018 Decrypting Cryptocurrency Scams Workshop hosted by the Consumer Financial Protection Bureau in Chicago, Illinois, the 2018 Virtual Currency Basics Webinar hosted by the Consumer Financial Protection Bureau via webcast, the 2018 Fintech Forward Conference hosted by the Commodity Futures Trading Commission in Washington, D.C., the 2018 Annual Conference hosted by the Fraud Investigators Association of Texas in Houston, Texas, the 2018 FBI Crime Day hosted by the Federal Bureau of Investigation and ePayResources in San Antonio, Texas, and the 2018 Southwest Securities Conference hosted by the State Securities Board, the United States Securities and Exchange Commission, and the Financial Industry Regulatory Authority in Dallas, Texas.
41. The Enforcement Division's work relating to the regulation of securities tied to cryptocurrencies has been covered by various media, and my statements relating to the regulation of securities tied to cryptocurrencies have been quoted in articles published by the Washington Post, CNBC, the London Daily Express, Bloomberg, Bloomberg BNA, the Dallas Morning News, the San Antonio Express-News, and the Austin American-Statesman. My statements relating to the regulation of cryptocurrencies and/or enforcement actions relating to cryptocurrencies have also been carried in industry articles published by CoinDesk, CBN, Blockchain News, Bitcoin Exchange Guide, newsBTC, CryptoSlate, and Cryptovest.
42. I worked closely with other employees to prepare and publish resources relating to the regulation of investments tied to cryptocurrencies. These resources are hosted on the agency's webpage and are accessible by the public at <https://www.ssb.texas.gov/cryptocurrency-resources>, and they include a 14-page report titled *Enforcement Report: Widespread Fraud Found in Cryptocurrency Offerings*.

BACKGROUND INFORMATION RELATING TO THIS CONTESTED CASE

43. On or around February 15, 2018, the Enforcement Division learned that an agent acting on behalf of parties to this contested case was publishing advertisements for investments tied to cryptocurrencies in the financial services forum of craigslist.org. This financial service forum specifically targets residents of Houston, Texas.
44. On or around February 17, 2018, the Enforcement Division opened Investigation No. 5127 to formally investigate, among other things, the parties publishing advertisements for investments tied to cryptocurrencies in Texas. The investigation also considered the same and related parties offering other investments tied to cryptocurrencies in Texas.
45. I approved the opening of the investigation and assigned the case to an attorney assigned to the Austin Office of the Enforcement Division. I actively participated in the investigation of the case, and I remained responsible for managing the investigation and reviewing evidence obtained during the investigation.
46. After uncovering evidence in the case and reviewing the evidence obtained by others during the investigation, I concluded that Symatri, LLC FKA Sivas, LLC, Mintage Mining, LLC, BC Holdings and Investments LLC DBA Mintage Mining, Social Membership Network Holding, LLC, NUI Social, LLC, Darren Olayan, Wyatt McCullough, and William Douglas Whetsell were offering investments tied to cryptocurrencies in Texas that constituted investment contracts regulated as securities. I also determined they were illegally, fraudulently, misleadingly, and/or deceptively offering said securities in Texas.
47. On or about July 3, 2018, I recommended the Securities Commission enter an emergency cease and desist order pursuant to Section 23-2 of the Securities Act to stop the aforementioned parties from threatening immediate and irreparable harm to the investing public.
48. On July 11, 2018, the Securities Commissioner entered the Emergency Order against Symatri, LLC FKA Sivas, LLC, Mintage Mining, LLC, BC Holdings and Investments LLC DBA Mintage Mining, Social Membership Network Holding, LLC, NUI Social, LLC, Darren Olayan, Wyatt McCullough, and William Douglas Whetsell.<sup>7</sup>
49. Mr. McCullough and Mr. Whetsell did not file a timely challenge to the Emergency Order, and the Emergency Order is now final and not subject to appeal as it relates to them.

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<sup>7</sup> The Emergency Order erroneously indicated it was signed and entered on June 11, 2018. On July 30, 2018, the Securities Commissioner corrected the Emergency Order to reflect that it was, in fact, signed and entered on July 11, 2018.

50. On or about August 3, 2018, counsel for Respondents<sup>8</sup> filed a written challenge to modify or set aside the Emergency Order. The written challenge was timely and satisfied the requirements of Section 23-2.C of the Securities Act.
51. The Enforcement Division and counsel for Respondents, acting pursuant to Section 23-2.D of the Securities Act, mutually agreed to waive the requirement that the hearing on the matter be held no later than the tenth day after the date of the agency's receipt of the written request for the hearing.
52. After communicating with counsel for the Respondents, the Enforcement Division prepared a Notice of Hearing. As described within the Notice of Hearing, the sole purpose of the contested case is to determine whether affirm, modify or set aside the Emergency Order only as it relates to Respondents.
53. The Enforcement Division plans to designate and call me as an expert witness at the hearing on the merits of this contested case. I have prepared this written statement knowing it will be filed and disclosed in to counsel for Respondents.
54. I have attached all documents, tangible things, reports, models, and data compilations that have been provided to, reviewed by, or prepared by or for me in anticipation of my testimony. I understand these records will be provided to the Respondents, but they will not be filed with SOAH. I will, however, ensure these records become available upon request.
55. My opinion and my anticipated testimony are also predicated on the statutes and caselaw identified herein as well as a recent public report released by the United States Securities and Exchange Commission that details the applicability of federal securities law to investments in the form of cryptocurrency issued by The DAO.<sup>9</sup>
56. After considering these records, these statutes, these cases, and this report, I formed the opinion that the investments tied to cryptocurrencies that are the subject of the Emergency Order constitute investment contracts regulated as securities by the Securities Act.

SUMMARY OF THE  
KEY FEATURES OF BITCOIN AND OTHER CRYPTOCURRENCIES

57. The key facts and conclusions set forth in the Emergency Order relate to the offer of investments tied to cryptocurrencies in Texas. I believe it is essential to understand cryptocurrencies in order to fully consider of these key facts and conclusions, as well as the evidence that will be admitted in support of or against these key facts and conclusions. I therefore plan to offer testimony that

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<sup>8</sup> As Mr. McCullough and Mr. Whetsell did not challenge the Emergency Order, Respondents include only Symatri, LLC FKA Sivitas, LLC, Mintage Mining, LLC, BC Holdings and Investments LLC DBA Mintage Mining, Social Membership Network Holding, LLC, NUI Social, LLC, and Darren Olayan.

<sup>9</sup> Release No. 81207, *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO* (July 25, 2017).

summarizes the general nature of cryptocurrencies, as well as the use of sophisticated technology to electronically transmit digital assets that have value.

58. Although as many as 2,000 digital currencies have been introduced into the market over the last decade, Bitcoin, arguably the most popular and prevalent cryptocurrency, serves as a useful model for considering the general nature of cryptocurrencies and the use of sophisticated technology to electronically transmit digital assets that have value.
59. Bitcoin was created by Satoshi Nakamoto, although this name is probably a pseudonym that refers to an anonymous developer or group of developers. In any event, Satoshi Nakamoto unveiled Bitcoin in November 2008 by posting a message in an internet forum. The message described Bitcoin as a “new electronic cash system that’s fully peer-to-peer, with no trusted third party.” The message also contained an abstract for a paper styled *Bitcoin: A Peer-to-Peer Electronic Cash System* and a hyperlink that allowed anyone to access the document.
60. The posting generated some interest, and Satoshi Nakamoto began to interact with a small but growing group of users. They collaborated to continue the development of the digital currency until sometime in or around 2010, when Satoshi Nakamoto purportedly turned over his work to the community and simply disappeared. Satoshi Nakamoto’s identity has never been confirmed.
61. Bitcoin remained fairly innocuous until 2013. In January 2013, bitcoin was trading for around \$13.00 per coin. The price fluctuated throughout the ensuing months but eclipsed \$100.00 per coin in April 2013 and \$500.00 per coin at the beginning of November 2013 before reaching more than \$1,200 per coin toward the end of November 2013.
62. The price of bitcoin continued to fluctuate until it roared to unprecedented highs in 2017. On July 13, 2017, bitcoin was trading at approximately \$2,364.00 per coin. Three months later, on October 13, 2017, its price had more than doubled and bitcoin was trading at approximately \$5,640.00 per coin. Its price climbed to around \$7,777.38 on November 17, 2017 and spiked to its peak at nearly \$20,000.00 in December 2017. The price of bitcoin has greatly decreased since its peak, and bitcoin was trading for around \$4,300 per coin as of November 23, 2018.
63. Bitcoin is only one of many different cryptocurrencies. Recent reports indicate as many as 2,000 different bona fide cryptocurrencies have been introduced into the market, including many different cryptocurrencies priced at various values per coin. At its peak, the market capitalization of all cryptocurrencies appears to have been more than approximately \$825 billion as recently as January 2018. The market capitalization of all cryptocurrencies, much like the market capitalization of bitcoin, has decreased since that time, and the market capitalization of all cryptocurrencies appears to have fluctuated between approximately \$238 billion and \$140 billion as recently as November 2018.
64. Although different cryptocurrencies may be designed for different purposes, Bitcoin was created to serve as an electronic payment network where users send and receive bitcoin, along with the value attributed thereto, over the internet. Although bitcoin is often described as a substitute for

cash for the internet, the description is somewhat simplified because, unlike traditional fiat currencies, bitcoin is not issued or backed by a central bank or government and users can only use bitcoin to pay for a good or service from a party that accepts Bitcoin as payment for goods or services. Still, the market attributes value to bitcoin, and this attribution of value allows bitcoin to be used as a form of payment between willing buyers and willing sellers.

65. Bitcoin and other cryptocurrencies differ from fiat currencies in a number of ways. First and foremost, bitcoin is not tangible. Bitcoin is essentially long lines of code that exist only in computers and in the internet. Accordingly, owners cannot put bitcoin in their pocket, hand bitcoin to a clerk, or store bitcoin under their mattress.
66. Instead of physically handing bitcoin to another party to pay for a good or service, owners manage their cryptocurrencies using an application often referred to as a digital wallet, an eWallet, an e-wallet, or simply as a wallet. Once an owner accesses his or her digital wallet and initiates a transfer of bitcoin, the transaction is verified by an independent confederation of computers running the Bitcoin source software. These computers confirm transfers of bitcoin, ultimately permitting or denying the completion of the transaction.
67. The independent confederation of computers running the source software is not managed or administered by a centralized authority. Instead, users voluntarily dedicate computing resources to its maintenance. These users are provided with an incentive to dedicate their computing resources to verify transactions, as the source software may award them with bitcoin for their work. Users who dedicate their computing resources to verify transactions are often called “miners,” and the process of dedicating computing resources to verify transaction is often generally referred to as “mining.”
68. Mining, described in somewhat greater detail, is the dedication computing power, often measured as a hash rate, to check, verify, and record transactions on Bitcoin’s distributed ledger, which is typically known as the blockchain. Mining generates bitcoin upon the creation and recording of data in a permanent file referred to as a “block” on the blockchain. The bitcoin generated through mining is allocated to miners who successfully perform the necessary calculations to manage the blockchain and secure the network.<sup>10</sup> The source software’s protocol controls the aggregate number of bitcoin generated through mining by reducing the fixed allocation to miners who discover a new block by half every four years and capping the total number of bitcoin in circulation at 21 million. It is predicted the final bitcoin will be mined sometime in or around 2140.

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<sup>10</sup> In addition to mining, consumers can purchase bitcoins from an exchange, which is an organization that allows people to buy, sell, or trade cryptocurrencies such as bitcoin using different fiat currencies or even different cryptocurrencies. Bitcoins may also be acquired from owners, who may pay for a good or service using bitcoins, sell their bitcoins to another person for fiat currency, or simply gift or transfer bitcoins to another party.

69. The blockchain also acts as a distributed public ledger that sequentially records, and provides immediate access to, a record of all transfers of bitcoin. It can be reviewed through online services often referred to as “block explorers,” which are programs or websites that permit the search and navigation of the blocks on the Bitcoin blockchain, as well as the contents of each block. These block explorers essentially provide snapshots of the blockchain, including information about every transfer of bitcoin. Although anyone can use a block explorer to review transactions in blocks on the blockchain, the blockchain does not provide comprehensive information about each transaction. For example, persons are unable to access information to identify the names of parties to each transaction and, as a result, owners of bitcoin are provided a significant degree of anonymity when sending or receiving the cryptocurrency.
70. Although Bitcoin may be introduced into the market through allocation to miners assisting in the recording of transactions in the blockchain, most people simply do not have the resources or expertise to effectively compete with other miners in the mining of bitcoin. As a result, organizations are now leveraging their technical skill and knowledge of cryptocurrencies, as well as powerful hardware and specialized facilities, to provide a means for individuals to access industrial-scale cryptocurrency mining. Although the terms of their services vary, individuals often pay fiat currency or cryptocurrency to these organizations to participate in a cryptocurrency mining program managed by the organization, and they often receive a return paid either in fiat currency or cryptocurrency based on the profitability of the cryptocurrency mining program managed by the organization.
71. This contested case deals with cryptocurrency mining, as the Emergency Order found Respondents were offering two investments tied to the mining of various cryptocurrencies and one investment tied to the mining of Kala, a new cryptocurrency developed and introduced into the market by Respondent Symatri.

THE MARKETING OF INVESTMENTS IN  
CRYPTOCURRENCY MINING BY THE AGENTS ACTING ON BEHALF OF MINTAGE MINING

72. The Emergency Order alleges, and the attached records confirm, Mr. McCullough and Mr. Whetsell were offering investments in cryptocurrency mining issued by Respondent Mintage Mining to Texas residents.<sup>11</sup> I reviewed records that show Mr. McCullough posted at least two advertisements that targeted Texas residents, and he used these advertisements to publicly offer investments in cryptocurrency mining issued by Respondent Mintage Mining.<sup>12</sup> The title of the first advertisement highlighted the passivity and profitability of the investment by claiming investors could “[m]ake up to 7% weekly through crypto mining!” and “[e]arn money doing nothing!” The title of the second advertisement identified Respondent Mintage Mining as the issuer of the investments and claimed investors would be “PAID WEEKLY!”
73. These records also show Mr. McCullough continued to publicly tout the profitability of the investments in the body of the advertisements. He claimed, for example, that “[a]verages of interest vary from 3-7% WEEKLY,” “[a]nnual percentages range from 189-250% annually depending on the crypto market,” and “[l]ong term gains are up into the hundreds of thousands of dollars in 3 years with less than 3k invested.” Mr. McCullough even shared the details of his experience as an investor, publicly claiming he was “up 500% on his investment in 7 weeks” and his “uncle [was] up 4,000% in 10 weeks!”
74. An advertisement attributed to Mr. McCullough incorporates a table purporting to show the result of the average payout per week on a cryptocurrency investment. The table identifies Respondent Mintage Mining and suggests the investments returned 5.036% during the period ending December 6, 2017, 5.479% during the period ending December 13, 2017, 4.791% during the period ending December 20, 2017, 3.773% during the period ending December 27, 2017, 3.575% during the week ending January 3, 2017, and 3.476% during the week ending January 10, 2018. The table is accompanied by statements commonly referred to as testimonials, and these

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<sup>11</sup> For the reasons set forth throughout this statement, my opinion is that Mr. McCullough and Mr. Whetsell were “agents” of Respondent Mintage Mining as that term is defined by Section 4.D of the Securities Act. The statute defines the term “agent” to “include every person or company employed or appointed or authorized by a dealer to sell, offer for sale or delivery, or solicit subscriptions to or orders for, or deal in any other manner, in securities within this state, whether by direct act or through subagents...”.

<sup>12</sup> For the reasons set forth throughout this statement, my opinion is that Respondent Mintage Mining was an “issuer” of cryptocurrency mining investments, which is defined by Section 4.G of the Securities Act to “mean and include every company or person who proposes to issue, has issued, or shall hereafter issue any security.” I also opine that Respondent Mintage Mining was a “dealer” in securities tied to cryptocurrency mining as that term is defined by Section 4.C of the Securities Act. The statute defines the term “dealer” to “include every person or company other than an agent, who engages in this state, either for all or part of his or its time, directly or through an agent, in selling, offering for sale or delivery or soliciting subscriptions to or orders for, or undertaking to dispose of, or to invite offers for any security or securities and every person or company who deals in any other manner in any security or securities within this state. Any issuer other than a registered dealer of a security or securities, who, directly or through any person or company other than a registered dealer, offers for sale, sells or makes sales of its own security or securities shall be deemed a dealer and shall be required to comply with the provisions hereof.”



statements include a testimonial from a person that states, "I am in my seventies and having been involved with Mintage Mining for just a few short months, I am thrilled with my Mintage Mining experience" and another testimonial from a different person that states "Number one opportunity to get involved with Cryptocurrency... Mintage Mining gives full transparency..."

75. I reviewed records that indicate a person identified as ██████████<sup>13</sup> sent an email to [kjbcx-6512891126@serv.craigslist.org](mailto:kjbcx-6512891126@serv.craigslist.org), the craigslist email address associated with an advertisement for cryptocurrency mining investments posted in the financial services forum of craigslist.org dedicated to Houston, Texas. ██████████ responded to these advertisements by corresponding with Mr. McCullough via email. The email message chain reflects Mr. McCullough represented "we just got our payouts yesterday and it was about 2.1% back on our money" and this 2.1% return was "[p]retty awesome considering if we averaged just that we're looking at almost 110% return on your money annually." Mr. McCullough also explained he "anticipate[d] those returns to be much higher!"
76. I also reviewed records understood to depict ██████████ and Mr. McCullough corresponding by text message. ██████████ initiated the correspondence, claiming he came across "a craigslist ad in Houston" and he was "looking to get into crypto." Mr. McCullough responded to the advertisement by promoting investments tied to cryptocurrency, sending information identifying Respondent Mintage Mining, and explaining "... there's a lot of scams going around, and our company makes sure they fall within the FTC's guidelines." Mr. McCullough also touted the profitability of these investments by claiming, for example, that he "made a minimum of 1.5% on [his] money all the way up to 7% WEEKLY," he "just made 1.645% on [his] money last week," that "you start hitting 6-7 figures after 4yrs," and "[a]nnual interest rate can vary depending on bitcoin[']s price. But expect anywhere from 80-250!"
77. The aforementioned records relating to the advertisements posted by Mr. McCullough, as well as communications between Mr. McCullough and ██████████, records purporting to show advertisements placed by Mr. Whetsell and other records reviewed by me, show that Mr. McCullough and Mr. Whetsell claimed the investments in cryptocurrency mining were passive. For example, Mr. McCullough told ██████████ that "this isn't a DIY program or software, I'm paying a company to mine multiple cryptos and get a percentage back in return." Additionally, both Mr. McCullough and Mr. Whetsell represented investors rely on Respondent Mintage Mining to "acquir[e] hash power weekly in order to ensure availability and reliability." Respondent Mintage Mining also purportedly employs some type of artificial intelligence that drives the profitability of the investments, as the "Advanced Mining System... Mines the Right Coin at the Perfect Time" and "our Advanced Proprietary Mining AI evaluates the current cryptocurrency market and strategically picks the best coin to mine."

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<sup>13</sup> ██████████ is an alias used by a financial examiner assigned to the Enforcement Division to conduct undercover investigations of suspect securities offerings. I am redacting his alias from this statement because public disclosure of his alias may jeopardize unrelated ongoing investigations

78. I formed the opinion that, taken together, the records depicting public advertisements posted by Mr. McCullough and Mr. Whetsell, as well as the records reflecting communications between Mr. McCullough and ██████, show the investments in cryptocurrency mining issued by Respondent Mintage Mining are being touted as profitable and passive investments, and that potential investors responding to the advertisements expected to receive profits based on the efforts of others.

