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LEGAL STATUS OF VINChain TOKENS (VIN)

February 14, 2018

I. LEGAL ISSUES TO BE ANALYZED

This report sets forth a legal analysis as to whether the VINChain tokens (VIN) would likely constitute securities pursuant to relevant U.S. securities laws for purposes of Section 2(a)(1) of the Securities Act of 1933 (“Securities Act”) and Section 3(a)(10) of the Securities Exchange Act of 1934 (“Exchange Act”), including Howey Test, Family Resemblance Test, and Risk Capital Test, which are used in the United States to recognize a particular instrument as a security and other analytical frameworks.

Please consider that each of the tests can be interpreted in different ways, depending on the state, judicial instance, and the particular circumstances of the case. While analysing, we were moving from the generally accepted criteria for the application of these tests.

II. DEFINITIONS

In order to analyse VIN under the federal securities laws, we start with the broad definition of “security” contained in Section 2(a)(1) of the Securities Act: *“any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate ... transferable share, investment contract ... or, in general, any interest or instrument commonly known as a ‘security’, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing”*.¹

For the purpose to guide the Client on general approach in such matters, we introduce a list of rights normally granted to the holder and typically associated with a blockchain token that likely does not meet the definition of “security”:

¹ We note that the Supreme Court has stated that the definitions of “security” under the Securities Act and the Exchange Act are treated as being the same, despite some technical differences. SEC v. Edwards, 540 U.S. 398 (2004) (citing Reves v. Ernst & Young, 494 U.S. 56, 61 n.1 (1990)).² See Edwards, 540 U.S. at 390.

1. Rights to access or license the platform or network;
2. Rights to charge a toll for such access or license;
3. Rights to contribute labor or effort to the platform or network;
4. Rights to use the platform or network and its outputs;
5. Rights to sell the products of the platform or network; and
6. Other rights not typically associated with a security ownership.

Please note that this is not an exhaustive list of rights that reduce the risk of a token to be determined as “security”.

For the same purpose, we also introduce a list of investment interests of the holder typically associated with a blockchain token, that would, in our view, constitute a security:

1. Status as a creditor or lender;
2. Equity interest;
3. Ownership interest in a legal entity or partnership;
4. Share of profit and/or losses, or assets and/or liability;
5. Claim in bankruptcy as equity interest holder or creditor;
6. Holder of a repayment obligation from the platform or network or the legal entity issuer of the blockchain token and
7. A convertible future allowing the holder to convert a token into instrument with one or more investment interests.

Please note that this is not an exhaustive list of investment interests that increase the risk of a token to be classified as “security”.

Based on the above mentioned definitions and our view of relevant case law, our analysis of the White Paper and understanding of the facts and VIN Token structure, we believe that it is highly unlikely that the VIN Token will be deemed to represent a security, subject to the specific facts, circumstances, and characteristics of the VIN Token itself and provided that the company complies with all of our recommendations and edits to the White Paper, Token Purchase Agreement, FAQ and marketing materials.

III. RISKS ASSESSMENT AND ANALYSIS

1. THE HOWEY TEST

The Howey Test is one of the most important tests that is widely used to determine whether a contract qualify as a security. It was introduced in 1946 in the U.S. Supreme Court case of *SEC v. Howey*, 328 U.S. 293 (1946). The standards of the *Howey* analysis were reaffirmed by the Supreme Court in 2004 in *SEC v. Edwards*, 540 U.S. 398 (2004).

In this case, the U.S. Supreme Court developed a four-part test to determine whether an agreement constitutes an investment contract and, therefore, a security. According to The Court ruling, a contract constitutes an investment contract that meets the definition of security if there is:

- (i) an investment of money;
- (ii) in a common enterprise;

- (iii) with an expectation of profits;
- (iv) solely from the efforts of others (e.g., a promoter or third party), "regardless of whether the shares in the enterprise are evidenced by formal certificates or by nominal interest in the physical assets used by the enterprise." Howey, 328 U.S. at 298-99.

In order to be considered a security, all four factors must be met.²

It should be noted that Howey test is the only securities test which is adapted for the distinctive features of Token Sale.

Element 1: Is there an investment of money?

Tokens that are not sold for value do not involve an investment of money. For example, if all tokens are distributed for free, or are only produced through mining, then there is no sale for value. Tokens which are sold in a crowdsale, at any time, regardless of whether sold for fiat or crypto currency or anything else of value involve an investment of money. Also, an investment of money may include not only the provision of capital, assets, and cash, but also goods, services, or a promissory note.³

Given the broad definition of a money investment and the fact that VIN Tokens will be distributed through a sale by VINChain to the buyers with the price set per token, **this element of the test will, most likely, be viewed as satisfied.** We reach this conclusion notwithstanding the fact that there may be a cap on the total amount raised and purchased.