THE MINTAGE MINING WEBSITE  
AND ITS PLATFORM FOR SELLING INVESTMENTS TIED TO CRYPTOCURRENCY MINING

79. I reviewed records purporting to show a webpage maintained by Respondent Mintage Mining (hereinafter referred to as the *Mintage Mining Website*) that describes Respondent Mintage Mining as “a collaborative crypto mining platform that brings cryptocurrency enthusiasts together to mine the most current coins on the most state-of-the-art hardware.” It explains Respondent Mintage Mining offers “managed” investments tied to cryptocurrency mining.
80. The Mintage Mining Website touts the passivity of the investments in cryptocurrency mining. It echoes the statements contained in records purporting to be the advertisements published by its agents, Mr. McCullough and Mr. Whetsell, in claiming “[w]e do the work so you don’t have to.”
81. The Mintage Mining Website also clearly states that investors are dependent on the managerial efforts of Respondent Mintage Mining in order to generate a profit from the cryptocurrency investments. It even referred to the investments as “managed hash rate contracts” and “managed mining hardware rental agreements” that are tied to its “exclusive managed mining hardware,” apparently meaning that someone other than the investor is “managing” the hardware and the investments.
82. The Mintage Mining Website also explains that investors are reliant on Respondent Mintage Mining’s Advanced Proprietary Algorithm. Much like the statements set forth in records purporting to be advertisements published by its agents, the Mintage Mining Website claims Respondent Mintage Mining’s “Advanced Proprietary Algorithm evaluates the current cryptocurrency market and strategically adjusts to the best coin each piece of hardware can mine” and its Auto-Switching Algorithms “[m]ine the [r]ight [c]oin at the [r]ight [t]ime.” It also explains that, “[e]ach week, our Advanced Proprietary Mining AI evaluates the current cryptocurrency market and strategically picks the best coin to mine for the highest payout.” Respondent Mintage Mining’s access and use of artificial intelligence and algorithms seem to play the critical role in the effectiveness of the cryptocurrency mining program, and I did not review any information set forth in the Mintage Mining Website or elsewhere that indicates investors play a similar critical role.
83. The Mintage Mining Website also clearly indicates investors expect to receive a profit. It explains that “[a]ll mining earnings are carefully calculated and distributed to your Mintage account once per week. The amount deposited comes from what was mined from your rented hardware the previous week. Earnings are immediately available to be withdrawn OR you can use your earnings

to join any available rental agreement or hash rate batch.” In fact, my review of the Mintage Mining Website shows an expectation of profitability is the only reason investors purchased an investment in cryptocurrency mining through Respondent Mintage Mining.

#### THE OPEN-ENDED UNIT INVESTMENT PROGRAM

84. The Emergency Order alleges, and the attached records confirm, that Respondent Mintage Mining was offering investments called “open-ended hardware rentals.” I have reviewed records such as the Mintage Mining Website that reflect Respondent Mintage Mining also referred to these “open-ended hardware rentals” as “open ended mining rental contracts,” “open ended hardware agreements,” and “open ended rental share agreements.” These investments are simply called the “Open-Ended Unit Investment Program” in the Emergency Order.
85. The Mintage Mining Website indicates Respondent Mintage Mining was selling units in the Open-Ended Unit Investment Program for \$2.00 per unit with a first-time purchase minimum of \$25.00, payable in Bitcoin, LiteCoin, Bitcoin Cash or Bitcoin Gold, with the total purchase price calculated in bitcoin.
86. I understand that potential investors were required to register an account through the Mintage Mining Website before they were able to purchase an investment in the Open-Ended Unit Investment Program.
87. After registering an account, potential investors accessed a webpage under the Mintage Mining Website that identifies a number of specific configurations of hardware to mine cryptocurrencies. The webpage references these configurations using an alpha-numeric string referred to as an Agreement Number, as well as the date the configuration would activate. By way of example, at one point the configurations included the following:
- a. Agreement #5b070a, activating on June 14, 2018, referred to a configuration that included two DragonMint B29s,<sup>14</sup> two DragonMint B52s,<sup>15</sup> two Baikal Giant Bs,<sup>16</sup> and two Baikal Giant x10s,<sup>17</sup>

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<sup>14</sup> The DragonMint B29 is hardware manufactured by Halong Mining and was released in March 2018. It has a maximum hash rate of 2.1 TH/s, power consumption of 900W, and maximizes efficiency in mining Decred while running the Blake256R14 algorithm.

<sup>15</sup> The DragonMing B52 is hardware manufactured by Halong Mining and was released in March 2018. It has a maximum hash rate of 3.83 TH/s, power consumption of 1380W, and maximizes efficiency at mining SiaCoin while running the Blake2B algorithm.

<sup>16</sup> The Baikel Giant B is hardware manufactured by Baikal and was released in January 2018. It has a maximum hash rate of 160GH/s, power consumption of 300W, and maximizes efficiency at mining Decred, PascalLite, Lbry, PascalCoin, and SiaCoin while running the Blake256R14, Blake256R8, Blake2B, Lbry, and Pascal algorithms.

<sup>17</sup> The Baikal Giant x10 is hardware manufactured by Baikal and was released November 2017. It has a maximum hash rate of 10 GH/s, power consumption of 500W, and maximizes efficiency in mining Myriad-

- b. Agreement #5b16e7, activating on July 26, 2018, referred to a configuration that included five iBeLink DSM6Ts,<sup>18</sup> and
  - c. Agreement #5b16e7, activating on October 25, 2018, referred to a configuration that included twenty GMO B2 SHA-256 ASIC Miners.<sup>19</sup>
88. The Mintage Mining Website provides potential investors with information relating to their ability to invest in each hardware configuration. This information includes the total number of units available in each hardware configuration, as well as the current number of units sold in each hardware configuration. For example, at one point the Mintage Mining Website showed:
- a. Respondent Mintage Mining already sold 1,306.2 units out of a total of 18,000 available units in Agreement #5b070a, meaning that potential investors could have purchased up to 16,693.8 units in this hardware configuration for \$2.00 per unit payable in Bitcoin, Litecoin, Bitcoin Cash or Bitcoin Gold,
  - b. Respondent Mintage Mining already sold 11.42 units out of a total of 19,000 available units in Agreement #5b16e7, meaning that potential investors could have purchased up to 18,988.58 units in this hardware configuration for \$2.00 per unit payable in Bitcoin, Litecoin, Bitcoin Cash or Bitcoin Gold, and
  - c. Respondent Mintage Mining already sold 126.84 units of out a total of 25,000 available units in Agreement #5b16e7, meaning that potential investors could have purchased up to 24,873.16 units in this hardware configuration for \$2.00 per unit payable in Bitcoin, Litecoin, Bitcoin Cash or Bitcoin Gold.
89. Potential investors accessed the Mintage Mining Website and purchased units in these hardware configurations and other hardware configurations promoted by Respondent Mintage Mining.
90. After investors purchased units in the hardware configurations, they became entitled to mining revenue, less hosting and management fees, once per week according to their share of the rental agreement for the hardware configuration. Respondent Mintage Mining, through the Mintage Mining Website, promised to pay the mining revenue to digital wallets designed to hold

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Groestl, Digibyte, DigitalPrice Classic, Onix, CannabisCoin, Dash, and GeoCoin while running the X11, Quark, Qubit, Myriad-Groestl, and Skein algorithms.

<sup>18</sup> The iBeLink DSM6T is hardware manufactured by iBeLink and was released June 2018. It has a maximum hash rate of 6TH/s, power consumption of 2100W, and maximizes efficiency at mining Decred running the Blake256R14 algorithm.

<sup>19</sup> The GMO B2 SHA-256 ASIC Miner is hardware manufactured by GMO and was released October 2018. It has a maximum hash rate of 24 TH/s, power consumption of 1950W, and maximizes efficiency at mining Bitcoin, eMark, Peercoin, Bitcoin Cash, Joulecoin, Unbreakable, Curecoin, Acoin, Terracoin, and Crown running the SHA-256 algorithm.

cryptocurrencies, and investors were afforded the opportunity to withdraw the mining revenue at any time so long as their balance exceeded 0.0025 BTC.

91. Although the Mintage Mining Website indicates the Open-Ended Unit Investment Program involves an “[o]pen[-]ended agreement” with “no set expiration date,” it also claims the investments in the configurations are valid for the length of time disclosed by Respondent Mintage Mining. In any event, the Mintage Mining Website explains that these investments terminated if the mining revenue earned by the rented hardware under contract became unprofitable for eight consecutive weeks.

#### THE HASH RATE UNIT INVESTMENT PROGRAM

92. The Emergency Order alleges, and the attached records confirm, that Respondent Mintage Mining was offering investments called “hash rate units” and “3-year hash rate share” products. I have reviewed records such as the Mintage Mining Website that reflect Respondent Mintage Mining also referred to these “hash rate units” and “3-year hash rate share” products as “3-year agreements,” “3-year mining agreements,” “hash power service agreements,” and various other terms. These investments are simply called the “Hash Rate Unit Investment Program” in the Emergency Order.
93. Respondent Mintage Mining was selling units in the Hash Rate Unit Investment Program for \$1.00 per unit with a first-time purchase minimum of \$25.00, payable in Bitcoin, LiteCoin, Bitcoin Cash, or Bitcoin Gold, with the total purchase price calculated in Bitcoin.
94. I understand potential investors were required to register an account through the Mintage Mining Website to purchase investments in the Hash Rate Unit Investment Program.
95. After registering an account, potential investors accessed a webpage that identifies various “batches.” A batch appears to simply be a name given to a predefined amount of computing power attributable to hardware hosted by Respondent Mintage Mining that Respondent Mintage Mining planned to use to mine cryptocurrencies using specific algorithms.
96. At one point, potential investors were able to purchase units in a batch that ran proportional algorithms that included 20% cryptonight, 5% qubit, 10% myriad-groestl, 10% skein, 5% script, 15% blake2b, 5% quark and 30% decred.
97. Respondent Mintage Mining would use hardware running these algorithms to mine cryptocurrencies that included digibyte, auroracoin, myriadcoin, zcash, siacon, dash, electroneum, and monero.
98. Respondent Mintage Mining offered 250,000 units in this batch for \$1.00 per unit payable in payable in Bitcoin, LiteCoin, Bitcoin Cash, or Bitcoin Gold. At one point, Respondent Mintage Mining had sold 120,237.14 units in this batch, meaning that potential investors were able to

purchase up to 129,762.86 of the remaining units for \$1.00 per unit payable in payable in Bitcoin, LiteCoin, Bitcoin Cash, or Bitcoin Gold.

99. Potential investors were able to navigate through the Mintage Mining Website and purchase units in this batch and other batches identified by Respondent Mintage Mining.
100. After purchasing units in batches, and after deployment of the batches, investors were paid net mining revenue, less a five percent fee payable to Respondent Mintage Mining, once per week. Respondent Mintage Mining paid the mining revenue to digital wallets designed to hold cryptocurrencies, and investors were afforded the opportunity to withdraw the mining revenue at any time so long as their balance exceeded a specified minimum amount that varied based on Bitcoin network transaction fees.
101. Although the Mintage Mining Website indicated the Hash Rate Unit Investment Program was a "156 week agreement," it also claimed the investments terminated if the mining hash power under contract became unprofitable for 60 consecutive days.

#### INVESTMENTS IN THE KALA RIGS

102. The Emergency Order alleges, and the attached records confirm, that Respondent Symatri operated the Core Platform and the Reach Platform.
103. I reviewed records that purport to depict a website maintained by Respondent Symatri accessible at <https://www.symatri.com>. This website described the Core Platform, explaining that the Core Platform afforded members the opportunity to use their phone, tablet or computer to complete marketing activities that provided feedback to businesses. These marketing activities included the completion of surveys, the downloading of applications, the trial of products, and the review of videos. Members were told they would earn "points" whenever they completed these tasks.
104. The website also described the Reach Platform, explaining that the Reach Platform afforded members the opportunity to redeem or spend points earned through the Core Platform. Investors were reportedly able to use their points to acquire iPads, Go-Pros, cell phones, Fitbits, gift cards, and other products.
105. In addition to promoting the Core Platform and the Reach Platform, this website also promoted Kala, a cryptocurrency Respondent Symatri planned to introduce into the ecosystem.<sup>20</sup> I reviewed other records that purport to depict stylistically similar websites accessible at <https://kalacoin.io> and <https://ito.kalatoken.io> and noted both of these websites claim to be copyrighted by

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<sup>20</sup> The Emergency Order did not allege, in any way, that Kala, standing alone, constituted a security regulated by the Securities Act. Instead, the Emergency Order alleged that investments in hardware referred to therein as Kala Rigs, which purportedly allowed investors to earn Kala that could be monetized for a profit, taken together with the predominant entrepreneurial and managerial efforts of others, constituted securities regulated by the Securities Act.

Respondent Symatri. I also reviewed a webpage maintained on Facebook titled Kala Token that was accessible at <https://www.facebook.com/officialkalatoken>. For convenience, this statement collectively refers to the webpages accessible at <https://www.symatri.com>, <https://kalacoin.io>, and <https://ito.kalatoken.io>, as well as the Facebook webpage accessible at <https://www.facebook.com/officialkalatoken>, as the *Symatri Websites*.

106. The Symatri Websites indicate that, in 2018, Respondent Symatri introduced Kala as an ERC-20<sup>21</sup> cryptocurrency maintained on the Ethereum blockchain during an initial token offering that commenced in 2018.<sup>22</sup> The Symatri Websites claim more than 13,000 users signed up for the initial token offering, Respondent Symatri sold more than 814 million Kala, and it raised more than \$8.5 million and more than 880 bitcoin.
107. The Symatri Websites announced plans to integrate Kala into Respondent Symatri's Core Platform and its Reach Platform. They explained that members who earned points by completing marketing activities as part of the Core Platform could transfer their points to Kala. They also explained that owners of Kala could use Kala to purchase goods in the Reach Platform.
108. The Symatri Websites show that Kala was not designed solely to integrate with the Core Platform and the Reach Platform. Instead, Respondent Symatri also claimed Kala was fungible and transferable, and that it expected Kala to be traded on a cryptocurrency exchange in the near future. Accordingly, based on the Symatri Websites and other records attached to this statement, I believe Respondent Symatri was creating a market for Kala, whereby potential owners of Kala could speculate on the price of Kala by purchasing the token at a certain price and then publicly trade the token for a profit at a later date if its price increased.
109. On or about April 10, 2018, Respondent Symatri took another step toward creating a market for Kala by using the Symatri Websites to announce its plan to remove Kala as an ERC20 token on the Ethereum blockchain. It stated it would begin building a blockchain for Kala as a fork of the Bitcoin blockchain.

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<sup>21</sup> ERC-20 tokens are tokens designed to be used on the Ethereum blockchain, where "ERC" stands for "Ethereum Request For Comments" and "20" is an identification number that distinguishes the ERC-20 standard from other standards. Only tokens that meet certain mandatory standards are classified as ERC-20 tokens.

<sup>22</sup> The Symatri Websites refers to a Team or Advisory Team or Founding Team, and identifies the "Team" as Respondent Olayan in his capacity as CEO of Respondent Symatri, Reid Tanaka in his capacity as President of Respondent Symatri, Kinsey Lindgren in her capacity as Chief Marketing Officer of Respondent Symatri, Hiro Takahashi in his capacity as Chief Technology Officer of Respondent Symatri, Matt Palmer in his capacity as Finance Controller of Respondent Symatri, and Curtis Olayan in his capacity as Chief Operating Officer of Respondent Symatri. The Symatri Websites also purport to be copyrighted by Respondent Symatri. The Terms and Conditions and Privacy Policy on a Symatri Website also reflect Respondent Symatri's involvement.

110. On or about May 30, 2018, Respondent Symatri took yet another step toward creating a market for Kala, using the Symatri Websites to announce Respondent Mintage Mining would be supplying and shipping Kala Rigs. The Kala Rigs are pre-configured hardware that run the SHA256 algorithm with a maximum hashrate of 4Th/s for a power consumption of 1027 watts. The Kala Rigs are designed to mine Kala, much like other hardware mines bitcoin and other proof-of-work cryptocurrencies, once Respondent Symatri completed its development of the new blockchain.
111. Respondent Symatri, through the Symatri Websites, claims Respondent Mintage Mining pre-configured each Kala Rig and, after purchase and delivery, sent the Kala Rigs to investors. Investors would take possession of their Kala Rigs.<sup>23</sup>
112. The records show, after taking possession of Kala Rigs, investors were not required to undertake significant managerial efforts to operate the Kala Rigs or to mine Kala. This model is drastically different from traditional cryptocurrency mining, where miners are often required to use technical expertise to research, identify, purchase, configure, program, repair, replace, and otherwise manage hardware and to research, identify, acquire, configure, manage, and use relevant software.
113. The passivity of investors taking custody of Kala Rigs is reflected in an email sent by Respondent Symatri. This email shows the investment in Kala Rigs is passive, as the email notes that “[y]our Kala mining rig will be delivered to you pre-configured for mining. Just set it up in a few simple steps, and you’ll be ready to start earning your rewards!” The message also contained an attached file in \*.docx format titled *Kala Rig FAQ*. This FAQ contains a list of questions and corresponding answers relating to the Kala Rigs. It states that Respondent Mintage Mining is the “company shipping/selling the Kala rigs” and “Mintage Mining pre-configures the rig before it ships” with a “power supply, power cord, ethernet cable, and instructions on how to operate the rig.” Investors were told they simply needed to receive the pre-configured rigs and complete a “simple plug in process.” The only “qualifications that have to be met to be able to host the rig” are “access to a power supply and wired internet access” or, alternatively, access to Wi-Fi. In fact, the FAQ clarified

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<sup>23</sup> Based on the attached records, I believe Respondent Symatri was acting as an “issuer” of investments in Kala Rigs as that term is defined by Section 4.G of the Securities Act, which defines the term “issuer” to “mean and include every company or person who proposes to issue, has issued, or shall hereafter issue any security.” I am also of the opinion that both Respondent Symatri and Respondent Mintage Mining were acting as “dealers” of investments in Kala Rigs. Section 4.C of the Securities Act defines the term “dealer” to “include every person or company other than an agent, who engages in this state, either for all or part of his or its time, directly or through an agent, in selling, offering for sale or delivery or soliciting subscriptions to or orders for, or undertaking to dispose of, or to invite offers for any security or securities and every person or company who deals in any other manner in any security or securities within this state. Any issuer other than a registered dealer of a security or securities, who, directly or through any person or company, other than a registered dealer, offers for sale, sells or makes sales of its own security or securities shall be deemed a dealer and shall be required to comply with the provisions hereof...” Alternatively, Respondent Mintage Mining may be considered an “agent” of Respondent Symatri as the term “agent” is defined by Section 4.D of the Securities Act. The statute defines “agent” to “include every person or company employed or appointed or authorized by a dealer to sell, offer for sale or delivery, or solicit subscriptions to or orders for, or deal in any other manner, in securities within this state, whether by direct act or through subagents...”



that an investor cannot attempt to manage their own Kala Rig, because “[i]f they would like to reconfigure the rig... it will not work within the Mintage network.” This statement implies investors would not be able to earn Kala if they attempted to make their Kala Rig more efficient in mining Kala.

114. The email also contained an attached file in \*.docx format titled *KALA RIG SPECS & CARE*. This file is a brief document that essentially explains investors needed only to plug the Kala Rigs into an outlet using the provided power supply, keep the Kala Rig in a room with a temperature of 0-40 degrees Celsius (32-104 degrees Fahrenheit), and use a cheap airblower to remove dust. Accordingly, no other efforts are necessary to earn Kala through mining using a Kala Rig, and these ministerial efforts hardly appear to be managerial in nature.
115. Respondent Symatri also highlighted the passivity of the investments in the Kala Rigs by comparing the investments in the Kala rights to the use of traditional mining hardware. In a posting on the Symatri Websites dated May 23, 2018, Respondent Symatri explained that “[m]ost mining rigs require miners to purchase and assemble: Motherboard Hardware, Graphic Processing Units (GPUs), Processor/CPU, RAM, Power Supply, Power Switch and Power Risers.” It also noted that “with the drastic increase in crypto mining, some of these parts are hard to come by” and that recent reports indicate “many popular and most [sic] effective mining hardware prices have doubled if not tripled in price, if you can find them on the shelves at all.” The posting then contrasted the difficulty of traditional mining with mining Kala, explaining “[b]ut Kala mining rigs ship pre-configured, and only take a few easy steps to set up.” It noted Kala Rigs require “[n]o research, ordering and waiting for parts, or assembling and configuring required.” Investors can “[s]imply plug, mine, and receive [their] Kala reward.”
116. While Respondent Symatri was touting the investments in the Kala Rigs as described in the preceding paragraphs, Respondent Mintage Mining sold the first group of 750 Kala Rigs for \$3,500.00 per unit, payable in Bitcoin, Bitcoin Cash, Bitcoin Gold, or Litecoin. Respondent Symatri announced that investors purchasing one of the first 750 Kala Rigs from Respondent Mintage Mining would be provided exclusive access to mining Kala during the first thirty days.
117. The Mintage Mining Website indicates Respondent Mintage Mining began selling the second group of 1,250 Kala Rigs for \$4,000.00 per unit, again payable in fiat currency or cryptocurrency. Respondent Mintage Mining also announced plans to sell an additional 10,000 Kala Rigs after selling the 1,250 Kala Rigs that were part of the second group.
118. The Mintage Mining Website explains that investors who purchased and operated the Kala Rigs were not provided with Kala based on the performance of their own Kala Rigs. Instead, the number of Kala produced each day was simply split between owners as follows:
  - a. Assuming 10,000,000 Kala were produced each month, investors owning one of 100 Kala Rigs earned 100,000 Kala per day or 3,000,000 Kala per month regardless of the performance of their own Kala Rig,

- b. Assuming 10,000,000 Kala were produced each month, investors owning one of 500 Kala Rigs earned 20,000 Kala per day or 600,000 Kala per month regardless of the performance of their own Kala Rig, and
  - c. Assuming 10,000,000 were produced each month, investors owning one of 1,000 Kala Rigs earned 10,000 Kala per day or 300,000 Kala per month regardless of the performance of their own Kala Rig.
119. Respondent Symatri, through the Symatri Websites, told investors the price of Kala was \$0.02 per token, meaning investors who purchased Kala Rigs and earned a pro rata distribution of Kala per the terms outlined in the preceding paragraphs would profit as follows:
- a. Assuming 10,000,000 Kala were produced each month, investors owning one of 100 Kala Rigs earned 100,000 Kala collectively priced at \$2,000.00 per day or 3,000,000 Kala collectively priced at \$60,000.00 per month. An investor in the first group able to liquidate Kala at the price set by Respondent Symatri would therefore receive a profit of \$56,500.00, or more than 1,614% of his or her principal investment, after the first month alone.
  - b. Assuming 10,000,000 Kala were produced each month, investors owning one of 500 Kala Rigs earned 20,000 Kala collectively priced at \$400.00 per day or 600,000 Kala collectively priced \$12,000.00 at per month. An investor in the first group able to liquidate Kala at the price set by Respondent Symatri would therefore receive a profit of \$8,500.00, or more than 242% of his or her principal investment, after the first month alone.
  - c. Assuming 10,000,000 were produced each month, investors owning one of 1,000 Kala Rigs earned 10,000 Kala collectively priced at \$200.00 per day at or 300,000 Kala collectively priced at \$6,000.00 per month. An investor in the first group able to liquidate Kala at the price set by Respondent Symatri would therefore receive a profit of \$2,500.00, or more than 71% of his or her principal investment, after the first month alone.
120. Respondent Symatri, through the Symatri Websites, also announced that investors who purchased Kala Rigs as part of the first group would have exclusive access to mining Kala during the first month, and as such they would be able to “enjoy an approximate monthly reward amount of 250,000 Kala.” Accordingly, given Respondent Symatri claimed Kala was priced at \$0.02 per token, investors who purchased Kala Rigs as part of the first group “could earn approximately \$5,000 in that first month alone!” In other words, Respondent Symatri was telling potential investors their purchase of a Kala Rig as part of the first group entitled them to a return equal to their principal investment of \$3,500.00 as well as profits of an additional \$1,500.00 during the very first month.
121. Respondent Symatri, through the Symatri Websites, also touted the profitability of the purchase of Kala Rigs as part of the second group. It claimed investors who purchased Kala Rigs as part of the second group would earn a minimum of 1,895 Kala per day and 56,861 Kala per month. It

therefore claimed that these investors would earn a minimum of \$1,137.00 in Kala in the first month alone and they “will keep earning every month their rig is mining.”

122. Respondent Symatri began touting the profitability of investing in the Kala Rigs and earning Kala wholly and completely without regard to the Core Platform and the Reach Platform. For example, the Symatri Websites show Respondent Symatri was comparing the introduction of Kala to the introduction of bitcoin and comparing the profitability associated with mining Kala shortly after its introduction to the profitability associated with mining bitcoin shortly after its introduction. A posting on the Symatri Websites dated May 21, 2018, even suggested that “early” investors who purchased Kala Rigs to mine Kala could earn lucrative profits similar to “early” investors who mined bitcoin and reaped significant profits after monetizing the bitcoin. It read in part:

If you were given the chance to go back in time and be one of the first to mine Bitcoin, would you take it? Bitcoin’s first miners earned 200 BTC from home in just two days. With the current BTC value of around \$8,000, those two days of mining would now be worth over \$1.5 million.

123. Regardless of the representations about the profitability of mining Kala as part of the first or second group, the records show the profitability of investments in the Kala Rigs were largely dependent upon the market for Kala. Under the model described by Respondent Symatri, in a market with demand for Kala, investors who obtained Kala through the mining of their Kala Rigs would be able to sell Kala for \$0.02 per token. If demand increased relative to supply, investors who obtained Kala through the mining of their Kala Rigs should have been able to sell Kala for more than \$0.02 per token, reaping even greater profits than those touted in the records described herein. Conversely, if the market for Kala failed to develop, investors owning Kala would experience difficulty in liquidate and monetizing their investments, and the investments may well become essentially worthless.
124. Not surprisingly, investors were considerably dependent upon Respondent Symatri’s commitment to develop a market for Kala and ensure that Kala would be listed on a cryptocurrency exchange.<sup>24</sup> Assuming Respondent Symatri secured a listing for Kala on a cryptocurrency exchange, investors could sell Kala to willing buyers for either \$0.02 per token or whatever price was set by the market for Kala.
125. The Symatri Websites show Respondent Symatri understood the critical need to list Kala on a cryptocurrency exchange. On May 17, 2018, it even posted a blog entry titled *Kala’s Pathway to the Crypto Exchanges*. It began by noting that “[o]ne of the questions asked often is, ‘When is Kala getting on the exchange?’” It answered the question by stating, “[w]ith recent shifts in regulations and trends in today’s cryptocurrency market, Kala’s advisory team is carefully planning and executing a confident plan to get Kala on a crypto exchange.” It followed by explaining that many

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<sup>24</sup> A cryptocurrency exchange is an organization that typically affords its customers the opportunity to buy, sell, or exchange one cryptocurrency for other cryptocurrencies or fiat currency. Cryptocurrency exchanges typically operate on the internet, allowing clients to buy, sell, or exchange through an online platform.

crowdsales failed, and “[w]ith so many volatile crypto coins out there, exchanges are being more selective than before and are choosing currencies that have value, stability and sustainability.” It then listed out the “Steps to Getting Kala on an Exchange” and set forth a DNA containing milestones. The entry noted these milestones “will maximize Kala’s value and create a sustainable decentralized network, making Kala a crypto coin exchanges want to have.” It listed these milestones as follows:

- a. Respondent Symatri explained it needed to complete the final stage of an audit of the initial token offering of Kala so that it could verify “all Kala purchased have been completed and deposited correctly.” Respondent Symatri listed a date of May 2018 for this milestone.
- b. Respondent Symatri explained it needed to complete the pre-sale of Kala Rigs, which were the “[e]xclusive sale of mining rigs to the Kala community and Symatri partners.” Respondent Symatri listed a date of May 2018 for this milestone.
- c. Respondent Symatri recognized it needed to finalize the Kala blockchain code, which meant that it needed to “[f]inish programming the Kala blockchain so that Kala can be issued and mining [can] begin.” Respondent Symatri listed a date of May 2018 for this milestone.
- d. Respondent Symatri represented it needed to issue Kala. Respondent Symatri listed a date of June 2018 for this milestone.
- e. Respondent Symatri explained persons needed to begin mining Kala through “Exclusive Kala Rigs” so “mining rigs can begin actively mining” and owners can begin “earning Kala rewards.” It listed a date of June 2018 for this milestone.
- f. Respondent Symatri represented it needed to continue the sale of Kala Rigs to the “Kala Community” and that Kala Rigs were available for purchase as it built the network. It listed a date of June 2018 for this milestone.
- g. Respondent Symatri recognized the necessity of it building “Kala’s Network” so that, “[a]s mining rigs become active, Kala’s network continues to grow, stabilize and become decentralized. Respondent Symatri represented that it would begin working on this milestone in June 2018.
- h. Respondent Symatri recognized it needed to “Reach Targeted Hash Power Threshold” because as “Kala’s network hits the hashpower threshold,” the “exchanges [will be] eager to accept Kala. Respondent Symatri also noted this milestone “ensures the network is safe and sustainable.” It did not list a date for this milestone.
- i. Respondent Symatri explained it would “Get [Kala] on [an] Exchange” and that this milestone is dependent upon previous milestones. Respondent Symatri also noted this

would ensure Kala is “accepted onto crypto exchanges with a stable and consistent value.”

126. The entry concluded by stressing confidence in the milestones, explaining the “path Symatri designed to get Kala on the exchange is a careful and confident one.” It noted “[h]undreds of cryptocurrencies have jumped on exchanges too quickly, and have failed or been kicked off. Kala’s advisory team have and continue to consult with crypto experts, partners, and exchanges to protect Kala’s network, solidify it’s [sic] value, and start off with a higher exchange value.”

## LEGAL BASIS FOR REGULATING SECURITIES

127. The Securities Act does not regulate all offers and all sales of all investments in Texas. Instead, it regulates the offer and sale of investments that constitute “securities” in Texas.
128. Section 4.A of the Securities Act identifies those types of investments that constitute securities by defining the term “security” and “securities” to include the following:
- any limited partner interest in a limited partnership, share, stock, treasury stock, stock certificate under a voting trust agreement, collateral trust certificate, equipment trust certificate, preorganization certificate or receipt, subscription or reorganization certificate, note, bond, debenture, mortgage certificate or other evidence of indebtedness, any form of commercial paper, certificate in or under a profit sharing or participation agreement, certificate or any instrument representing any interest in or under an oil, gas or mining lease, fee or title, or any certificate or instrument representing or secured by an interest in any or all of the capital, property, assets, profits or earnings of any company, investment contract, or any other instrument commonly known as a security, whether similar to those herein referred to or not...
129. Section 4.A of the Securities Act was last amended by the legislature well before recent advances in computing technology, the advent of modern online communications, and increasingly globalized access to the internet. Not surprisingly, the definition of “security” and “securities” does not expressly state that products that incorporate cryptocurrencies are regulated as securities.<sup>25</sup>

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<sup>25</sup> This statement does not consider whether the Securities Act regulates Bitcoin, Ether, Monero, Litecoin or other cryptocurrencies. Instead, this statement only considers whether the Securities Act regulates the offer of investments tied to Bitcoin, Ether, Monero, Litecoin or other cryptocurrencies. As the Director of the Enforcement Division, I know that this is not a new, novel, or otherwise unique position, as federal and state securities laws have historically regulated investments tied to assets as securities even when the underlying asset would not itself, standing alone, be regulated as a security. For example, in *In re Gardner*, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,757 (N.Y. Sup. Ct. 1979), a court sitting in New York held the sale of investments in diamonds – and not the sale of diamonds, standing alone – constituted the sale of securities, reasoning that:

Although the petitioners believe that it is crystal clear that the subject matter of sales by [the promoter] are in the same nature as the sale of any item of personal property, and that the fact that a diamond may often have value as an investment does not change the nature of the transaction, it is also true that the manner in which an item is sold and presented to the buying public is very often a factor, if not a major one, in determining the nature of the relationship between the seller and the purchaser of an item.

*See also SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 348 (1943) (holding that the sale of assignments in oil leases, otherwise considered interests in real property, constituted securities when “the undertaking to drill a well runs through the whole transaction as the thread on which everybody’s beads were strung.”).

130. The statutory definition of a “security” does, however, provide an investment that constitutes an “investment contract” is regulated as a security, just as traditional products such as stocks and bonds are regulated as securities.<sup>26</sup> Therefore, pursuant to Section 4.A of the Securities Act, any instrument that constitutes an “investment contract” is a security as a matter of law and is regulated as a security as a matter of law. Accordingly, an instrument tied to cryptocurrencies that constitutes an “investment contract” is a security as a matter of law and is regulated as a security as a matter of law.
131. The term “investment contract” is not defined by the Securities Act. Instead, the term has been defined by a robust body of caselaw that comprised of opinions handed down by the United States Supreme Court and the Texas Supreme Court. These courts, as well as other federal and state courts, have adopted a test to determine whether a specific product constitutes an investment contract regulated as a security. As described herein, this precedent demands the test be broadly applied to the endless number of unique and innovative investment schemes continuously introduced into the market, and as such investment contracts have been found in numerous exotic investment programs including products tied to animals such as muskrats,<sup>27</sup> earthworms,<sup>28</sup> and chinchillas,<sup>29</sup> as well as investments tied to yachts,<sup>30</sup> vending machines,<sup>31</sup> vineyards,<sup>32</sup> art,<sup>33</sup> and gold and silver coins.<sup>34</sup>
132. The remainder of this statement describes key caselaw relevant to the analysis of the Open-Ended Unit Investment Program, the Hash Rate Unit Investment Program and the investments in the

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<sup>26</sup> This report only considers whether the investments in cryptocurrency mining programs constitute investment contracts. It does not consider whether these investments constitute other types of securities, such as certificates in or under profit sharing or participation agreements.

<sup>27</sup> See *State v. Robbins*, 240 N.W. 456 (Minn. 1932).

<sup>28</sup> See *Smith v. Gross*, 604 F.2d 639 (9th Cir. 1979).

<sup>29</sup> See *Hollywood State Bank v. Wilde*, 70 160 P.2d 846 (Cal. 1945); *Miller v. Central Chinchilla Group, Inc.*, 494 F.2d 414 (8th Cir. 1974).

<sup>30</sup> See *SEC v. Payne*, 33 F. Supp. 988 (D. Mass. 1940).

<sup>31</sup> See *Ascher v. United States*, 143 F.2d 592 (6th Cir. 1944); *Ek v. Nationwide Candy Div., Ltd.* 403 So. 2d 780 (La. App. 1981), *cert. denied*, 407 So. 2d 732 (La. 1981); *Wheeler v. State*, 659 P.2d 1241 (Alaska Ct. App. 1983).

<sup>32</sup> See *Kerst v. Nelson*, 213 N.W. 904 (1927).

<sup>33</sup> See *Stenger v. R.H. Love Galleries*, 741 F.2d 144 (7th Cir. 1984); *Dagget v. Jackie Fine Arts, Inc.*, 733 P.2d 1142 (Ariz. Ct. App. 1986).

<sup>34</sup> See *Jenson v. Continental Fin. Corp.*, 404 F. Supp. 806 (D. Minn. 1975); *SEC v. Brigadoon Scotch Distribs., Ltd.*, 388 F. Supp. 1288 (S.D.N.Y. 1975).

Kala Rigs.<sup>35</sup> It then applies these holdings to the facts of this case, concluding that the Open-Ended Unit Investment Program, the Hash Rate Unit Investment Program and the investments in the Kala Rigs constitute investment contracts regulated as securities by the Securities Act.

SEC v. W.J. HOWEY CO.

AND THE DEFINITION OF THE TERM "INVESTMENT CONTRACT" UNDER FEDERAL LAW

133. In *SEC v. W.J. Howey Co.*,<sup>36</sup> the United States Supreme Court first considered the definition of the term "investment contract" as that term is set forth in Section 2(1) of the Securities Act of 1933, also known as the Truth in Securities Act and Federal Securities Act (hereinafter referred to as the *Act of 1933*).<sup>37</sup>
134. The facts involved an investment offering where a promoter offered tracts in a citrus grove coupled with a service contract. The promoter and the servicing company were collectively responsible for cultivating the groves, harvesting fruit, and selling fruit to third parties for a profit. The servicing company was provided with full discretion and authority over cultivation, harvesting, and marketing. Investors received returns largely derived from its work.
135. Unlike stocks, bonds, and notes, Section 2(1) of the Act of 1933 does not define the term "security" to expressly include investments in groves, investments in the harvesting of fruit, or investments in the marketing of citrus. Section 2(1) of the Act of 1933 does, however, define the term security to include an "investment contract." The United States Supreme Court therefore considered whether the investments tied to citrus groves constituted investment contracts regulated as securities by the Act of 1933.

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<sup>35</sup> As described herein, the purpose of this statement is to set forth my analysis of the jurisdiction of the State Securities Board to regulate the Open-Ended Unit Investment Program, the Hash Rate Unit Investment Program and the investments in the Kala Rigs. For the convenience of the reader, this statement refers to certain parties that clearly offered the Open-Ended Unit Investment Program, the Hash Rate Unit Investment Program and the investments in the Kala Rigs. It does not take a position as to whether Respondent Olayan, Respondent Social Membership Network Holding, or others also offered the Open-Ended Unit Investment Program, the Hash Rate Unit Investment Program, and the investments in the Kala Rigs. Although these important issues will be addressed at a hearing on the merits of this contested case, the scope of this memorandum is limited to describing my application of the investment contract test and nothing more.

<sup>36</sup> 328 U.S. 293 (1946). As described herein, *Howey* was adopted by the Texas Supreme Court and serves as precedent for construing the term "investment contract" as defined by Section 4.A of the Securities Act.

<sup>37</sup> 15 U.S.C. § 77b (1933). The Act of 1933, much like the Securities Act, defines the term "security" to include an "investment contract." Although *Howey* solely addresses the definition of "investment contract" under federal law, the federal and state securities laws are often construed in a consistent manner. Section 10-1 of the Securities Act even provides that the Securities Act may be "construed and implemented to effectuate its general purpose to maximize coordination with... federal law and administration." Also, as described later herein, the Texas Supreme Court adopted the definition of "investment contract" set forth by the United States Supreme Court in *Howey*.



136. Drawing upon blue sky law and other sources, the United States Supreme Court defined an investment contract as a “contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.”<sup>38</sup>
137. When considering the applicability of this definition to the investments in tracts of the citrus grove coupled with the service contract, the United States Supreme Court reasoned the test was not to be applied in a narrow or restrictive manner. Instead, the Court recognized its investment contract test “embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.”
138. The facts set forth in the case satisfied this standard, and as such the Court held the investments in the tracts in the citrus grove coupled with the service contract constituted investment contracts. As investment contracts, the investments were regulated as securities by the Act of 1933.

SEARSY V. COMMERCIAL TRADING CORP.  
AND THE ADOPTION OF THE TEST FOR AN “INVESTMENT CONTRACT” IN TEXAS

139. In 1977, in *Searsy v. Commercial Trading Corp.*,<sup>39</sup> the Texas Supreme Court considered the adoption of the investment contract standard articulated by the United States Supreme Court in *Howey*.<sup>40</sup>
140. *Searsy* involved a promoter that sold puts, calls, and double options on commodity future contracts.
141. The Securities Act did not define the term “securities” to include puts, calls, and double options on commodity future contracts. Section 4.A of the Securities Act does, however, define the term “securities” to include an “investment contract.” The Texas Supreme Court therefore considered

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<sup>38</sup> Although *Howey* is widely considered the first case to articulate the standard for an investment contract, in *SEC v. Edwards*, 540 U.S 389 (2004), the United States Supreme Court also “observed that when Congress included ‘investment contract’ in the definition of security, it ‘was using a term the meaning of which had been crystallized’ by the state courts’ interpretation of their ‘blue sky’ laws. *Id.*, at 298. (Those laws were the precursors to federal securities regulation and were so named, it seems, because they were “aimed at promoters who ‘would sell building lots in the blue sky in fee simple.’ ” 1 *L. Loss & J. Seligman*, Securities Regulation 36, 31–43 (3d ed. 1998) (quoting *Mulvey*, Blue Sky Law, 36 *Can. L. Times* 37 (1916)).

<sup>39</sup> 560 S.W.2d 637 (1977)

<sup>40</sup> *Searsy* does not mark the first time a Texas court considered the adoption of the investment contract standard set forth in *Howey*. Texas appellate courts began adopting the definition of “investment contract” before the Texas Supreme Court adopted the standard. *See e.g. Clayton Brokerage Co. of St. Louis, v. Mouer*, 520 S.W.2d 802 (Tex. Civ. App. Austin 1975); *King Commodity Co. v. State*, 508 S.W.2d 439 (Tex. Civ. App. Dallas 1974).

whether the puts, calls, and double options on commodity future contracts constituted investment contracts regulated as securities by the Securities Act.

142. The Texas Supreme Court adopted the investment contract standard first articulated by the United States Supreme Court in *Howey*. It held that the test for an investment contract has four factors: (1) an investment of money, (2) a common enterprise, (3) the expectation of profits, (4) and profits generated solely from the efforts of others.
143. In adopting the investment contract standard, the Texas Supreme Court, much like the United States Supreme Court, recognized the breadth of the test. It even noted “[t]he *Howey* test has been applied in many cases to hold various forms of money-making schemes to constitute investment contracts.”
144. Although the puts, calls, and double options on commodity future contracts apparently readily satisfied the first factor of the investment contract test, relating to an investment of money, the Texas Supreme Court conducted a more thorough analysis of the second factor, relating to a common enterprise. In conducting this more thorough analysis, the Texas Supreme Court reasoned a “common enterprise” may be established through a showing of either “horizontal commonality” or “vertical commonality.”
145. It explained that horizontal commonality is present when “the success of one investor is concomitant with the success of other investors,” then concluded that horizontal commonality was not present because different investors purchasing puts, calls, and double options on commodity future contracts recognized “varying investment results because different commodity options were bought and exercised at different times.”
146. The Texas Supreme Court, however, noted “[t]he more recent weight of authority” permits a showing of vertical commonality in lieu of horizontal commonality to satisfy the second factor of the investment contract test. It defined vertical commonality to exist when “the success of the investor is dependent upon the efforts and success of the promoter.<sup>41</sup>” It relied upon an analogous situation in *King Commodity Co.*<sup>42</sup> in recognizing that “[t]he money necessary to hedge each option could only come from pooling of the premiums paid by other customers and that if [the promoter]’s use of this money in its trading operations was not profitable, no funds would be available to pay the customers their profits.” It therefore found the investments in commodity option contracts involved vertical commonality, and this showing was sufficient to satisfy the requirement of a common enterprise necessary to prove the second factor of the investment contract test.