Element 2: Common enterprise

If the sale of tokens is made before any code has been deployed on a blockchain, it is more likely to result in a common enterprise where the profits arise from the efforts of others. This is because the buyers are completely dependent on the actions of the developers, and the buyers cannot actually participate in the network until a later time. And vica versa, if there is a functioning network, there is less likely, but still it may have some similarities to a common enterprise where the profits arise from the efforts of others. The closer the sale is to launch of the network, the less likely it is to be a common enterprise.

VINChain team confirmed that there is a functioning VINChain network that is ready to be launched. According to the company, any incentives are derived through token holders' own efforts, rather than through a passive investment. The platform participants are, in fact, the main contributors to the platform database and may not be considered passive investors who solely rely on efforts of others.

The circuit courts of appeal are divided in their interpretation of the common enterprise clause of the Howey Test. The term "common enterprise" isn't precisely defined, and courts have used different interpretations. Most federal courts define a common enterprise as one that is

² See *Edwards*, 540 U.S. at 390.

³ See, e.g., *Int'l Bhd. Of Teamsters v. Daniel*, 439 U.S. 551, 560 n.12 (1979); *Hector v. Wiens*, 533 F.2d 429, 432-33 (9th Cir. 1976); *Sandusky Land, Ltd. V. Uniplan Groups, Inc.*, 400 F. Supp. 440, 445 (N.D. Ohio 1975).

horizontal, meaning that investors pool their money or assets together to invest in a project, however, other courts use different definitions. The interpretations of this clause exist primarily in these three categories, although circuit courts sometimes use multiple categories:

- (a) Horizontal Commonality. Horizontal commonality exists with the pooling of investor contributions, whereby the success of the individual investor depends on the success of the overall ventures. Pooling can sometimes - but does not always - include a pro-rata sharing of profits.⁴ Horizontal commonality may be absent when the users obtain unique assets (e.g., a condo) by which the profit they obtain is dependent on the success of their individual asset rather than the common good. Whether funds are pooled appears to be the key question, and, thus, in cases where there is no sharing of profits or pooling of funds, a common enterprise may not be deemed to exist.⁵
- (b) Broad Vertical Commonality. The broad vertical approach considers whether the success of the token holders depends on the promoter's expertise. If there is such reliance, then a common enterprise will be deemed to exist.⁶
- (c) Narrow Vertical Commonality. Narrow vertical commonality exists when investor's profits are tied to the promoters' profits.⁷

If the VIN framework is actually decentralized, has no centralized administration and VIN holders get the ability there is a **high likelihood that VIN will not be viewed as having a common enterprise**. Please note, that the less the level of control by the VINChain.io is and the more tools VIN token holders will have to influence the process (such as an opportunity to contribute to VINChain information base and to select, add, or remove information providers), the more likely VIN token will not be viewed as having a common enterprise.

Element 3: Expectation of profits

That is broadly defined as any form of capital appreciation, cash return on investment or other earnings such as dividends and interests. Under this element, profit refers to the type of return or income an investor seeks on their investment (rather than the profits that the system or issuer might earn). Thus, for purposes of blockchain tokens, this could refer to any type of return or income earned as a result of being a blockchain token holder, which would be narrowed to the extent it is derived passively, i.e., from the efforts of others. Since courts consider this factor through the lens of the "efforts of others" factor, we analyze this prong along with the fourth factor below. In other words, just because there is a return or profit, does not mean that the investment contract is a security. It is the essentially passive nature of the return, as determined

⁴ See e.g., *Curran v. Merrill Lynch*, 622 F.2d 216 (6th Cir. 1980).

⁵ See e.g., *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96, 101 (finding discretionary future trading account was not investment contract because there was no pooling of funds); *Wals v. Fox Hills Dev. Corp.*, 24 F.3d 1016 (7th Cir. 1994) (promoter of condominium timeshare did not pool profits and thus no common enterprise existed).

⁶ See e.g., *SEC v. Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974) (promoter's recommendations regarding certain futures contracts demonstrated investor reliance on promoter's expertise).