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<sup>41</sup> A number of other courts have also held that a showing of either horizontal commonality or vertical commonality satisfies the investment contract test. See e.g. *Hocking v. Dubois*, 885 F.2d 1449 (9th Cir. 1989), cert. denied, 494 U.S. 1078 (1990); *Dooner v. NMI Ltd.*, 725 F. Supp. 153 (S.D.N.Y. 1989); *Dagget v. Jackie Fine Arts, Inc.*, 733 P.2d 1142 (App. 1986).

<sup>42</sup> 508 S.W.2d 439 (Tex.Civ.App.Dallas 1974, no writ).

147. Although the puts, calls, and double options on commodity future contracts apparently readily satisfied the third factor of the investment contract test, given that investors clearly expected to receive a profit from investments, the Texas Supreme Court elaborated on the fourth and final factor of the investment contract test, relating to profits being earned “solely from the efforts of others.” Its analysis recognized “[e]arly cases construing the Howey test gave literal effect to the phrase ‘solely from the efforts of others’” and that investors were “required to have exerted no effort with regard to the investments.” The Texas Supreme Court also explained that “[t]he more recent trend, however, and in our view the more reasonable approach, is to use a more realistic test which inquires whether the investor made any significant efforts” instead of whether the investor made no efforts. It stated:

The “solely from the efforts of others” requirement could be easily evaded by requiring the investor to exert some modicum of effort, such as picking one orange in the Howey citrus groves. This would be a blind and mechanical view of what constitutes an investment contract. We agree that the more realistic test is “whether the efforts made by those other than the investor are undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.”<sup>43</sup>

148. The facts set forth in this case satisfied the fourth factor, and the Texas Supreme Court held the puts, calls, and double options on commodity future contracts constituted investment contracts. As investment contracts, they were regulated as securities by the Securities Act.

SEC V. EDWARDS AND THE AFFIRMATION  
OF THE BROAD SCOPE OF THE DEFINITION OF “INVESTMENT CONTRACT” UNDER FEDERAL LAW

149. In 2004, the United States Supreme Court reconsidered the breadth of *Howey* in *Edwards*.<sup>44</sup> As described herein, in *Edwards* the United States Supreme Court strongly affirmed the broad scope of the term “investment contract” and the need for its flexible principles to be broadly applied to the countless and variable schemes sold to the public.
150. *Edwards* was predicated on a lawsuit filed by the United States Securities and Exchange Commission against a promoter who sold investments tied to payphones. The investments were structured so investors purchased payphones and executed leasing and management contracts that required the promoters to select a site for the payphones, install the equipment, arrange for telephonic connections, collect revenues, and repair the equipment as necessary. The leasing and management agreements provided investors were entitled to a fixed return paid on a monthly

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<sup>43</sup> citing *SEC Glenn W. Turner Enterprises*, 474 F.2d 476 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973); *King Commodity Co.*, 508 S.W.2d at 439 (Tex.Civ.App.Dallas 1974, *no writ*); *State Commissioner of Securities v. Hawaii Market Center, Inc.*, 485 P.2d 105 (1971).

<sup>44</sup> 540 U.S. 389 (2004).

basis over a fixed term, and buyback agreements obligated the promoter to repurchase the payphones at the expiration of the term of the investments.

151. The Act of 1933 did not expressly define the term “security” to include investments in payphone or sale-leaseback agreements. Nevertheless, the United States District Court for the Northern District of Georgia found the payphone investment scheme constituted an investment contract. The United States Court of Appeals for the Eleventh Circuit, however, reversed the district court opinion after finding the payphone investment scheme did not constitute an investment contract.<sup>45</sup> The appellate court relied on *United Housing Foundation v. Forman*<sup>46</sup> in significantly limiting the third prong of the *Howey* test to require that profits be derived either from participation in earnings or capital appreciation. Applying the underlying facts to this narrow reading of the law, the appellate court held that investors did not expect profits in the form of participation in earnings because they were entitled to a fixed rate of return regardless of the profitability of their payphone, and they did not expect profits in the form of capital appreciation because their returns were not tied to the value of the payphones.<sup>47</sup>
152. The United States Supreme Court reversed the appellate court opinion and held that an investment scheme promising a fixed rate of return may constitute an investment contract. It sharply rebuked the appellate court, explaining the *Howey* test has always constituted a flexible rather than static principle that must be broadly applied to new and creative investment schemes. It even quoted a prior opinion in support of this assertion as follows:

“Congress’ purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called...” To that end, it enacted a broad definition of “security,” sufficient “to encompass virtually any instrument that might be sold as an investment.”<sup>48</sup>

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<sup>45</sup> See *SEC v. ETS Payphones*, 300 F.3d 1281 (11th Ct. App. 2002).

<sup>46</sup> 421 U.S. 837 (1975). In *Foreman*, the United States Supreme Court considered whether shares of stock in a housing project were securities when investors were required to purchase the stock as a condition of acquiring an apartment, the shares could not be transferred while investors lived in the apartment, the shares could not be sold for a profit when investors terminated their residency, and the shares did not convey voting rights based upon the number of shares held by investors. Although the transactions involved the sale of shares of stock, the United States Supreme Court recognized the use of the term “stock” to refer to the instruments was not dispositive. It reasoned the shares of stock issued by the housing project did not bear any characteristics commonly associated with traditional shares of stock and that investors were not acquiring the shares of stock to speculate on its profitability but instead only to obtain the right to possess an apartment. It therefore held that the shares of stock did not constitute securities under federal law.

<sup>47</sup> The appellate court also held that the payphone investment scheme failed to satisfy the fourth factor of the *Howey* test. It reasoned that “[b]ecause [investors’] returns were contractually guaranteed, those returns were not derived from the efforts of Edwards or anyone else at [the issuer]; rather, they were derived as a benefit of the investors’ bargain under the contract.”

<sup>48</sup> 540 U.S. at 393 (quoting *Reves v. Ernst & Young*, 494 U. S. 56, 61 (1990)).

153. It also reasoned that, given this context, the third factor of the *Howey* test may be satisfied because “[t]here is no reason to distinguish between promises of fixed returns and promises of variable returns... In both cases, the investing public is attracted by representations of investment income.”
154. The United States Supreme Court also warned about the dangerous consequences of narrowly defining the term “investment contract.” It recognized, for example, under a narrow reading “unscrupulous marketers of investments could evade the securities laws by picking a rate of return to promise.” Not surprisingly, it concluded it would not “read into the securities laws a limitation not compelled by the language that would so undermine the laws’ purpose.”

ARNOLD V. LIFE PARTNERS AND THE AFFIRMATION  
OF THE BROAD SCOPE OF THE DEFINITION OF “INVESTMENT CONTRACT” UNDER STATE LAW

155. In 2004, in *Griffitts v. Life Partners*,<sup>49</sup> an appellate court sitting in Waco considered whether investments in life settlement contracts<sup>50</sup> issued by Life Partners, Inc., constituted investment contracts regulated as securities by the Securities Act.
156. The appellate court, in an unpublished memorandum opinion, held that the investments in life settlement contracts issued by Life Partners, Inc., did not constitute investment contracts regulated by the Securities Act. The opinion largely relied upon and incorporated a similar holding by the United States Circuit Court for the District of Columbia in *SEC v. Life Partners*.<sup>51</sup>

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<sup>49</sup> 2004 WL 1178418 (Tex. App.—Waco May 26, 2004, no pet.) (mem. op.).

<sup>50</sup> A life settlement contract is the sale of a life insurance policy from its owner to a third party for a price in excess of the cash surrender value of the life insurance policy but less than the face value of the life insurance policy. Third parties may thereafter sell fractional interests in the death benefits of the settled policy to investors. In many cases, investors pay money to the third party to obtain a fractional interest in the death benefits of the settled policy. The third party often uses their principal to pay for premiums incurred during the life expectancy of the person insured by the insurance policy, thereby ensuring the life insurance policy stays in force and effect during his or her life expectancy. When the insured dies, the third party, as the owner of the insurance policy, typically files a claim with the insurance carrier and takes the steps necessary to make sure the investors receive a return paid from the death benefits associated with the insurance policy.

<sup>51</sup> 87 F.3d 536 (D.C. Cir. 1996). The D.C. Circuit Court handed down *Life Partners* before the United States Supreme Court handed down its opinion in *Edwards*. Following the United States Supreme Court’s Opinion in *Edwards*, in 2005 the United States Court of Appeals for the Eleventh Circuit strongly rebuked the D.C. Circuit Court’s opinion. See *SEC v. Mutual Benefits Corp.*, 408 F.3d 737 (2005). In *Mutual Benefits*, the Court considered whether investments in the death benefits of life insurance policies constituted investment contracts regulated as securities by the Act of 1933. It “decline[d] to adopt the test established by the *Life Partners* court” and recognized “[t]he rule set forth in *Howey* and reiterated in *Edwards*, directs us to broadly apply the Security Acts of 1933 and 1994 [sic] to all ‘schemes devised by those who seek the use of money of others on the promise of profits.’”

157. The Enforcement Division investigated Life Partners, Inc. and, based upon evidence uncovered during its investigation, I determined that *Griffitts* and *Life Partners* were erroneous readings of the securities laws and erroneous applications of the investment contract tests articulated in *Searsy* and *Howey*. Accordingly, I determined Life Partners, Inc. had been offering and selling, and was continuing to offer and sell, investments in life settlement contracts that were investment contracts regulated as securities by the Securities Act. I also determined Life Partners, Inc. had issued investments in life settlement contracts with a face value of \$2 billion or more, it had been and was continuing to defraud thousands of investors, and defrauded investors stood to lose the entirety of their principal investment.
158. I therefore authorized the division to pursue a civil enforcement action to enjoin Life Partners, Inc. from continuing to violate the Securities Act through its illegal and fraudulent sale of securities in the form of investments in life settlement contracts. I also determined a court should appoint a receiver over Life Partners, Inc. to marshal its assets for the benefit of defrauded investors.
159. The State of Texas filed the civil enforcement action in district court in Travis County, Texas. After a hearing, the district court denied relief, holding the investments in life settlement contracts did not constitute investment contracts regulated as securities by the Securities Act.
160. Around the same time, a different district court denied relief to investors in a class action lawsuit who filed a separate action against Life Partners, Inc., in Dallas County, Texas. The State of Texas appealed its case to the Austin Court of Appeals, and the class of plaintiffs appealed their case to the Dallas Court of Appeals.
161. The Dallas Court of Appeals reversed in part, affirmed in part, and remanded, holding the investments in life settlement contracts issued by Life Partners, Inc. constituted securities under the Securities Act.<sup>52</sup> The Austin Court of Appeals also held the investments in life settlement contracts issued by Life Partners, Inc. constituted securities under the Securities Act.<sup>53</sup> Life Partners, Inc. filed a petition for review in both cases, and the Texas Supreme Court granted the petition for review and consolidated the appeals in *Life Partners v. Arnold*.<sup>54</sup>
162. The key issue in *Arnold* was whether investments in life settlement contracts issued by Life Partners, Inc. constituted investment contracts regulated as securities by the Securities Act.

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<sup>52</sup> See *Arnold v. Life Partners*, 416 S.W.3d at 592.

<sup>53</sup> See *State v. Life Partners*.

<sup>54</sup> 464 S.W.3d 660 (2015).

163. The Texas Supreme Court began its analysis by considering not only the Securities Act and caselaw related thereto, but also the robust body of precedent established by the United States Supreme Court,<sup>55</sup> federal courts, and state courts.
164. After reviewing these standards, it enunciated three key principals that control the construction of the term investment contract, all of which require a flexible application of the test. The Texas Supreme Court explained it must first “broadly construe” the term to “maximize the protection the Act is intended to provide to the investing public.” Second, the Court “must focus on the ‘economic realities’ of the transaction to determine whether it meets the test’s requirements.” Finally, “if the ‘economic realities’ satisfy the requirements, it must conclude that the transaction is an ‘investment contract’ regardless of the labels or terminology the parties used to describe it.”
165. The Texas Supreme Court also reiterated the four elements of the investment contract test. It wrote as follows:

In light of these principles, we conclude that an “investment contract” for purposes of the Texas Securities Act means (1) a contract, transaction, or scheme through which a person pays money (2) to participate in a common venture or enterprise (3) with the expectation of receiving profits, (4) under circumstances in which the failure or success of the enterprise, and thus the person’s realization of the expected profits, is at least predominately due to the entrepreneurial or managerial, rather than merely ministerial or clerical, efforts of others, regardless of whether those efforts are made before or after the transaction...

166. Applying this standard, the Texas Supreme Court unanimously found the investments in life settlement contracts constituted investment contracts and were thus regulated as securities in Texas.

AT LEAST ONE COURT HAS CONSIDERED THE APPLICABILITY OF THE INVESTMENT CONTRACT TEST WHEN PURCHASERS INVEST CRYPTOCURRENCIES AND NOT FIAT CURRENCY

167. Although cryptocurrencies are a relatively new phenomenon, courts are now beginning to hear cases where promoters use bitcoin and other cryptocurrencies to offer and sell securities. In *SEC*

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<sup>55</sup> Importantly, the Texas Supreme Court approvingly cited *SEC v. CM Joiner Leasing Corp.*, 320 U.S. 344 (1943), explaining the federal securities laws “included ‘investment contract’ as just one of an extensive list of the different types of transactions that constitute securities, the [United States Supreme] Court remarked that ‘the reach of the [a]ct does not stop with the obvious and commonplace’ and “[i]nstead, ‘[n]ovel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proves as [a] matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as ‘investment contracts...’”

*v. Shavers*,<sup>56</sup> the United States District Court for the Eastern District of Texas heard one of the first notable cases involving an investment platform that incorporated bitcoin.<sup>57</sup>

168. The case involved a promoter selling investments in a cryptocurrency trading scheme. Investors were required to use bitcoin, and not fiat currency, to purchase investments in the cryptocurrency trading scheme.
169. The United States Securities and Exchange Commission filed a civil enforcement action and argued the investments in the cryptocurrency trading scheme constituted investment contracts regulated as securities by the Act of 1933. Mr. Shavers argued that investments in the cryptocurrency trading program did not constitute securities, at least in part, because investors purchased their investment using bitcoin and bitcoin did not constitute money under the first factor of the investment contract test.
170. In 2013, the United States District Court for the Eastern District of Texas issued a memorandum opinion that held the transfer of bitcoin from investors to Shavers for purposes of investing in the cryptocurrency trading program constituted the investment of money.<sup>58</sup> It reasoned as follows:

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<sup>56</sup> Case No. 4:13-CV-416, 2014 WL 4652121 (E.D. Tex. Sept. 18, 2014).

<sup>57</sup> The United States Securities and Exchange Commission has since filed a number of other actions against promoters charged with illegally and/or fraudulently offering and/or selling securities tied to cryptocurrencies. These cases include *SEC v. 1Pool Ltd. Aka 1Broker and Patrick Brunner*, No. 1:18-CV-02244-TNM, filed in the United States District Court for the District of Columbia in November 2018, *SEC v. Blockvest, LLC and Reginald Buddy Ringgold, III a/k/a Rasool Abdul Rahim El*, No. 18-CV-2287-GPC (BLM), filed in the United States District Court for the Southern District of California in October 2018, *SEC v. Jeffrey James and Saint James Holding and Investment Company Trust*, No. 2:18-MC-00135, filed in the United States District Court for the Central District of California in October 2018, *SEC v. PlexCorps, et al.*, No. 17-CV-07007, filed in the United States District Court for the Eastern District of New York in December 2017, *SEC v. Titanium Blockchain Infrastructure Services, Inc., EHI Internetwork and Systems Management, Inc. aka EHI-INSM, Inc., and Michael Alan Stollery aka Michael Stollaire*, 2:18-CV-04315-DSF (JPRx), filed in the United States District Court for the Central District of California in May 2018, *SEC v. AriseBank, Jared Rice Sr., and Stanley Ford*, 3:18-CV-0186-M, filed in the United States District Court for the Northern District of Texas in January 2018, *SEC v. REcoin Group Foundation, et al.*, No. 17-CV-05725, filed in the United States District Court of the Eastern District of Texas in September 2017, and *SEC v. Jon E. Montroll and Bitfunder*, 18-CV-1582, filed in the United States District Court of the Southern District of New York in February 2018. Additionally, in December 2015, the United States Securities and Exchange Commission also filed a civil action in the United States District Court for the District of Connecticut in *SEC v. Homero Joshua Garza, GAW Miners, LLC and ZenMiner, LLC*, No. 15-CV-01760, alleging the defendants sold shares in a cryptocurrency mining operation when they lacked the capacity to engage in large-scale mining. According to the complaint, the lack of capacity meant most investors paid for a share of computing power that never existed. The district court entered final judgments in favor of the government. In 2018, Mr. Garza was convicted and sentenced to 21 months imprisonment by the United States District Court for the District of Connecticut in *United States v. Homera Joshua Garza*, No. 17-CR-158. The United States Securities and Exchange Commission has published information about all of these cases on its website, which is accessible to the public.

<sup>58</sup> See *Shavers* at Dkt. 23.



It is clear that Bitcoin can be used as money. It can be used to purchase goods or services, and as [Mr.] Shavers stated, used to pay for individual living expenses. The only limitation of Bitcoin is that it is limited to those places that accept it as a currency. However, it can also be exchanged for conventional currencies, such as the U.S. dollar, Euro, Yen and Yuan. Therefore, Bitcoin is a currency or form of money, and investors wishing to invest in [the cryptocurrency investment program] provided an investment of money.

171. After concluding the transfer of bitcoin constituted an investment of money, the Court considered the three remaining factors comprising the investment contract test. It concluded vertical commonality existed between investors and Shavers because investors relied on Mr. Shaver's expertise in the bitcoin markets and local markets, and because Mr. Shavers promised considerable returns due to his specialized skill and expertise in trading and exchanging bitcoin. The Court also found investors expected up to 3.9% daily interest as profit based on his management of the cryptocurrency trading program. The Court therefore held that investments in the cryptocurrency trading program constituted investment contracts that were securities.
172. The defense later moved the Court to reconsider its ruling and moved the Court to dismiss for lack of subject matter jurisdiction.<sup>59</sup> The Court granted the motion to reconsider its prior decision and again addressed whether the investment program constituted a security. The Court conducted a lengthy analysis, eventually concluding that:

Bitcoin has a measure of value, can be used as a form of payment, and is used as a method of exchange. As such, the Bitcoin investments in this case can satisfy the "investment of money" prong set out by the Supreme Court in *Howey*. While the Court recognizes that Bitcoin does not have legal tender status, the Court notes that legal tender status is not required to establish that the investments at issue are investment contracts. Thus, the Court finds that the... investments in this case are "investment contracts" and "securities" for purposes of federal securities law. Thus, the Court finds that it has subject-matter jurisdiction over this case.

173. Having again held that the investments in the cryptocurrency trading program constituted securities, the Court denied that defense's motion to dismiss for lack of subject-matter jurisdiction and ultimately entered a final judgment in favor of the United States Securities and Exchange Commission. The United States Attorney's Office for the Southern District of New York also charged Mr. Shavers with securities fraud and wire fraud.<sup>60</sup> Mr. Shavers pleaded guilty to one

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<sup>59</sup> *Shavers* at Dkt. 46, 77.

<sup>60</sup> See *United States of America v. Shavers*, Case No., 1:15-cr-00157, filed on November 3, 2014, in the United States District Court for the Southern District of New York.

count in the indictment and was sentenced to serve eighteen months in federal prison followed by three years of supervised release.

**THE SEC HAS PUBLISHED A REPORT THAT DETAILS THE APPLICATION  
OF THE INVESTMENT CONTRACT TEST TO INVESTMENTS TIED TO CRYPTOCURRENCIES**

174. The holding in *Shavers* is consistent with a report published by the United States Securities and Exchange Commission summarizing its investigation of The DAO, a Decentralized Autonomous Organization, which is an organization embodied in computer code and executed on a digital distributed ledger.<sup>61</sup>
175. As described in the report, The DAO was supposed to operate as an online for-profit entity that would create and hold assets through the issuance and sale of DAO Tokens to investors. The DAO would use cryptocurrencies tendered by investors to fund “projects,” and investors would share in the earnings from the projects as their return on the purchase of the DAO Tokens. Investors were also able to sell the DAO Tokens on platforms, purportedly for a profit or, at the very least, to liquidate and monetize their cryptocurrencies.
176. From April 30, 2016, through May 28, 2016, The DAO sold around 1.15 million DAO Tokens in exchange for approximately 12 million Ether through a website accessible by the public. Ether is a digital currency based on the Ethereum blockchain, and at the time the offering closed, the total value of the 12 million Ether was \$150 million.<sup>62</sup>
177. After The DAO raised the equivalent of \$150 million in Ether but before it was able to begin funding projects, thereby generating earnings for investors, a malicious attacker or a group of malicious attackers exploited flaws in The DAO’s code. Their penetration of the system led to the theft of around one-third of The DAO’s assets, which were largely Ether tendered by investors.
178. The United States Securities and Exchange Commission conducted an investigation and issued a report to provide advice regarding autonomous organizations and other organizations using distributed ledger or blockchain-enabled means of raising capital. The report largely focused on the applicability of the investment contract standard to The DAO’s offering of DAO Tokens, and it concluded that the DAO Tokens constituted investment contracts regulated as securities.

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<sup>61</sup> See Release No. 81207, *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO* (July 25, 2017).

<sup>62</sup> Ethereum, like Bitcoin, is a decentralized open-source public distributed platform, and Ether is the fundamental cryptocurrency run on the Ethereum blockchain. Unlike Bitcoin, Etheruem uses “smart contracts,” which are computer protocols designed to enforce contract. The “smart contracts” require the performance of certain tasks and operate much like traditional contracts. The United States Senate’s Joint Economic Committee even remarked that, “[w]hile smart contracts might sound new, the concept is rooted in basic contract law. Usually, the judicial system adjudicates contractual disputes and enforces terms, but it is also common to have another arbitration method, especially for international transactions. With smart contracts, a program enforces the contract built into the code.”

179. The United States Securities and Exchange Commission determined The DAO's sale of DAO Tokens involved an investment of money, thereby satisfying the first factor of the investment contract test. The first factor of the investment contract test provides an investment contract only exists if persons invest money. As noted in the report, The DAO raised capital through the sale of DAO Tokens by requiring investors to invest Ether, a cryptocurrency, instead of traditional fiat currencies. The United States Securities and Exchange Commission, citing *Shavers*<sup>63</sup> and *Useton v. Comm. Lovelace Motor Freight, Inc.*,<sup>64</sup> recognized that an investment of cryptocurrency in the form of Ether constitutes an investment of money by reasoning "[s]uch investment is the type of contribution for value that can create an investment contract under *Howey*." Therefore, according to the report, the facts satisfied the first factor of the investment contract test.
180. The United States Securities and Exchange Commission also determined The DAO's sale of DAO Tokens created a common enterprise, thereby satisfying the second factor of the investment contract test. The second factor of the investment contract test provides that an investment contract only exists if persons invest in a common enterprise. As explained herein, a showing of "horizontal commonality" satisfies this requirement, and horizontal commonality exists when the success of one investor is concomitant with the success of other investors. Although the report did not expressly analyze the existence of horizontal commonality among investors, investors purchasing DAO Tokens were clearly in horizontally common relationships with other investors. These investors were treated the same or in a substantially similar manner insofar as they tendered Ether for DAO Tokens, the Ether was pooled, The DAO planned to use Ether to fund projects and generate profits, and investors could receive profits in the form of distributions of Ether. This showing is more than sufficient to prove the existence of horizontal commonality, and the facts therefore satisfied the second factor of the investment contract test.
181. The United States Securities and Exchange Commission further determined The DAO's sale of DAO Tokens satisfied the third factor of the investment contract test. The third factor of the investment contract test provides an investment contract only exists if investors have a reasonable expectation of profitability. As recognized by the United States Securities and Exchange Commission, the term "profits" is defined broadly under the securities laws to include "dividends, other periodic payments, or the increased value of the investment." As described in the report, The DAO planned to use Ether tendered by investors to fund projects, and investors were able to vote to either use the Ether generated from projects to fund new projects or to direct the distribution of Ether to investors. Even though investors would receive their "profits" in the form of Ether, and not a fiat currency, the United States Securities and Exchange Commission recognized investors "stood to share in potential profits from the contracts" for the projects and thus "a reasonable investor would have been motivated, at least in part, by the prospect of profits

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<sup>63</sup> 2014 WL 4652121 at 1

<sup>64</sup> 940 F.2d 564 at 574 (10th Cir. 1991) (holding that in "spite of *Howey*'s reference to an 'investment of money,' it is well established that cash is not the only form of contribution or investment that will create an investment contract.").

on their investment of [Ether] in The DAO.<sup>65</sup> The report therefore concluded the investments in DAO Tokens satisfied the third factor of the investment contract test.

182. Finally, the United States Securities and Exchange Commission determined The DAO's sale of DAO Tokens satisfied the fourth factor of the investment contract test. The fourth factor of the investment contract test provides investment contracts only exist when investors are dependent on the significant efforts of others. As explained herein, the fourth factor does not require a showing that investors were wholly passive; instead, it requires only a showing that the managerial efforts made by others are the "undeniably significant ones" and that they are those "essential managerial efforts which affect the failure or success of an enterprise." Not surprisingly, the United States Securities and Exchange Commission found investors purchasing DAO Tokens were relying on others to manage The DAO and put forth project proposals that could generate profits for them. Additionally, the United States Securities and Exchange Commission recognized managers of The DAO published a website that described their vision, provided information to investors through online media that addressed various topics, and touted their expertise in Ethereum, the platform on which The DAO operated. Therefore, even though investors were afforded the opportunity to vote and thereby direct certain key operations of The DAO, the United States Securities and Exchange Commission found that investors were reliant on others for the failure or success of The DAO. The DAO Tokens therefore satisfied the fourth factor of the investment contract analysis.
183. Based on the forgoing, the United States Securities and Exchange Commission concluded that, even though The DAO was dealing in cryptocurrencies, investors were purchasing investments using cryptocurrencies, and returns were paid using cryptocurrencies, that DAO Tokens nevertheless constituted investment contracts because involved the investment of money in a common enterprise with the expectation of profits based on the managerial efforts of others.<sup>66</sup>

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<sup>65</sup> Although not addressed in detail in the report, investors stood to profit through means other than the mere distribution of Ether; they also stood to profit through the appreciation in price of DAO Tokens. Although the hacking incident precluded The DAO from successfully funding projects, receiving returns on the projects, and paying distributions in Ether to investors, the demand for DAO Tokens and the corresponding price of DAO Tokens would almost surely increase if The DAO proved successful in its operations. Investors purchasing DAO Tokens prior to the success of The DAO would therefore be able to monetize their DAO Tokens, selling their DAO Tokens through an exchange or other platform for consideration greater than the original price of the tokens. The difference between the higher price and the lower price at acquisition would constitute a profit.

<sup>66</sup> The application of laws regulating the offer and sale of securities, to include investments tied to cryptocurrencies, is not novel. Although *Shavers* and *The DAO* reinforced the broad application of the securities laws to investments tied to cryptocurrencies, federal courts hearing commodities cases are also broadly applying commodities laws to cryptocurrencies. For example, in September 2018 the United States District Court of the District of Massachusetts entered an order in *CFTC v. My Big Coin Pay*, Civil Action No. 18-10077-RWZ (September 26, 2018). The key issue in the case was whether My Big Coin, a virtual currency subject to futures trading, constituted a commodity. The Court broadly read the term "commodity" to include "a host of specifically enumerated agricultural products as well as 'all other goods and articles . . . and all services rights and interests . . . in which contracts for future delivery are presently or in the future dealt in.'" The Court specifically agreed with the United States Commodity Futures Trading Commission that

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“Congress’ approach to defining ‘commodity’ signals an intent that courts focus on categories—not specific items.” The Court found that “[t]his broad approach also accords with Congress’s goal of ‘strengthening the federal regulation of the . . . commodity futures trading industry,’ . . . since an expansive definition of ‘commodity’ reasonably assures that the CEA’s regulatory scheme and enforcement provisions will comprehensively protect and police the markets.” The holding is consistent with another case involving a virtual currency, *CFTC v. McDonnell*, Case No. 1:18-cv-00361-JBW-RLM (E.D. N.Y. August 23, 2018).

THE OPEN-ENDED UNIT INVESTMENT PROGRAM  
CONSTITUTES AN INVESTMENT CONTRACT THAT IS REGULATED AS A SECURITY

184. I have reviewed the records attached to this statement, and my review and my knowledge indicate the investments in the Open-Ended Unit Investment Program involve investments of money in a common enterprise with the expectation of profits to come from the significant efforts of others. I have concluded the investments in the Open-Ended Unit Investment Program satisfy all four factors of the investment contract test and therefore constitute investment contracts regulated as securities by the Securities Act.
185. The Open-Ended Unit Investment Program involves an investment of money, satisfying the first factor of the investment contract test. As described herein, the Mintage Mining Website shows that investors in the Open-Ended Unit Investment Program purchased units of certain configurations of hardware.<sup>67</sup> The configurations were referred to by an agreement number, such as Agreement #5b070A, Agreement #5b16e7, Agreement #5b16e7, or any of the other various agreement numbers set forth in the Mintage Mining Website. The cost of a unit in each agreement was \$2.00 per unit with a first-time purchase minimum of \$25.00, payable in bitcoin, LiteCoin, Bitcoin Cash, or Bitcoin Gold, with the total purchase price calculated in bitcoin. These facts show investors were investing money in the form of cryptocurrencies to purchase units in the Open-Ended Unit Investment Program.
186. Respondents may argue that an investment paid in cryptocurrency, as opposed to fiat currency, cannot satisfy the first factor of the investment contract test. I do not agree with this argument and further believe that any such argument is erroneous and inconsistent with prior court holdings, and that any such argument is inconsistent with records published by the United States Securities and Exchange Commission and the State Securities Board which provide the public with meaningful notice about the applicability of the securities laws to investments tied to cryptocurrencies. I also believe any such argument essentially urges SOAH to create a new legal standard that ensures white-collar criminals and other bad actors are able to defraud the public while easily evading regulation by the securities laws.
187. My analysis of any such argument relies in part on the necessity of a broad reading of the securities laws established by cases that include *Howey*, *Searsy*, *Edwards* and *Arnold*. It also relies on *Shavers*, where the United States District Court for the Eastern District of Texas found the use of a cryptocurrency, instead of fiat currency, to purchase an investment in a cryptocurrency trading program did not impact the investment contract test because cryptocurrencies, like fiat currencies, have value. This holding is consistent with analysis announced by the United States Securities and Exchange Commission in *The DAO*, where it reasoned an investment purchased using cryptocurrency instead of a fiat currency satisfied the first factor of the investment contract

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<sup>67</sup> The Mintage Mining Website, as well as other records attached hereto and incorporated herein, also support the analysis of the investment contract test. I prepared this statement by focusing on key records that are clearly relevant to the analysis and did not reference these records because they often prove duplicative or contain information substantively similar to the other information described herein. Nevertheless, all records that served as a basis for this statement are being provided to Respondents.

test. Much like the United States Securities and Exchange Commission published *The DAO*, the State Securities Board has articulated its position that products predicated on an investment of cryptocurrencies can constitute securities, as it has entered at least one emergency administrative action against a promoter of an illegal and fraudulent cryptocurrency securities scheme who accepted payment in cryptocurrency instead of fiat currency. The State Securities Board has published this emergency administrative action, as well as other relevant information, on its website, and its website is accessible by the public.

188. Any argument that an investment of cryptocurrency, as opposed to fiat currency, cannot satisfy the first factor of the investment contract test is extremely dangerous to the public. The courts have warned that a narrow reading of the law may encourage bad actors to devise schemes to circumvent regulation. For example, in *Edwards* the United States Supreme Court refused to narrowly construe the investment contract test, explaining that “[t]his Court will not read into the securities laws a limitation not compelled by the language that would so undermine the laws’ purpose” of protecting investors. In *Arnold*, the Texas Supreme Court agreed that courts must first “broadly construe” the investment contract test to “maximize the protection the Act is intended to provide to the investing public.” Failure to broadly construe the test will encourage white-collar criminals and other bad actors to embrace nuance, making minuscule changes to structure of their fraudulent schemes by requiring victims to invest cryptocurrencies instead of fiat currencies. These changes, under a narrow construction of the test, will ensure they can evade regulation and freely threaten irreparable public harm. *Life Partners*, *Arnold*, and other cases show that promoters who are able to defeat the applicability of the securities laws are able to effectuate widespread fraud, exploiting hundreds or thousands of victims without fear that regulators may bring enforcement actions to stop their schemes. The precedent set by the United States Supreme Court and the Texas Supreme Court simply does not contemplate a scenario where courts provide the judicial equivalent of a get-out-of-jail-free card.
189. The Open-Ended Unit Investment Program involves a horizontally common enterprise, satisfying the second factor of the investment contract test. As set forth in *Searsy*, horizontal commonality exists when “the success of one investor is concomitant with the success of other investors.” The Open-Ended Unit Investment Program satisfies this standard because all investors, without regard to their experience or qualification or any other factor, tendered \$2.00, payable in specified cryptocurrencies, to purchase one or more units out of a limited supply of units in a particular hardware configuration. These investors were then pooled with other investors who also tendered \$2.00, payable in the same specified cryptocurrencies, to purchase one or more of the same units out of the same limited supply of units in same hardware configuration. After Respondent Mintage Mining deployed the particular hardware configuration and its computers began mining cryptocurrencies, all investors who purchased units in the same hardware configuration shared in the profits generated from the computers that were part of said hardware configuration. As a result, the success of an investor who owned units in a particular hardware configuration was concomitant with the success of all other investors who owned the other units in the same hardware configuration. They simply won or lost together.

190. The analysis of commonality is supported by a consideration of the economic realities of the investments in the Open-Ended Unit Investment Program. In *Arnold*, the Texas Supreme Court held that the focus of the investment contract test must be upon the economic realities of the transaction, meaning that “any labels or terminology the parties may have used” are not dispositive to the analysis. As described herein, Respondent Mintage Mining was using technical labels and terminology to promote the Open-Ended Unit Investment Program, describing it as the purchase of a unit in a particular “configuration,” where each particular “configuration” corresponds to an “agreement” labeled using a string of alpha numeric characters. The agreements labeled using these strings of alpha numeric characters identified sophisticated niche hardware not used in routine computing, such as DragonMint B29s, Baikal Giant Bs, and GMO B2 SHA-256 ASIC Miners. Respondent Mintage Mining even described the hardware using even more technical terminology, such as “hash rates” and “average power consumption,” and “auto switch algorithms.”
191. Although Respondent Mintage Mining used technical labels and terminology to promote the Open-Ended Unit Investment Program, the economic realities of the investments are strikingly simple. Investors were essentially purchasing one or more units from a predefined pool of units, much like investors may purchase one or more shares in a fund that issues a predefined pool of shares, one or more limited partnership interests in a limited partnership that issues a predefined pool of limited partnership interests, or one or more instruments representing an interest in an oil or gas lease from a driller that issues a predefined pool of instruments representing interests in an oil or gas lease. Although the terms may vary from offering to offering, at a very basic level, these shares, limited partnership interests, and the instruments representing interests in an oil and gas lease often provide that all investors are concomitant with each other, where investors tender the same amount of money to share in the same profits from the underlying venture. Not surprisingly, the Securities Act provides that these shares, limited partnership interests, and instruments representing interests in oil and gas leases constitute securities. When disregarding the technical labels and terminology used by Respondent Mintage Mining, the investments in the Open-Ended Unit Investment Program were substantively similar to these securities insofar as investors tendered the same amount of money to receive the same stake in the underlying venture and to share in the same profits from the underlying venture. Accordingly, the economic realities of the Open-Ended Unit Investment Program reveal investors who purchased units in the Open-Ended Unit Investment Program shared the exact same horizontal relationship as investors who purchased any of the aforementioned securities. Not surprisingly, when the analysis focuses not on technical labels and terminology but rather on the economic realities of the transaction, investors are shown to share a concomitant, horizontal relationship with each other, thereby satisfying the second factor of the investment contract test.
192. The Open-Ended Unit Investment Program also involved a vertical common enterprise, providing an alternative means of satisfying the second factor of the investment contract test. In *Searsy*, the Texas Supreme Court adopted vertical commonality as a substitute for horizontal commonality, and it explained that “vertical commonality” exists when “the success of the investor is dependent upon the efforts and success of the promoter.” The Open-Ended Unit Investment Program satisfies this standard, because the success of each investor, measured in terms of the net mining



revenue<sup>68</sup> paid weekly to each investor's digital wallet, was entirely dependent on the efforts and success of the Respondent Mintage Mining's management of the hardware configurations and the use of computers to mining cryptocurrencies. In this case, Respondent Mintage Mining was admittedly responsible for managing the venture, as it was telling investors it "do[es] all the work so [they] don't have to." It identified its work as, among other things, hosting, maintaining, and optimizing each hardware piece, as well as developing and implementing its "Advanced Proprietary Algorithm" that "evaluates the current cryptocurrency market and strategically adjusts to the best coin each piece of hardware can mine." It even charges a fee – which it notably refers to as a *management* fee – for its services. Investors, on the other hand, appear entirely passive, responsible only for withdrawing the proceeds derived from Respondent Mintage Mining's management of the hardware. This relationship is more than sufficient to create a vertically common relationship between investors and Respondent Mintage Mining, and the facts therefore satisfy the second factor of the investment contract test.

193. The Open-Ended Unit Investment Program involves the expectation of profits, satisfying the third factor of the investment contract test. In *Searsy and Arnold*, the Texas Supreme Court held an investment contract exists only when investors expect to receive profits. In this case, investors not only expected to receive profits, but they may also have expected to receive lucrative profits valued at far more than returns associated with traditional securities markets. Their expectation of profitability from the purchase of investments in the Open-Ended Unit Investment Program is evidenced, in part, by the advertisements published by Mr. McCullough and Mr. Whetsell, correspondence sent by Mr. McCullough, and statements set forth in the Mintage Mining Website.
194. The expectation of the profitability of the Open-Ended Unit Investment Program is apparent from the advertisements published by Mr. McCullough. As described herein, Mr. McCullough was publicly claiming investors could "[m]ake up to 7% weekly through crypto mining," explaining that an investment in cryptocurrency mining "[a]verages of interest vary from 3-7% WEEKLY," noting "[a]nnual percentages range from 189-250% annually depending on the crypto market," and stating "[l]ong term gains are up into the hundreds of thousands of dollars in 3 years with less than 3k invested." He continued to tout the lucrative profitability of investments in cryptocurrency mining in part by publicly announcing he was "up 500% on his investment in 7 weeks" and his "uncle [was] up 4,000% in 10 weeks!" He also posted a table that purported to support his claims, showing that investments in cryptocurrency mining returned 5.036% during

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<sup>68</sup> As was the case with the analysis of horizontal commonality among investors, the economic realities of the transaction only clarify the presence of a vertically common relationship among investors. For example, although Respondent Mintage Mining referred to the payment of "net mining revenue" to investors and represented "net mining revenue" would be paid to digital wallets, the economic reality is that these payments are actually the substantive equivalent of the distribution of proceeds of the venture paid to accounts held by investors. Accordingly, the economic reality is that Respondent Mintage Mining is engaging in a venture, paying itself a fee derived from the proceeds of the venture, and then distributing the remaining proceeds of the venture to accounts maintained by investors. Although this process may not be readily apparent given the technical labels and terminology used by Respondent Mintage Mining, it is nevertheless typical in traditional securities offerings.

the period ending December 6, 2017, 5.479% during the period ending December 13, 2017, 4.791% during the period ending December 20, 2017, 3.773% during the period ending December 27, 2017, 3.575% during the week ending January 3, 2017, and 3.476% during the week ending January 10, 2018. These facts show investors were being drawn to the Open-Ended Unit Investment Program because the Open-Ended Unit Investment Program was supposed to return profits generated from cryptocurrency mining.