⁷ See *SEC v. Eurobond Exchange Ltd.*, 13 F.3d 1334 (9th Cir. 1994) (imposition of profit limitations on investors through requiring promoter to receive excess return rate tied promoter's fortunes to investors).

by the “efforts of others” analysis, that results in an “investment contract” and security as opposed to a simple contract instrument.

The answer to the question whether there is an expectation of profit basically lays in the area of what function particular token has. Tokens which give, or purport to give, traditional equity, debt, or other investor rights are almost certainly securities. A token, which does not have any real function or is used in a network with no real function, is very likely to be bought with an expectation of profit from the efforts of others, because no real use or participation by token holders is possible. Voting rights alone do not constitute real functionality. A token which has a specific function that is only available to token holders is more likely to be purchased in order to access that function and less likely to be purchased with an expectation of profit.

According to the White Paper, VINChain’s smart-contract is represented by VIN Token. The main purpose and utility of the VIN token is a membership in and access to VINChain platform with some rights that are unique to those VIN holders. Specifically, **VIN token holders will have access to unique decentralized database and will be able to participate in this database on the VINChain platform. The main utility of VIN Token is to get an access and opportunity to participate in VINChain platform that accumulates information on used cars that may be useful for all secondary car market participants, including car owner, car dealers, insurance companies, and financial institutions. This is a strong argument for VINChain to be viewed as NOT satisfying the third element of the Howey Test.**

Element 4: Predominantly from the efforts of others

A token, the value of which depends on someone taking specific manual action outside of the network, means that the token is not functional in and of itself. Instead, the token relies on a level of trust in a third party taking action off-blockchain. This sort of token is more likely to be bought for speculation. A token which is built with all the necessary technical permissions and works automatically in accordance with a smart contract means that the token holder does not rely on manual actions of any third party. This means that the buyers are more likely to purchase the token for use rather than with the expectation of profit from the efforts of others. However, just because there is a return or profit, it does not mean that the token sale contract is a security. It is the essentially passive nature of the return, as determined by the “efforts of others” analysis, that results in a “token sale contract” and security as opposed to a simple contract instrument.

Regarding this issue we are citing findings by U.S. District Court, D. New Jersey on September 4, 2013: “If the holder of the membership interest participates actively in the LLC (it is “member-managed”), a court is likely to find that he is not relying solely on the efforts of others and the interest is not a security. If the interest holder does not participate actively in the LLC (it is “manager-managed”), then a court is likely to find that he is a passive investor and the interest is a security.”⁸

Therefore, in order to avoid giving an expectation of profit solely from the effort of promoters or third parties to the token purchaser, the token shall not offer any form of dividends, interest, or any other passive income. The best way is to involve token holders in platform/network activity, make the token useful, and structure it as, for example, membership in or access to a network.

⁸ See e.g. *SYNC Labs LLC v. Fusion Manufacturing* (U.S. District Court, D. New Jersey, Sept. 4, 2013)

The main goal in structuring the product token is to provide a beneficial or consumptive use of it to the token holders as opposed to expectation of profit/dividends.

With regard to VIN token, according to VINChain team, all functionality is inherent in the token and occurs programmatically, meaning, that a token is built with all the necessary technical permissions and the token holder does not rely on manual actions of any third party. If the main incentive to buy a token is an opportunity to get the access to and the utility of a specific blockchain platform and its utility benefits, such a token may not be deemed a passive investment relying on the efforts of others. The VIN Token holders will participate in the development and utility of VINChain database, which means that the main incentive to buy VIN token is derived through token holders' own efforts, rather than through a passive investment, and, since VINChain network allows VIN holders to participate in and contribute to the use of VINChain platform, VIN should not be considered a passive investment.

Additionally, if the sale of tokens is made before any code has been deployed on a blockchain, it is more likely to result in a common enterprise, where the profits arise from the efforts of others. This is because the buyers are completely dependent on the actions of the developers, rely on their efforts to develop the platform, and cannot actually participate in the network until a later time. And vice versa, if there is an existing functioning network, and the buyers step in as members of the network who have specific rights and opportunity to influence the outcome, such system should not be viewed as a common enterprise where the profits arise from the efforts of others. The closer the sale is to launch of the network, the less likely there is to be a common enterprise. In VINChain network case, as noted above, there is a functioning platform, where the project team has already developed the network that is ready for launching. Any incentives are derived through token holders' own efforts, rather than through a passive investment.

Finally, it is material how the token sale is marketed. Using investment-related language like 'returns' and 'profits' encourages buyers to buy a token for speculation, rather than use. Marketed as a sale of tokens which give the right to access and use the network, tokens are likely to be bought for utility purpose. VIN Tokens sale is marked as Token Sale and does not operate with words like "investment," "returns" or "profits". The main incentive for the token holders is not to get a profit, but rather to get an access to a unique database that provides them with an important information regarding the secondary car market.

Given the analysis above, provided that the company will comply with all of our recommendations and edits to the White Paper, the VIN Token should not be viewed as an investment with an expectation of profits derived solely from efforts of other.

RESULTS OF THE HOWEY TEST: VIN Token Sale in the US may look like the activity related to the money investments in the project, which means that Element 1 of the test is very likely to be satisfied. However, the remaining three elements appear to be not satisfied. According to the information provided by the company, VINChain has already developed the platform that is ready to be launched. Thus, VIN Token Sale campaign does not, while still may, meet the second, the "common enterprise" element. What is even more important, VIN token has a specific functionality that is only available to token holders and is more likely to be purchased in order to access that function and less likely

to be purchased with an expectation of profit. Therefore, it is highly unlikely that it can be deemed satisfying the third, the “expectation of profit” element. It is also highly unlikely that VIN Token meets the “solely from efforts of others” element since VIN Token holders, according to the White Paper, are active contributors to the platform functioning influencing the outcome of the process. Since in order to be classified as a security, a token must satisfy all four elements and, based on our analysis, the VIN Token only meets one, it is improbable for the VIN token to be considered a security according to the Howey Test, provided the company complies with all of our recommendations and edits to the White Paper, Token Purchase Agreement, FAQ. and marketing materials.

2. FAMILY RESEMBLANCE TEST

A separate securities test is the Reves “Family Resemblance” test from the U.S. Supreme Court decision in *Reves v. Ernst and Young* (1990) aimed at determining whether a bill should be classified as a security. The test starts with the default presumption, that a bill is a security, but this presumption may be rebutted if it bears a “family resemblance” to one of the enumerated categories on a judicially developed list of exceptions.

The Family Resemblance test considers the following elements:

- (i) the parties’ motivation;
- (ii) the plan of instrument distribution;
- (iii) the expectation of the investing public; and
- (iv) the presence of alternative regulatory regime.

It should be noted that, unlike the Howey Test, there is no rule for all the factors to be met, but the “strong resemblance” should be proved in this case.

Element 1: Parties Motivation

The first factor is described as the motivation that prompts “a reasonable seller and buyer to enter into” the transaction. If the seller’s motivation is to raise money for his/her business and the buyer’s motivation is to earn profits, then the instrument is likely to be deemed a security. This may also apply when the instrument has not necessarily characteristic of a security, but the investors reasonably expected that they were buying a security, and would be protected by the accompanying securities laws.

In VINChain case, according to the White Paper, the Buyer should be motivated to use the functionality of the platform, e.g. have an access to the worldwide base of used cars, participate in choosing, adding, removing information providers, and in selecting what specific information should be available through VINChain network, rather than by expectation to raise money. Therefore, it is unlikely, while still possible, for the VIN purchasers to be motivated by raising money and earning profits.

Element 2: The Plan of Instrument Distribution

The second factor of the Family Resemblance test determines whether the instrument is being distributed for investment or speculation. If the instrument is being offered and sold to a broad segment or the general public for investment purposes, it is a security. According to the White Paper, although the issuance and sale of VIN Tokens are publicly accessible, they are mostly oriented on the specific audience involved in blockchain technological development and interested particularly in the global secondary car market. At the same time, blockchain community that is interested particularly in the secondary car market information may still represent a broad segment of potential participants, therefore, it is possible, while, we believe, unlikely, for the VIN token to be viewed as an investment instrument rather than a simple purchase contract.

Element 3: The Expectation of The Investing Public

An instrument will be deemed a security where the reasonable expectation of the investing public is that the securities laws (and accompanying anti-fraud provisions) apply to the investment. Generally, VINChain's White Paper, Purchase Agreement, Risk Matrix, and other marketing information do not constitute an offer or solicitation to sell shares or securities. Moreover, all of these documents emphasize that the VIN token should not be viewed as a security. Consequently, it would be unreasonable for participating public and is highly unlikely that the VIN token purchasers would expect for the securities laws to apply to this case.

Element 4: The Presence of Alternative Regulatory Regime

The fourth, and final, factor is a determination whether another regulatory scheme "significantly reduces the risk of the instrument, thereby rendering the application of the Securities Act unnecessary". While the Securities Act and the Securities Exchange Act seem to apply to Token Sales in the United States should the VIN be viewed as a security, an alternative regulatory regime in VINChain case may be the laws of Estonia, where VINChain is incorporated and operates its business.