195. The expectations of profitability are also shown in communications between Mr. McCullough and ██████.<sup>69</sup> As described herein, during correspondence via email, Mr. McCullough told ██████ “we just got our payouts yesterday and it was about 2.1% back on our money,” this 2.1% return was “[p]retty awesome considering if we averaged just that we’re looking at almost 110% return on your money annually,” and he “anticipate[d] those returns to be much higher!” During correspondence via text message, Mr. McCullough told ██████ he “made a minimum of 1.5% on [his] money all the way up to 7% WEEKLY,” he “just made 1.645% on [his] money last week,” that “you start hitting 6-7 figures after 4yrs,” and even though “[a]nnual interest rate can vary depending on bitcoin[']s price,” ██████ could “expect anywhere from 80-250!” These facts also show investors were being drawn to the investments in cryptocurrency mining because the investments in cryptocurrency mining were not only supposed to return profits, but lucrative profits that significantly exceed the profits associated with the traditional markets for investments.
196. In addition to the advertisements and communications attributable to Mr. McCullough, the statements contained in the Mintage Mining Website also show Respondent Mintage Mining was

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<sup>69</sup> The mere fact that evidence was obtain from an undercover investigator, as opposed to a person who purchased investments in cryptocurrency mining from the Respondents, does not impact the analysis. As explained in *Warfield v. Alaniz*, 569 F.3d 1015, the investment contact standard is an objective, not subjective, inquiry. 569 F.3d 1015 (9th Cir. 2009) (citing *Howey* in recognizing that “courts conduct an objective inquiry into the character of the instrument or transaction offered based on what the purchasers were ‘let to expect,’ 328 U.S. at 298-99, and quoting *Joiner* in recognizing that “[t]he test [for determining whether an instrument is a security] is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect.”). The *Warfield* court recognized that precedent clearly demonstrates “courts have frequently examined the promotional materials associated with an instrument or transaction in determining whether an investment contract is present.” *Id.* (citing *Edwards*, 540 U.S. at 392 (observing that a payphone sale and buyback scheme involved investment contracts where promotional materials noted “potential for ongoing revenue generation”); *Forman*, 421 U.S. at 854 (noting, in the course of finding investment contract test not met, that the promotional materials “[n]owhere . . . seek to attract investors by the prospect of profits” and rather “repeatedly emphasize] ] the ‘nonprofit’ nature of the endeavor”); *Rice v. Branigar Org.*, 922 F.2d 788, 791 (11th Cir. 1991) (holding investment contract definition was not met where promotional materials for housing development did not emphasize investment value of lots); *SEC v. Goldfield Deep Mines Co. of Nev.*, 758 F.2d 459, 464-65 (9th Cir.1985) (relying in part on brochure’s representations of profit possibility in finding ore purchase reinvestment program satisfied *Howey* test); *Aldrich v. McCulloch Props., Inc.*, 627 F.2d 1036, 1039-40 (10th Cir.1980) (stating that in determining whether real estate transaction constitutes security, “promotional emphasis of the developer” is “[c]entral”); *United States v. Carman*, 577 F.2d 556, 564 (9th Cir.1978) (holding an investment contract was present where business “consistently promoted the package it offered as an investment”).

telling investors they would profit from an investment in the Open-Ended Unit Investment Program. For example, the Mintage Mining Website represented Respondent Mintage Mining maximizes profitability through its proprietary artificial intelligence, which evaluated the cryptocurrency market and strategically picked the best coin to mine for the highest payout. The Mintage Mining Website also explained investors would, after purchasing units in hardware configurations and the underlying computers used this artificial intelligence to mine cryptocurrencies, receive a share of the net mining revenue. The Mintage Mining Website referred to these shares of net mining revenue as “earnings,” and it claimed Respondent Mintage Mining deposited earnings into investors digital wallets once per week. The Mintage Mining Website did not describe these earnings as illusory or otherwise inaccessible to investors, as it represented investors were able to immediately withdraw the earnings generated from cryptocurrency mining. Even if the earnings are paid in cryptocurrencies, which have value as described herein, investors could nevertheless use the cryptocurrencies to purchase goods or services from a willing seller or monetize the cryptocurrencies by trading the cryptocurrencies for fiat currencies through an exchange.

197. The economic realities of the transaction support the conclusion that the advertisements and communications attributable to Mr. McCullough and the statements set forth in the Mintage Mining Website show that investors expected to receive a profit from their purchase of an investment in the Open-Ended Unit Investment Program. The records do not reflect that investors were acting with a charitable intent, or that they were simply providing money to Respondent Mintage Mining without the expectation of the receipt of anything of value in return. Instead, a common-sense review of the offering shows investors would only purchase an investment in the Open-Ended Unit Investment Program if they expected to receive something of value in return. In this case, the expectation is that they would receive earnings generated from Respondent Mintage Mining’s management of hardware used to mine cryptocurrencies. The economic reality, therefore, is investors were purchasing investments in the Open-Ended Unit Investment Program with the expectation of a profit, regardless of whether that profit was paid in cryptocurrencies or fiat currencies.
198. Respondents may argue Respondent Mintage Mining was paying earnings in cryptocurrencies, instead of paying earnings in fiat currency, and that its use of cryptocurrencies in lieu of fiat currencies, defeats the third factor of the investment contract test. I do not agree with any such argument for many of the reasons set forth in Paragraph 185 through Paragraph 187 relating to the use of cryptocurrencies instead of fiat currencies to purchase an investment in the Open-Ended Unit Investment Program.
199. SOAH should reject an argument that the payment of earnings in cryptocurrencies defeats the investment contract test, largely because *Howey*, *Searsy*, *Edwards* and *Arnold* establish the need to broadly apply the investment contract test to new and unique products. In *Shavers*, the United States District Court for the Eastern District of Texas agreed with this rationale when it found the use of a cryptocurrency, instead of fiat currency, to purchase an investment in a cryptocurrency trading program did not impact the first factor of the investment contract test because cryptocurrencies, like fiat currencies, have value. The same reasoning should equally apply to the

third factor of the investment contract test. Respondent Mintage Mining was paying earnings in cryptocurrencies, and cryptocurrencies have value. As described herein, investors could thereafter use the cryptocurrencies to purchase goods or services from a willing seller, or they could monetize the cryptocurrencies by trading the cryptocurrencies for fiat currencies through an exchange. Accordingly, I do not believe there is any reason to narrow the reading of the third factor of the investment contract test to exclude earnings paid in cryptocurrencies.

200. My position is consistent with the analysis set forth by the United States Securities and Exchange Commission in *The DAO*, where it reasoned returns paid in cryptocurrencies satisfied the fourth factor of the investment contract test. In *The DAO*, the United States Securities and Exchange Commission considered whether distributions paid in Ether, a cryptocurrency, constituted the payment of profits. The United States Securities and Exchange Commission recognized that the term “profits” is broadly construed to include “dividends, other periodic payments, or the increased value of the investment.” Therefore, even though investors would receive their “profits” in the form of Ether, and not a fiat currency, the United States Securities and Exchange Commission recognized investors “stood to share in potential profits from the contracts” for the projects and thus “a reasonable investor would have been motivated, at least in part, by the prospect of profits on their investment of [Ether] in The DAO.”
201. My analysis of the dangers of narrowly construing the third factor of the investment contract test include reasoning similar to the reasoning set forth in Paragraph 185 through Paragraph 187 of this statement, relating to the applicability of the investment contract test when investors purchase investments using cryptocurrencies instead of fiat currencies. As described therein, courts have warned a narrow reading of the law may encourage bad actors to devise schemes to circumvent regulation. For example, in *Edwards*, the United States Supreme Court refused to narrowly construe the investment contract test, explaining “[t]his Court will not read into the securities laws a limitation not compelled by the language that would so undermine the laws’ purpose” of protecting investors. In *Arnold*, the Texas Supreme Court agreed courts must first “broadly construe” the investment contract test to “maximize the protection the Act is intended to provide to the investing public.” Failure to broadly construe the test will encourage white-collar criminals and other bad actors to embrace nuance, making minuscule changes to structure of their fraudulent schemes by requiring victims to invest cryptocurrencies instead of fiat currencies. These changes, under a narrow construction of the test, will ensure they can evade regulation and freely threaten irreparable public harm. *Life Partners*, *Arnold*, and other cases show that promoters who are able to defeat the applicability of the securities laws are able to effectuate widespread fraud, exploiting hundreds or thousands of victims without fear that regulators may bring enforcement actions to stop their schemes. The precedent set by the United States Supreme Court and the Texas Supreme Court simply does not contemplate a scenario where courts provide the judicial equivalent of a get-out-of-jail-free card.
202. The Open-Ended Unit Investment Program is a passive investment where profits are derived only from the significant efforts of Respondent Mintage Mining, thereby satisfying the fourth factor of the investment contract test. In *Searsy*, the Texas Supreme Court rejected a “blind and mechanical view” of the fourth factor of the investment contract test, reasoning that narrowly construing the

requirement would encourage promoters to evade regulation by “exert[ing] some modicum of effort.”<sup>70</sup> The Texas Supreme Court therefore adopted a broad construction of the fourth factor of the investment contract test, holding it is satisfied when “the efforts made by those other than the investor are undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.” In *Arnold*, the Texas Supreme Court rearticulated this broad construction of the fourth factor, directing courts to consider whether “which the failure or success of the enterprise, and thus the person’s realization of the expected profits, is at least predominately due to the entrepreneurial or managerial, rather than merely ministerial or clerical, efforts of others, regardless of whether those efforts are made before or after the transaction...” The advertisements published by Mr. McCullough and Mr. Whetsell, communications between Mr. McCullough and ██████, and statements set forth in the Mintage Mining Website show investors are passive and reliant on efforts of Respondent Mintage Mining, and their expectation of profit is at least predominantly due to the entrepreneurial or managerial efforts of Respondent Mintage Mining.

203. The advertisements published by Mr. McCullough and Mr. Whetsell demonstrate that Respondent Mintage Mining is predominantly responsible for the entrepreneurial or managerial efforts associated with cryptocurrency mining. For example, their advertisements show investors are not reliant on their own technical skills and resources to mine cryptocurrencies because an

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<sup>70</sup> Respondents may argue that investments in the Open-Ended Unit Investment Program, as well as the Hash Rate Unit Investment Program, were not passive investments and investors were not reliant on the predominant managerial efforts of others because Respondent Mintage Mining was inviting investors to act as sales agents and paying commission for recruiting new investors. Any such argument fails because Respondent Mintage Mining was not requiring investors to recruit new investors to purchase investments in its cryptocurrency mining programs and the act of recruiting new investors did not increase, decrease or in any way impact the mining revenue paid per the terms of the Open-Ended Unit Investment Program. In other words, Respondent Mintage Mining’s recruitment of investors to sell its products was wholly and completely independent of its cryptocurrency mining investments, and investors could not take any managerial or entrepreneurial action – or any other meaningful action– that affected the profitability of their investments.

This situation was already addressed by the Texas Court of Criminal Appeals in *Bruner v. State*, 463 S.W.2d 205 (Tex. Crim. App. 1970). In *Bruner*, the Court examined transactions relating to the distribution of soap in a pyramid scheme. The facts show that the victim, as a participant in the pyramid scheme, “would be obligated to endeavor to bring guests to dinner parties given by the company, [and] he would share in ‘profits and dividends’ as a result of the investment made by any of such guests as well as the investments made by future invitees of his guests.” Not surprisingly, the Court correctly recognized that the victim was not “to play the passive role of an investor only” and that “[m]anagement was in the hands of the company but profits were not to be realized by [the victim] without his actual and continued participation.” As the agreement “contemplat[ed] his active and actual participation,” the Court could not conclude that it constituted an investment contract. This type of scheme is very different than the scheme in the present case. Respondent Mintage Mining, as described herein, was selling passive investments where investors do not need to take any action whatsoever to secure a profit. They simply purchased investments in the Open-Ended Unit Investment Program and the Hash Rate Unit Investment Program and collected revenue derived solely from Respondent Mintage Mining’s technical skill, access to resources and management of hardware and software. Even when investors decided to act as sales agents and offer investments on behalf of Respondent Mintage Mining, their act of securing new investor had no impact on the profitability of their investments in the Open-Ended Unit Investment Program and the Hash Rate Unit Investment Program.

“Advanced Mining System” ensures the hardware “[m]ines the [r]ight [c]oin at the [p]erfect [t]ime” and the “Advanced Proprietary Mining AI evaluates the current cryptocurrency market and strategically picks the best coin to mine.” The advertisements even suggest that investors were wholly passive because “[w]e do the work so you don’t have to.” Investors do not appear to have undertaken any efforts to ensure the success of the investments in cryptocurrency mining, much less the significant, managerial efforts necessary to effectively host and manage hardware used to mine various cryptocurrencies. These statements alone appear sufficient to satisfy the fourth factor of the investment contract test.

204. Mr. McCullough even clarified the passivity of investors in relation to Respondent Mintage Mining when corresponding with ██████ via text message. He told ██████ that “this isn’t a DIY program or software,” seemingly meaning that investors aren’t managing programs or software on a do-it-yourself basis. Instead, Mr. McCullough clearly explained that he was “paying a company to mine multiple cryptos and get a percentage back in return.” In other words, Respondent Mintage Mining, and not an individual investor, is responsible for mining cryptocurrencies to generate a return. These statements only strengthen the analysis of the fourth factor, showing that investors are expecting profits due to the entrepreneurial or managerial efforts of Respondent Mintage Mining in mining cryptocurrencies.
205. The representations contained within the Mintage Mining Website also show that investors purchasing investments in the Open-Ended Unit Investment Program are expecting profits due to the entrepreneurial or managerial efforts of Respondent Mintage Mining. The Mintage Mining Website contains statements that are the same or substantively similar to the aforementioned statements contained in advertisements published by Mr. McCullough and Mr. Whetsell. For example, the Mintage Mining Website touted the passivity of the investments in cryptocurrency mining, claiming that “[w]e do the work so you don’t have to.” It also referred to the investments as “managed hash rate contracts” and “managed mining hardware rental agreements” that are tied to its “exclusive managed mining hardware,” apparently meaning someone other than the investor was “managing” the hardware used to mine cryptocurrencies.<sup>71</sup> The Mintage Mining

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<sup>71</sup> The evidence clearly shows that Respondent Mintage Mining undertook significant entrepreneurial and managerial efforts before the actual sale of investments in the Open-Ended Unit Investment Program. These efforts apparently include, but certainly are not limited to, organizing the business, developing a business plan, employing and training personnel with appropriate qualifications, identifying and purchasing sophisticated hardware, configuring hardware and software, securing a facility or facilities to host the hardware, optimizing electrical costs, implementing cooling systems, developing algorithmic configurations and creating, testing and implementing artificial intelligence. Although Respondent Mintage Mining may have completed some or all these acts prior to the offer and sale of investments in the Open-Ended Unit Investment Program, as well as the other investments described herein, the law does not distinguish between entrepreneurial and managerial efforts completed prior to the sale of securities and entrepreneurial and managerial efforts completed after the sale of securities. See *Arnold*, 464 S.W.3d at 660 (2015). (citing *Life Partners*, 87 F.3d at 551 (D.C. Cir. 1996) (Wald, J., dissenting), in holding “that the entrepreneurial or managerial efforts that are relevant to this inquiry, whether those of the purchasers or of others, include those that are made prior to that transaction as well as those that are made after” and explaining that it “reach[ed] this conclusion in light of the guiding principles we have identified, because [it] agree[ed] that the ‘bright line rule dismissing the relevance of pre-purchase efforts “elevates a formal element, timing, over the economic reality of the investors’ dependence on the promoter [and] undercuts

Website further claimed investors were reliant on its Advanced Proprietary Algorithm. Much like the advertisements published by Mr. McCullough and Mr. Whetsell, the Mintage Mining Website claimed Respondent Mintage Mining’s “Advanced Proprietary Algorithm” evaluated the “current cryptocurrency market and strategically adjusts to the best coin each piece of hardware can mine” and its Auto-Switching Algorithms “[m]ine the [r]ight [c]oin at the [r]ight [t]ime.” It also explained “[e]ach week our Advanced Proprietary Mining AI evaluates the current cryptocurrency market and strategically picks the best coin to mine for the highest payout.” Respondent Mintage Mining’s description of its investments in cryptocurrency mining clearly show, even independent of the statements of its agents, investors are passive and are predominantly reliant upon the entrepreneurial or managerial efforts of Respondent Mintage Mining to mine cryptocurrencies for a profit.

206. Based on the forgoing, I have concluded the Open-Ended Unit Investment Program involves an investment of money in a common enterprise with the expectation of profits to be predominantly derived from the entrepreneurial or managerial efforts of Respondent Mintage Mining. I have therefore determined the Open-Ended Unit Investment Program satisfies the test for an investment contract adopted by the Texas Supreme Court, and as an investment contract it is regulated as a security by the Securities Act.

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the flexibility and ability to adapt to ‘the countless and variable schemes’ that are the hallmarks of the *Howey test*.”).

THE HASH RATE UNIT INVESTMENT PROGRAM  
CONSTITUTES AN INVESTMENT CONTRACT THAT IS REGULATED AS A SECURITY

207. I have reviewed the information set forth within this statement, and my review and my knowledge indicate the investments in the Hash Rate Unit Investment Program involve investments of money in a common enterprise with the expectation of profits to come from the significant efforts of others. I have concluded the investments in the Hash Rate Unit Investment Program satisfy all four factors of the investment contract test and therefore constitute investment contracts regulated as securities by the Securities Act.
208. The Hash Rate Unit Investment Program involves an investment of money, satisfying the first factor of the investment contract test. As described herein, potential investors accessed a webpage under the Mintage Mining Website that identified various “batches,” which appear to be the name given to a predefined amount of computing power attributable to hardware hosted and used by Respondent Mintage Mining to mine cryptocurrencies. Also, as described herein, at one point, potential investors were able to purchase units in a batch that ran proportional algorithms that included 20% cryptonight, 5% qubit, 10% myriad-groestl, 10% skein, 5% scrypt, 15% blake2b, 5% quark and 30% decred. Respondent Mintage Mining would use hardware running these algorithms to mine cryptocurrencies that included digibyte, auroracoin, myriadcoin, zcash, siacon, dash, electroneum and monero. Respondent Mintage Mining offered 250,000 units in this batch for \$1.00 per unit payable in payable in bitcoin, Litecoin, Bitcoin Cash, or Bitcoin Gold. At one point, Respondent Mintage Mining sold 120,237.14 units in this batch, meaning potential investors were able to purchase up to 129,762.86 units for \$1.00 per unit payable in payable in bitcoin, Litecoin, Bitcoin Cash, or Bitcoin Gold. These facts show investors were tendering cryptocurrencies to Respondent Mintage Mining to purchase investments in the Hash Rate Unit Investment Program, and these facts are sufficient to satisfy the first factor of the investment contract test.
209. As described in Paragraph 185 through Paragraph 187, relating to the Open-Ended Unit Investment Program, Respondents may argue that an investment of a cryptocurrency, as opposed to fiat currency, cannot satisfy the first factor of the investment contract test. As described herein, I do not agree with this argument, I believe any such argument is erroneous and inconsistent with prior court holdings, I believe that any such argument is inconsistent with records published by the United States Securities and Exchange Commission and the State Securities Board that provide the public with meaningful notice about the applicability of the securities laws to investments tied to cryptocurrencies. I also believe any such argument essentially urges SOAH to create a new legal standard that ensures white-collar criminals and other bad actors are able to defraud the public while easily evading regulation by the securities laws. The basis for these conclusions is the same as the basis for the conclusions set forth in Paragraph 185 through Paragraph 187.
210. The Hash Rate Unit Investment Program involves a horizontally common enterprise, and for reasons similar to those explained in Paragraph 188 to Paragraph 190 relating to the Open-Ended Unit Investment Program, the Hash Rate Unit Investment Program satisfies the second factor of the investment contract test. As set forth in *Searsy*, horizontal commonality exists when “the



success of one investor is concomitant with the success of other investors.” The Hash Rate Unit Investment Program satisfies this standard because all investors, without regard to their experience or qualification or any other factor, tendered \$1.00, payable in specified cryptocurrencies, to purchase one unit in a particular batch. They were then pooled with other investors who also tendered \$1.00, payable in the same specified cryptocurrencies, to purchase one of the same units out of the same limited supply of units in the same batch. After Respondent Mintage Mining deployed the batch and the batch mined cryptocurrencies, all investors who purchased units in the same batch shared in the profits generated from the batch. As a result, the success of an investor owning units in a particular batch was concomitant with the success of other investors owning the other units in the batch. Much like the investors in the Open-Ended Unit Investment Program, investors who purchased units in the Hash Rate Unit Investment Program won or lost together.

211. The analysis of commonality is supported by a consideration of the economic realities of the investments in the Hash Rate Unit Investment Program for the many of the same reasons set forth in Paragraph 189 to Paragraph 190 relating to the Open-Ended Unit Investment Program. In *Arnold*, the Texas Supreme Court held the focus of the investment contract test must be upon the economic realities of the transaction, meaning “any labels or terminology the parties may have used” are not dispositive to the analysis. As was the case with the Open-Ended Unit Investment Program, investors who purchased investments in the Hash Rate Unit Investment Program were essentially purchasing one or more units from a predefined pool of units, much like investors may purchase one or more shares in a fund that issues a predefined pool of shares, one or more limited partnership interests in a limited partnership that issues a predefined pool of limited partnership interests, or one or more instruments representing an interest in an oil or gas lease from a driller that issues a predefined pool of instruments representing interests in an oil or gas lease. Although the terms may vary from offering to offering, at a very basic level these shares, limited partnership interests, and the instruments representing interests in an oil and gas lease typically provide that all investors are concomitant with each other where investors tender the same amount of money to share in the same profits from the underlying venture. Not surprisingly, the Securities Act provides that these shares, limited partnership interests, and instruments representing interests in oil and gas leases constitute securities. When disregarding the technical labels and terminology used by Respondent Mintage Mining, the investments in the Hash Rate Unit Investment Program are substantively similar to these securities insofar as investors tendered the same amount of money to receive the same stake in the underlying venture and to share in the same profits generated by the underlying venture. Accordingly, the economic realities of the Hash Rate Unit Investment Program show an investor who purchased a unit in the Hash Rate Unit Investment Program shared the exact same horizontal relationship as investors who purchased any of the aforementioned securities. Therefore, when the analysis focuses not on technical labels and terminology but rather on the economic realities of the transaction, investors in the Hash Rate Unit Investment Program share a concomitant, horizontal relationship with each other, thereby satisfying the second factor of the investment contract test.
212. The Hash Rate Unit Investment Program also involves a vertical common enterprise, providing an alternative means of satisfying the second factor of the investment contract test. *Searsy* provides

“vertical commonality” exists when “the success of the investor is dependent upon the efforts and success of the promoter.” The Hash Rate Unit Investment Program clearly satisfies this standard, because the success of each investor, measured in terms of the net mining revenue paid weekly to each investor’s digital wallet,<sup>72</sup> is entirely dependent on the efforts and success of Respondent Mintage Mining’s management of computers in each batch. In this case, Respondent Mintage Mining was admittedly responsible for managing the batches, as its website was telling investors it “do[es] all the work so [they] don’t have to.” It identified its work as, among other things, hosting, maintaining, and optimizing each hardware piece, as well as developing and implementing its “Advanced Proprietary Algorithm” that “evaluates the current cryptocurrency market and strategically adjusts to the best coin each piece of hardware can mine.” Respondent Mintage Mining even charges a five percent fee for its services, meaning that both Respondent Mintage Mining and investors in the Hash Rate Unit Investment Program receive more money when the batches succeed at mining cryptocurrencies as opposed to when the batches do not succeed at mining cryptocurrencies. Respondent Mintage Mining and the investors in the Hash Rate Unit Investment Program were therefore inherently linked; they won or lost together.

213. For many of the same reasons set forth in Paragraph 192 to Paragraph 196, relating to the Open-Ended Unit Investment Program, the Hash Rate Unit Investment Program involves the expectation of profits, satisfying the third factor of the investment contract test. In *Searsy and Arnold*, the Texas Supreme Court held an investment contract exists only when investors expect to receive profits. In this case, investors not only expected to receive profits, but they may also have expected to receive lucrative profits valued at far more than returns associated with traditional securities markets. Their expectation of profitability from the purchase of investments in the Hash Rate Unit Investment Program is evidenced, at least in part, by the advertisements published by Mr. McCullough and Mr. Whetsell, correspondence sent by Mr. McCullough, and statements set forth in the Mintage Mining Website.
214. The expectation of the profitability of the Hash Rate Unit Investment Program is apparent from the advertisements published by Mr. McCullough and Mr. Whetsell, as well as his communication [REDACTED]. As described herein, Mr. McCullough was publicly claiming investors could “[m]ake up to 7% weekly through crypto mining,” explaining for an investment in cryptocurrency mining “[a]verages of interest vary from 3-7% WEEKLY,” noting “[a]nnual percentages range from 189-250% annually depending on the crypto market,” and stating “[l]ong term gains are up into the

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<sup>72</sup> Much like the analysis of commonality in the Open-Ended Unit Investment Program set forth in Paragraph 188 through Paragraph 191, and as was the case with the analysis of horizontal commonality among investors in the Hash Rate Unit Investment Program, the economic realities of the transaction only clarify the presence of a vertically common relationship among investors. For example, although the Mintage Mining Website refers to the payment of “net mining revenue” to investors and represents “net mining revenue” will be paid to digital wallets, the economic reality is that these payments are actually the substantive equivalent of the distribution of proceeds of the venture paid to accounts held by investors. Accordingly, the economic reality is Respondent Mintage Mining is engaging in a venture, paying itself a fee, and then distributing the remaining proceeds of the venture to accounts maintained by investors. Although the calculation of the fee may or may not differ from the fee described in Paragraph 191 relating to the Open-Ended Unit Investment Program, this relationship is nevertheless typical in traditional securities offerings.

hundreds of thousands of dollars in 3 years with less than 3k invested." He continued to tout the lucrative profitability of investments in cryptocurrency mining in part by publicly announcing he was "up 500% on his investment in 7 weeks" and his "uncle [was] up 4,000% in 10 weeks!" He also posted a table that purported to support his claims, showing investments in cryptocurrency mining returned 5.036% during the period ending December 6, 2017, 5.479% during the period ending December 13, 2017, 4.791% during the period ending December 20, 2017, 3.773% during the period ending December 27, 2017, 3.575% during the week ending January 3, 2017, and 3.476% during the week ending January 10, 2018.

215. Mr. McCullough continued to describe the profitability of the investments in cryptocurrency mining when communicating with [REDACTED]. During correspondence via text message, Mr. McCullough told [REDACTED] he "made a minimum of 1.5% on [his] money all the way up to 7% WEEKLY," he "just made 1.645% on [his] money last week," that "you start hitting 6-7 figures after 4yrs," and that even though "[a]nnual interest rate can vary depending on bitcoin[']s price," [REDACTED] could "expect anywhere from 80-250!" These facts also show investors were being drawn to the investments in cryptocurrency mining because the investments in cryptocurrency mining were supposed to return not only profits but lucrative profits.
216. In addition to the advertisements and communications attributable to Mr. McCullough, the statements contained in the Mintage Mining Website also show Respondent Mintage Mining was telling investors they would profit from an investment in the Hash Rate Unit Investment Program. For example, the Mintage Mining Website represented Respondent Mintage Mining maximized profitability through its proprietary artificial intelligence, which evaluated the cryptocurrency market and strategically picked the best coin to mine for the highest payout. The Mintage Mining Website also explained that, after investors purchased units in hardware configurations and the underlying computers used this artificial intelligence to mine cryptocurrencies, they would receive a share of the profits. The Mintage Mining Website referred to these profits as "earnings," and it claimed Respondent Mintage Mining deposited each investors' share of net mining revenue, less a five percent fee, into digital wallets owned by investors once per week. The Mintage Mining Website did not describe these earnings as illusory or otherwise inaccessible to investors, but instead represented that investors were able to immediately withdraw the earnings generated from cryptocurrency mining. Even if the earnings were paid in cryptocurrencies, which have value as described herein, investors could nevertheless use the cryptocurrencies to purchase goods or services from a willing seller or monetize the cryptocurrencies by trading the cryptocurrencies for fiat currencies through an exchange.
217. The economic realities of the transaction support the conclusion that the advertisements and communications attributable to Mr. McCullough and the statements set forth in the Mintage Mining Website show investors expected to receive a profit from their purchase of an investment in the Hash Rate Unit Investment Program. As explained in Paragraph 196, relating to the Open-Ended Unit Investment Program, the records do not reflect investors were acting with a charitable intent or that they were simply providing money to Respondent Mintage Mining without the expectation of the receipt of anything of value in return. Instead, a common-sense review of the offering shows investors would only purchase an investment in the Hash Rate Unit Investment

Program if they expected to receive something of value in return. In this case, the expectation is that they would receive earnings generated from Respondent Mintage Mining's management of hardware used to mine cryptocurrencies. The economic reality, therefore, is investors were purchasing investments in the Hash Rate Unit Investment Program with the expectation of a profit, regardless of whether that profit was paid in cryptocurrencies or fiat currencies.

218. Respondents may argue Respondent Mintage Mining was paying earnings in cryptocurrencies, instead of paying earnings in fiat currency, and its use of cryptocurrencies in lieu of fiat currencies defeats the third factor of the investment contract test. I do not agree with any such argument for the reasons set forth in Paragraph 185 through Paragraph 187 relating to the use of cryptocurrencies instead of fiat currencies to purchase an investment in the Open-Ended Unit Investment Program. As described within these paragraphs, I specifically believe any such argument is erroneous and inconsistent with prior court holdings, and any such argument is inconsistent with *The DAO*, which was published by the United States Securities and Exchange Commission and provides the public with meaningful notice about the applicability of the third factor of the investment contract test to investments that pay returns in cryptocurrencies instead of fiat currencies. I also believe any such argument will essentially urge SOAH to create a new legal standard that ensures white-collar criminals and other bad actors are able to defraud the public while easily evading regulation.
219. For many of the same reasons attributed to the Open-Ended Unit Investment Program in Paragraph 201 through Paragraph 204 of this statement, the Hash Rate Unit Investment Program is a passive investment where profits are derived only from the entrepreneurial or managerial efforts of Respondent Mintage Mining, and as such the Hash Rate Unit Investment Program satisfies the fourth factor of the investment contract test. As described within these paragraphs, in *Searsy*, the Texas Supreme Court rejected a "blind and mechanical view" of the fourth factor of the investment contract test, reasoning narrowly construing the requirement would encourage promoters to evade regulation by "exert[ing] some modicum of effort." The Texas Supreme Court therefore adopted a broad construction of the fourth factor of the investment contract test, holding it is satisfied when "the efforts made by those other than the investor are undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." In *Arnold*, the Texas Supreme Court confirmed the broad applicability of the fourth factor, focusing on "entrepreneurial or managerial, rather than merely ministerial or clerical," efforts of others. The advertisements published by Mr. McCullough and Mr. Whetsell, as well as statements set forth in the Mintage Mining Website, show that investors are passive and reliant on the significant, essential managerial efforts of Respondent Mintage Mining.
220. The advertisements published by Mr. McCullough and Mr. Whetsell demonstrate Respondent Mintage Mining is responsible for the significant, essential managerial efforts associated with cryptocurrency mining. For example, their advertisements show investors are not reliant on their own technical skills and resources to mine cryptocurrencies because an "Advanced Mining System" ensures the hardware "[m]ines the [r]ight [c]oin at the [p]erfect [t]ime" and the "Advanced Proprietary Mining AI evaluates the current cryptocurrency market and strategically picks the best coin to mine." The advertisements even suggest investors were wholly passive

because “[w]e do the work so you don’t have to.” Investors do not appear to have undertaken any efforts to ensure the success of the investments in cryptocurrency mining, much less the significant, managerial efforts necessary to effectively host and manage hardware used to mine various cryptocurrencies. These statements alone appear sufficient to satisfy the fourth factor of the investment contract test.

221. The representations contained within the Mintage Mining Website also show investors purchasing investments in the Hash Rate Unit Investment Program are reliant on the significant, essential managerial efforts of Respondent Mintage Mining. The Mintage Mining Website contains statements that are the same or substantively similar to the aforementioned statements contained in advertisements published by Mr. McCullough and Mr. Whetsell. For example, the Mintage Mining Website touted the passivity of the investments in cryptocurrency mining, claiming that “[w]e do the work so you don’t have to.” It also referred to the investments as “managed hash rate contracts” and “managed mining hardware rental agreements” that were tied to its “exclusive managed mining hardware,” apparently meaning someone other than the investor is “managing” the hardware used to mine cryptocurrencies. The Mintage Mining Website further claimed investors were reliant on its Advanced Proprietary Algorithm. Much like the advertisements published by Mr. McCullough and Mr. Whetsell, the Mintage Mining Website claimed Respondent Mintage Mining’s “Advanced Proprietary Algorithm” evaluates the “current cryptocurrency market and strategically adjusts to the best coin each piece of hardware can mine” and its Auto-Switching Algorithms “[m]ine the [r]ight [c]oin at the [r]ight [t]ime.” It also explained that, “[e]ach week our Advanced Proprietary Mining AI evaluates the current cryptocurrency market and strategically picks the best coin to mine for the highest payout.” Respondent Mintage Mining’s description of its investments in cryptocurrency mining clearly show that, even independent of the statements of its agents, investors are passive and reliant upon the entrepreneurial and managerial efforts of Respondent Mintage Mining to mine cryptocurrencies for a profit.
222. Based on the forgoing, I have concluded the Hash Rate Unit Investment Program involves an investment of money in a common enterprise with the expectation of profits to be derived from the significant, managerial efforts of Respondent Mintage Mining. I have therefore determined the Hash Rate Unit Investment Program satisfies the test for an investment contract adopted by the Texas Supreme Court, and as an investment contract it is regulated as a security by the Securities Act.

THE INVESTMENTS IN THE KALA RIGS  
CONSTITUTE INVESTMENT CONTRACTS THAT ARE REGULATED AS SECURITIES

223. I have reviewed the information set forth within this statement, as well as the records attached to this statement. My review and my knowledge indicate the investments in the Kala Rigs involve investments of money in a common enterprise with the expectation of profits to predominantly come from the entrepreneurial and managerial efforts of others. I have concluded the investments in the Kala Rigs satisfy all four factors of the investment contract test and therefore constitute investment contracts regulated as securities by the Securities Act.
224. An investment in the Kala Rigs involves an investment of money, satisfying the first factor of the investment contract test. The records reflect investors could purchase one or more of the first 750 Kala Rigs for \$3,500.00 per Kala Rig payable in bitcoin, Bitcoin Cash, Bitcoin Gold, or Litecoin, and investors could purchase one or more of the next 1,250 Kala Rigs for \$4,000.00 per Kala Rig, again payable in bitcoin, Bitcoin Cash, Bitcoin Gold, or Litecoin. These facts clearly show the investments in Kala Rigs involve investments of cryptocurrencies, which should be the legal equivalent of money for purposes of the investment contract test.
225. As described in Paragraph 185 through Paragraph 187 relating to the Open-Ended Unit Investment Program, Respondents may argue an investment of a cryptocurrency, as opposed to fiat currency, cannot satisfy the first factor of the investment contract test. As described herein, I do not agree with this argument and further believe any such argument is erroneous and inconsistent with prior court holdings, and any such argument is inconsistent with records published by the United States Securities and Exchange Commission and the State Securities Board that provide the public with meaningful notice about the applicability of the securities laws to investments tied to cryptocurrencies. I also believe any such argument will essentially urge SOAH to create a new legal standard that ensures white-collar criminals and other bad actors are able to defraud the public while easily evading regulation by the securities laws. The basis for these conclusions is the same as the basis for the conclusions set forth in Paragraph 185 through Paragraph 187, again relating to the Open-Ended Investment Program.
226. The investments in the Kala Rigs involve a horizontal common enterprise, satisfying the second factor of the investment contract test. As set forth in *Searsy*, horizontal commonality exists when “the success of one investor is concomitant with the success of other investors.” In this case, investors stood in a concomitant relationship with other investors because they purchased the same Kala Rigs as part of a grouping whereby the profits paid to investors were the same regardless of the efficiency, effectiveness or profitability of any individual investor’s Kala Rig.
227. The facts show investors in the first group were in a concomitant relationship with each other. Every investor could purchase one Kala Rig out of an aggregate of 750 available Kala Rigs. All Kala Rigs in the first grouping were priced at \$3,500.00, meaning each investor paid the same amount of money to receive the same product. The rewards paid to investors owning and operating Kala Rigs were the same and were not dependent on the efficiency, effectiveness, or profitability of any single Kala Rig. In other words, investors simply shared, on a pro rata basis, in the pool of Kala

generated through the collective mining of Kala. Therefore, each investor who invested in Kala Rigs and operated a Kala Rig as part of the first group received the exact same amount of Kala as all other investors who invested in and operated Kala Rigs as part of the first group. These facts demonstrate that investors shared a horizontally common relationship and the investments in the Kala Rigs satisfied the second factor of the investment contract test.

228. As described herein, Respondent Symatri clarified the horizontal nature of the returns paid to investors, representing investors who purchased Kala Rigs as part of the first group would be provided exclusive access to mining Kala during the first month, and as such they were able to “enjoy an approximate monthly reward amount of 250,000 Kala.” This statement shows each investor who purchased and operated a Kala Rig as part of the first group received the exact same “monthly reward” as all other investors who purchase and operated a Kala Rig as part of the first group. Moreover, given that Respondent Symatri claimed Kala was priced at \$0.02 per token, investors who purchased and operated Kala Rigs as part of the first group earned “approximately \$5,000 in th[e] first month alone.” In other words, Respondent Symatri was telling potential investors their purchase and operation of a Kala Rig as part of the first group entitled them to a return equal to their principal investment of \$3,500.00 as well as profits of an additional \$1,500.00. Again, these rewards were not dependent upon the productivity of any individual Kala Rig. Instead, these returns were paid to all investors in the first group regardless of the productivity of any individual investor’s Kala Rig. Accordingly, investors in the first group stood in a concomitant relationship with each other, satisfying the second factor of the investment contract test.
229. Respondent Symatri’s representations regarding the price of Kala serve as additional evidence that investors who purchased and operated a Kala Rig as part of the first group shared a horizontally common relationship. As described herein, Respondent Symatri told investors the price of Kala was \$0.02 per token, meaning investors who purchased and operated Kala Rigs earned a pro rata distribution of Kala as follows:
- a. Assuming 10,000,000 Kala were produced each month, investors owning one of 100 Kala Rigs would earn 100,000 Kala collectively priced at \$2,000.00 per day or 3,000,000 Kala collectively priced at \$60,000.00 per month. An investor in the first group able to liquidate Kala at the price set by Respondent Symatri would therefore receive a profit of \$56,500.00, or more than 1614% of his or her principal investment, after the first month alone.
  - b. Assuming 10,000,000 Kala were produced each month, investors owning one of 500 Kala Rigs would earn 20,000 Kala collectively priced at \$400.00 per day or 600,000 Kala collectively priced \$12,000.00 at per month. An investor in the first group able to liquidate Kala at the price set by Respondent Symatri would therefore receive a profit of \$8,500.00, or more than 242% of his or her principal investment, after the first month alone.
  - c. Assuming 10,000,000 were produced each month, investors owning one of 1,000 Kala Rigs would earn 10,000 Kala collectively priced at \$200.00 per day at or 300,000 Kala

collectively priced at \$6,000.00 per month. An investor in the first group able to liquidate Kala at the price set by Respondent Symatri would therefore receive a profit of \$2,500.00, or more than 71% of his or her principal investment, after the first month alone.

230. Respondent Symatri's representations clearly show that anyone who purchased a Kala Rig for \$3,500.00 as part of the first group and operated their Kala Rig with other persons who purchased and operated a Kala Rig as part of the first group were rewarded with the exact same number of cryptocurrencies. Respondent Symatri's representations also suggested these investors were able to monetize their Kala at \$0.02 per token, and therefore would have received the same profit and the same return on their principal. These facts show investors shared a horizontally common relationship, satisfying the second factor of the investment contract test.
231. For the reasons set forth herein that relate to the investors who purchased Kala Rigs as part of the first group, investors who purchased Kala Rigs as part of the second group also shared horizontally common relationship. The material difference in the analysis is that investors in the first group paid \$3,500 per Kala Rig, whereas investors in the second group paid \$4,000.00 per Kala Rig. Otherwise, investors who purchased Kala Rigs as part of the second group paid the same price for their Kala Rigs and received the same number of cryptocurrencies in return of operating their Kala Rigs. The investors in the second group also received the same return regardless of the efficiency, effectiveness, and productivity of their individual Kala Rigs. Respondent Symatri further suggested these investors could monetize their Kala for \$0.02 per token, meaning each investor in the second group who monetized their Kala received the exact same profit and the exact same return on principal. For the reasons set forth in this paragraph, investors in the second group, much like investors in the first group, shared a horizontally common relationship with each other. This horizontally common relationship satisfies the second factor of the investment contract test.
232. As a matter of convenience, the preceding paragraphs separately considered the applicability of the second factor of the investment contract test to investors in the first group and investors in the second group. My review, however, indicates all investors, regardless of their grouping, shared a horizontally common relationship. They were all investing principal to purchase, own, and operate a Kala Rig, and after the first month of mining investors in the first group and investors in the second group received the same exact same distribution of Kala. As described herein, Respondent Symatri stated Kala was priced at \$0.02 per token, and as such investors in the first group and investors in the second group, having received the same amount of Kala for their participation in the investment program, should have been able to monetize their Kala for \$0.02 and receive the exact same return. This relationship between investors in the first group and investors in the second group is sufficient to establish horizontal commonality and satisfy the second factor of the investment contract test.<sup>73</sup>

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<sup>73</sup> Notably, the facts of this case are strikingly similar to the facts of *Edwards*, a case cited with approval by the Texas Supreme Court in *Arnold*, wherein the United States Supreme Court affirmed the broad scope of the investment contract test. For purposes of the commonality analysis, the most meaningful difference may simply be a product of the evolution of technology, as the present case involves sophisticated hardware that mines cryptocurrencies and *Edwards* involved pay telephones. Regardless, in *Edwards*, the promoter was selling investments tied to pay telephones that purported to provide investors with a fixed return



233. The investments in the Kala Rigs involve the expectation of profits, satisfying the third factor of the investment contract test. In *Searsy and Arnold*, the Texas Supreme Court held an investment contract exists only when investors expect to receive profits. In this case, investors not only expected to receive profits, but as was the case with the Open-Ended Unit Investment Program and the Hash Rate Unit Investment Program, they appear to have expected to receive lucrative profits valued at far more than returns associated with traditional securities markets. Their expectation of profitability from the purchase of investments in the Hash Rate Unit Investment Program is evidenced, at least in part, by Respondent Symatri's statements regarding Kala and rewards generated through the operation of Kala Rigs.
234. As described herein, Respondent Symatri claimed Kala would be incorporated in the Core Platform and the Reach Platform. However, as also described herein, Respondent Symatri did not refer to Kala solely as a utility token.<sup>74</sup> Instead, Respondent Symatri touted the price of Kala, and its representations regarding the price of Kala demonstrate that investors expect to receive a profit through the mining of Kala. For example, as described herein, Respondent Symatri claimed Kala was priced at \$0.02 per token, and this fact indicates investors can earn a profit as follows:
- a. Assuming 10,000,000 Kala were produced each month, investors owning one of 100 Kala Rigs would earn 100,000 Kala collectively priced at \$2,000.00 per day or 3,000,000 Kala collectively priced at \$60,000.00 priced at per month. An investor in the first group able to liquidate Kala at the price set by Respondent Symatri would therefore receive a profit of \$56,500.00, more than 1614% of his or her principal investment, after the first month alone.
  - b. Assuming 10,000,000 Kala were produced each month, investors owning one of 500 Kala Rigs would earn 20,000 Kala collectively priced at \$400.00 per day or 600,000 Kala collectively priced \$12,000.00 at per month. An investor in the first group able to

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whereas in the present case Respondents Symatri and Mintage Mining are selling hardware that purports to provide investors with the same distributions. In both *Edwards* and the present case, the returns were not intertwined with the productivity of the underlying product, as in *Edwards* investors were paid regardless of the actual profitability of their own payphones and in the present case investors receive distributions regardless of the profitability of their hardware. The similarity of the facts is difficult to ignore, and only support the broad application of the appropriate jurisdictional standards.

<sup>74</sup> A utility token, sometimes called a "user token," may or may not involve the expectation of profitability. Owners often purchase utility tokens through an ICO, where the issuer raises capital through the sale of utility tokens uses the proceeds of the offering to develop a product a service. In certain situations, persons may not purchase these utility tokens with the expectation that they will be able to monetize the utility token and sell the utility token for a profit. Instead, these persons may be motivated by the opportunity to acquire the utility token and use it at a later date to access the products or services developed by the issuer. In this type of limited situation, depending on the facts of the case, the utility token may not constitute an investment contract regulated as a security because the utility token will not satisfy the third factor of the investment contract test.

liquidate Kala at the price set by Respondent Symatri would therefore receive a profit of \$8,500.00, more than 242% of his or her principal investment, after the first month alone.

- c. Assuming 10,000,000 were produced each month, investors owning one of 1,000 Kala Rigs would earn 10,000 Kala collectively priced at \$200.00 per day at or 300,000 Kala collectively priced at \$6,000.00 per month. An investor in the first group able to liquidate Kala at the price set by Respondent Symatri would therefore receive a profit of \$2,500.00, more than 71% of his or her principal investment, after the first month alone.

235. The expectation of profitability is also evident from Respondent Symatri's announcement that investors who purchased Kala Rigs as part of the first group had exclusive access to mining Kala during the first month. As described herein, it claimed they would be able to "enjoy an approximate monthly reward amount of 250,000 Kala." Accordingly, given Respondent Symatri was claiming that Kala was priced at \$0.02 per token, investors who purchased Kala Rigs as part of the first group "could earn approximately \$5,000 in that first month alone!" Investors acting upon these representations clearly expected to receive as profit, as Respondent Symatri was telling potential investors that their purchase of a Kala Rig as part of the first group would entitle them to a return equal to their principal investment of \$3,500.00 as well as profits of an additional \$1,500.00.

236. The expectation of profitability is further evidenced from Respondent Symatri's representations relating to the profitability of the purchase of Kala Rigs as part of the second group. It claimed that investors who purchased Kala Rigs as part of the second group earned a minimum of 1,895 Kala per day and 56,861 Kala per month. It also claimed these investors earned a minimum of \$1,137.00 in Kala in the first month alone and that they "will keep earning every month their rig is mining." These representations clearly show that investors expected to receive a profit from their investment in Kala Rigs.

237. The expectation of profit is evident from Respondent Symatri's representations relating to the secondary market for Kala. As explained in Paragraph 228 through Paragraph 229, and again in Paragraph 231, Paragraph 232 and Paragraph 233 through 235, the profitability of investments in the Kala Rigs was largely dependent upon the market for Kala. Under the model described by Respondent Symatri, if the public demands Kala, investors who invested in a Kala Rig and received a reward of Kala should be able to sell Kala for \$0.02 per token. If demand increased relative to supply, investors who obtained Kala through the mining of their Kala Rigs should have been able to sell Kala for more than \$0.02 per token. Conversely, if the market for Kala failed to develop, investors owning Kala may have been unable to liquidate or monetize their cryptocurrencies. Not surprisingly, these facts show investors are dependent upon Respondent Symatri's commitment to ensure that Kala is listed on a cryptocurrency exchange. Assuming Respondent Symatri secured a listing for Kala on a cryptocurrency exchange, investors can sell Kala for a profit.<sup>75</sup> As a key

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<sup>75</sup> This paradigm is strikingly similar to the token offering that predicated *In the Matter of Munchee Inc.*, Admin. Pro. No. 3-18304, Rel. No. 10445 (December 11, 2017) where the Securities and Exchange Commission brought an enforcement proceeding against a promoter that developed a smartphone application that permitted users to review restaurant meals. After developing the smartphone application,

reason for listing the cryptocurrency on a cryptocurrency exchange is to establish a market for owners to sell the cryptocurrency, Respondent Symatri's promise to attempt to secure a listing on a cryptocurrency exchange is further evidence that owners of Kala expected to receive a profit from its sale.

238. Not surprisingly, given the forgoing, Respondent Symatri was comparing the introduction of Kala to the introduction of bitcoin and comparing the profitability of mining Kala shortly after its inception to the profitability of mining bitcoin shortly after its inception. As described herein, a posting on the Symatri Websites dated May 21, 2018, even suggested that "early" investors who purchased Kala Rigs to mine Kala may earn lucrative profits similar to "early" investors who mined bitcoin and reaped significant profits after monetizing the bitcoin. It read in part:

If you were given the chance to go back in time and be one of the first to mine Bitcoin, would you take it? Bitcoin's first miners earned 200 BTC<sup>76</sup> from home in just two days. With the current BTC value of around \$8,000, those two days of mining would now be worth over \$1.5 million.

239. These records show investors who purchased Kala Rigs expected to receive a profit from their purchase of Kala Rigs. Respondents may, however, argue Respondent Symatri was paying rewards in cryptocurrencies, instead of paying earnings in fiat currencies, and that its use of cryptocurrencies in lieu of fiat currencies defeats the third factor of the investment contract test. I do not agree with any such argument for the reasons set forth in Paragraph 197 through Paragraph 200, relating to the use of cryptocurrencies instead of fiat currencies to pay returns to investors who purchased investments in the Open-Ended Unit Investment Program. As described within these paragraphs, I specifically believe any such argument is erroneous and inconsistent with prior court holdings, and any such argument is inconsistent with *The DAO*, which was published by the United States Securities and Exchange Commission and provides the public with meaningful notice about the applicability of the third factor of the investment contract test to investments that pay returns in cryptocurrencies instead of fiat currencies. I also believe any such argument will essentially urge SOAH to create a new legal standard that ensures white-collar criminals and other bad actors are able to defraud the public while easily evading regulation.
240. The investments in the Kala Rigs are investments where profits are derived predominantly from the entrepreneurial and managerial efforts of Respondent Symatri, thereby satisfying the fourth

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it raised capital through the sale of MUN tokens. Although the promoter created a digital ecosystem, much like Respondent Symatri created the Core Platform and Reach Platform, the promoter also claimed that it would work to secure a listing for MUN tokens on a number of cryptocurrency exchanges and suggested that investors could sell MUN tokens for a profit once the MUN tokens were listed on cryptocurrency exchanges. The Securities and Exchange Commission determined the offering of MUN tokens constituted a securities offering, and the matter was resolved when the promoter stopped its offering before delivering any tokens and returned proceeds to investors.

<sup>76</sup> Cryptocurrencies are often referred to by a unique abbreviation or symbol comprised of a series of alphanumeric characters, much like stocks are assigned a symbol comprised of a series of letters. The abbreviation for Bitcoin is BTC.

factor of the investment contract test. As described within this statement, in *Searsy*, the Texas Supreme Court rejected a “blind and mechanical view” of the fourth factor of the investment contract test, reasoning that narrowly construing the requirement would encourage promoters to evade regulation by “exert[ing] some modicum of effort.” The Texas Supreme Court therefore adopted a broad construction of the fourth factor of the investment contract test, holding that it is satisfied when “the efforts made by those other than the investor are undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.” In *Arnold*, it reaffirmed a broad reading of the fourth factor of the investment contract test, holding that it is satisfied when investors receive profits under circumstances in which the failure or success of the enterprise, and thus the person’s realization of the expected profits, is at least predominately due to the entrepreneurial or managerial... efforts of others.” It also held that the fourth factor should consider the predominance of these entrepreneurial and managerial efforts “regardless of whether those efforts are made before or after the transaction.” The records reflect the investments in the Kala Rigs satisfy this standard. Specifically, the Mintage Mining Website and the Symatri Websites, taken together, show that investors performed only some modicum of effort and were predominantly reliant on the entrepreneurial and managerial efforts of Respondent Symatri and Respondent Mintage Mining.

241. As described herein, the records show that, after taking possession of Kala Rigs, investors were not required to undertake significant managerial efforts to operate a Kala Rig. For example, the records show Respondent Symatri sent an email that demonstrated investors were not required to have any technical or sophisticated expertise or undertake any significant efforts to operate a Kala Rig. Instead, as reflected in the email, Respondent Symatri was telling investors that their “Kala mining rig will be delivered to you pre-configured for mining. Just set it up in a few simple steps, and you’ll be ready to start earning your rewards!” The statement, standing alone, shows that investors were not required to undertake significant efforts to operate the Kala Rigs.
242. The aforementioned email also contained an attached file in \*.docx format titled *Kala Rig FAQ*. This FAQ contained a list of questions and corresponding answers relating to the Kala Rigs. The FAQ stated Respondent Mintage Mining was the “company shipping/selling the Kala rigs,” that “Mintage Mining pre-configures the rig before it ships,” and that the shipment also contained a “power supply, power cord, ethernet cable and instructions on how to operate the rig.” Investors simply received the pre-configured rigs and undertook a “simple plug in process.” The FAQ even noted investors without any sophisticated knowledge of cryptocurrency mining or technical knowledge of computers were able to operate a Kala Rig, as it explained the only “qualifications that have to be met to be able to host the rig” are “access to a power supply and wired internet access” or, alternatively, access to Wi-Fi. In fact, the FAQ suggested investors were prevented from actually managing their Kala Rig because “[i]f they would like to reconfigure the rig... it will not work within the Mintage network.” This statement implies investors were precluded from exerting any entrepreneurial or managerial efforts, and instead were predominantly reliant upon Respondent Mintage Mining’s knowledge of cryptocurrency mining and technical knowledge of computers to configure the rig for them.

243. As also described herein, the email also contained an attached file in \*.docx format titled *KALA RIG SPECS & CARE*. This file is a brief document that essentially explains that investors needed only plug the Kala Rig into an outlet using the provided power supply, keep the Kala Rig in a room with a temperature of 0-40 degrees Celsius (32-104 degrees Fahrenheit), and use a cheap air blower to remove dust. Accordingly, investors were seemingly not required to perform any efforts, and certainly not entrepreneurial or managerial efforts, to operate their Kala Rigs and earn Kala as a return for operating their Kala Rigs.
244. Respondent Symatri, as further described herein, also highlighted the passivity of the investments in the Kala Rigs by comparing the investments in the Kala Rigs to the use of traditional mining hardware. For example, in a posting on the Symatri Websites dated May 23, 2018, Respondent Symatri explained “[m]ost mining rigs require miners to purchase and assemble: Motherboard Hardware, Graphic Processing Units (GPUs), Processor/CPU, RAM, Power Supply, Power Switch and Power Risers.” Respondent Symatri also noted “with the drastic increase in crypto mining, some of these parts are hard to come by” and recent reports indicate “many popular and most [sic] effective mining hardware prices have doubled if not tripled in price, if you can find them on the shelves at all.” The posting then contrasted the difficulty of traditional mining with mining Kala, explaining “[b]ut Kala mining rigs ship pre-configured, and only take a few easy steps to set up.” It noted Kala Rigs require “[n]o research, ordering and waiting for parts, or assembling and configuring required.” Investors therefore were able to “[s]imply plug, mine, and receive [their] Kala reward.”
245. Of course, the profitability of the investments in the Kala Rigs is largely dependent upon the price of Kala. As described herein, Respondent Symatri claimed the price of Kala was \$0.02 per token. However, investors could only monetize Kala for a profit if they could find a willing buyer who would purchase their cryptocurrencies. Not surprisingly, investors were highly reliant on Respondent Symatri’s efforts to create a market for Kala and secure a listing on a cryptocurrency exchange so investors could readily monetize their Kala. As described herein, Respondent Symatri, through the Symatri Websites, recognized that its entrepreneurial and managerial efforts were necessary to create a market for Kala and secure a listing for Kala on a cryptocurrency exchange.
246. The Symatri Websites show that Respondent Symatri understood the critical need to list Kala on a cryptocurrency exchange. On May 17, 2018, it posted a blog entry titled *Kala’s Pathway to the Crypto Exchanges*. It began by noting “[o]ne of the questions asked often is, ‘When is Kala getting on the exchange?’” It answered its own question by stating, “[w]ith recent shifts in regulations and trends in today’s cryptocurrency market, Kala’s advisory team is carefully planning and executing a confident plan to get Kala on a crypto exchange.” It followed by explaining that many crowdsales failed, and “[w]ith so many volatile crypto coins out there, exchanges are being more selective than before and are choosing currencies that have value, stability and sustainability.” It then listed out the “Steps to Getting Kala on an Exchange” and set forth milestones for securing a listing on a cryptocurrency exchange. The entry noted that these milestones “will maximize Kala’s value and create a sustainable decentralized network, making Kala a crypto coin exchanges want to have.” As described earlier in this statement, Respondent Symatri listed these milestones as follows:

- a. Respondent Symatri explained it needed to complete the final stage of an audit of the initial token offering of Kala so that it could verify “all Kala purchased have been completed and deposited correctly.” Respondent Symatri listed a date of May 2018 for this milestone.
  - b. Respondent Symatri explained it needed to complete the pre-sale of Kala Rigs, which were the “[e]xclusive sale of mining rigs to the Kala community and Symatri partners.” Respondent Symatri listed a date of May 2018 for this milestone.
  - c. Respondent Symatri recognized it needed to finalize the Kala blockchain code, which meant that it needed to “[f]inish programming the Kala blockchain so that Kala can be issued and mining [can] begin.” Respondent Symatri listed a date of May 2018 for this milestone.
  - d. Respondent Symatri represented that it needed to issue Kala. Respondent Symatri listed a date of June 2018 for this milestone.
  - e. Respondent Symatri explained persons needed to begin mining Kala through “Exclusive Kala Rigs” so that “mining rigs can begin actively mining” and owners can begin “earning Kala rewards.” It listed a date of June 2018 for this milestone.
  - f. Respondent Symatri represented it needed to continue the sale of Kala Rigs to the “Kala Community” and Kala Rigs were available for purchase as it built the network. It listed a date of June 2018 for this milestone.
  - g. Respondent Symatri recognized the necessity of it building “Kala’s Network” so that, “[a]s mining rigs become active, Kala’s network continues to grow, stabilize, and become decentralized. Respondent Symatri represented that it would begin working on this milestone in June 2018.
  - h. Respondent Symatri recognized it needed to “Reach Targeted Hash Power Threshold” because as “Kala’s network hits the hashpower threshold,” the “exchanges [will be] eager to accept Kala. Respondent Symatri also noted this milestone “ensures the network is safe and sustainable.” It did not list a date for this milestone.
  - i. Respondent Symatri explained it would “Get [Kala] on [an] Exchange” and this milestone is dependent upon previous milestones. Respondent Symatri also noted that this would ensure Kala is “accepted onto crypto exchanges with a stable and consistent value.”
247. The entry concluded with Respondent Symatri stressing confidence in its ability to satisfy the milestones, explaining that the “path Symatri designed to get Kala on the exchange is a careful and confident one.” It noted that “[h]undreds of cryptocurrencies have jumped on exchanges too quickly, and have failed or been kicked off. Kala’s advisory team have and continue to consult with

crypto experts, partners, and exchanges to protect Kala's network, solidify it's [sic] value, and start off with a higher exchange value."

248. These facts are sufficient to prove investors who purchased investments in the Kala Rigs may have performed some modicum of effort by taking possession of Kala Rigs, plugging the Kala Rigs into a power outlet, and connecting the Kala Rights to the internet, but that Respondent Symatri performed the predominant entrepreneurial and managerial efforts that affect the failure of success of the investments in the Kala Rigs. Respondent Symatri and Respondent Mintage Mining were collectively responsible for developing and implementing Kala, developing and implementing the Kala blockchain source code, programming the Kala Rigs with sophisticated software that would mine Kala, stabilizing the Kala network, ensuring the Kala network was safe and sustainable, reaching the targeted hash power threshold for the Kala network, developing a market for Kala, and securing a listing on cryptocurrency exchanges. As Respondent Symatri was predominantly responsible for the entrepreneurial and managerial efforts that affected the failure of success of the investments in the Kala Rigs, the investments in the Kala Rigs satisfy the fourth factor of the investment contract test.
249. Based on the forgoing, I have concluded the investments in the Kala Rigs involve investments of money in common enterprises with the expectation of profits to be predominantly derived from the entrepreneurial and managerial efforts of Respondent Symatri and Respondent Mintage Mining. I have therefore determined the investments in the Kala Rigs satisfy the test for investment contracts adopted by the Texas Supreme Court, and as investment contracts they are regulated as securities by the Securities Act.

## CONCLUSION AND SUMMARY OF TESTIMONY

250. Based on the forgoing, I have concluded the Open-Ended Unit Investment Program involves an investment of money in a common enterprise with the expectation of profits to be predominantly derived from the entrepreneurial and managerial efforts of Respondent Mintage Mining. I have therefore determined the Open-Ended Unit Investment Program satisfies the test for an investment contract adopted by the Texas Supreme Court, and as an investment contract it is regulated as a security by the Securities Act.
251. I have also concluded the Hash Rate Unit Investment Program involves an investment of money in a common enterprise with the expectation of profits to be predominantly derived from the entrepreneurial and managerial efforts of Respondent Mintage Mining. I have therefore determined the Hash Rate Unit Investment Program satisfies the test for an investment contract adopted by the Texas Supreme Court, and as an investment contract it is regulated as a security by the Securities Act.
252. I have further concluded the investments in the Kala Rigs involve investments of money in common enterprises with the expectation of profits to be derived from the significant, managerial efforts of Respondent Symatri and Respondent Mintage Mining. I have therefore determined the investments in the Kala Rigs satisfy the test for investment contracts adopted by the Texas Supreme Court, and as investment contracts they are regulated as securities by the Securities Act.



SIGNATORY PAGE

I confirm that this statement was prepared and adopted by the undersigned, Joseph Rotunda, in his capacity as the Director of the Enforcement Division of the State Securities Board, on the 18th day of December, 2018.

By:



Joseph Rotunda

Director, Enforcement Division

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