RESULTS ON FAMILY RESEMBLANCE TEST: According to the analysis of the above-described elements of Family Resemblance test, based on the information provided by the company and our analysis of all materials, it appears that the VIN token buyers are (1) motivated to use the functionality of the platform rather than to raise money, in particular, to have an access to and participate in the VINChain network, (2) that they understand the possible risk, and (3) there is an alternative regulatory regime available. At the same time, there is still a slight possibility that the VIN may be viewed as an investment instrument, if its narrow, specific buying audience is found to represent a large segment of general public.

3. RISK CAPITAL TEST

In 1959 in *Silver Hills v. Sobieski*, the California Supreme Court has adopted an additional securities test, which is applied in 16 states. States may use different frameworks to judge what constitutes a security. In California, the Risk Capital Test considers whether there is attempt by an issuer to:

- (i) raise funds for a business venture or enterprise;
- (ii) through an indiscriminate offering to the public at large;
- (iii) where the investor is in a passive position to affect the success of the enterprise; and
- (iv) the investor's money is substantially at risk because it is inadequately secured.

This test is different, and arguably more expansive, than the Howey Test used by the SEC in its analysis in "The DAO case". Further, each of the approximately 16 states that apply the Risk Capital analysis characterize it a bit differently, but there are common elements among them. Therefore, offering of securities made to residents of a particular state shall comply not only with U.S. security law but also with specific laws and regulations adopted in that state.

- It is important to remember that for as long as the token purchasers don't have a use of the tokens while waiting until the development of the product, the tokens can be deemed securities under the Risk Capital Test.
- The above-referenced analysis is referring to the U.S. law only. The United States has the most complex securities law, with includes statutory Federal law and State law as well as a very extensive (sometimes not very cohesive) case law.

Thus, in our view, there will be relatively very little chances that the VIN token would be deemed a security.

Element 1: Funds For a Business Venture or Enterprise

Are funds being raised for a business venture or enterprise? Obviously, the funds are collected for the purposes of VINChain network maintenance and development.

Element 2: Public Offering

The issuance and sale of VIN tokens are publicly accessible for capable adult US citizens on the equal rights.

Element 3: Position of The Investor

While the first two factors of the test is very difficult to avoid, the third factor is eliminated when token holders are not just passive members of the platform, but get to participate in business process by having specific rights to contribute to the process, such as the right to provide and obtain information, right to choose information providers, and right to select what specific information should be available through VINChain network. Thus, this element of the

Risk Capital test is not satisfied as the VIN token holders do have control over the business process.

Element 4: Risk For Investor's Money

It is important to remember that for as long as the token purchasers don't have a use of the tokens while waiting until the development of the product, the tokens can be deemed securities under the Risk Capital test. If the product is not ready for launch and the funds raised during the token sale are meant to be used for the initial product development and launch, it is nearly impossible to pass the Risk Capital Test without having an escrow, while using escrow minimizes the chance of recognition of VIN Token as a security.

This factor can be eliminated by providing an adequate security for the funds raised. This factor of substantial risk does not apply to VINChain's situation as, according to the Company, the VINChain platform has been already built and ready for launching and token purchasers may utilize the VIN tokens immediately upon their distribution. It appears that there is an adequate security in the form of existing product that VIN Token purchasers may already use.

RESULTS OF RISK CAPITAL TEST: As noted above, while it is very difficult to avoid the first two elements of the test, the last two prongs are, most likely, not met since (1) the VIN token holders get to participate in the business process and, therefore, are unlikely to be considered passive investors, and (2) the VIN Token holders' contributions seem to be adequately secured by the product, the VINChain platform, that has been already developed and ready for use upon the VIN Tokens distribution.

4. ADDITIONAL RISKS

Due to the lack of regulations that would be specific particularly to the ICO procedure as well as because of the uncertain regulatory status of cryptographic tokens, digital assets, and blockchain technology, it is impossible to predict when, how, or whether at all governmental authorities will regulate such technologies. It is, likewise, impossible to predict when, how, or whether at all any governmental authority may make changes to existing laws, regulations, and/or rules that will affect cryptographic tokens, digital assets, blockchain technology, and its applications. Such changes could negatively impact the status of VIN Tokens in various ways, including, for example, through a retroactive determination that VIN Tokens are regulated financial instruments that require registration. We believe, however, that, based on the current regulatory and case law, the VINChain Token represents a simple contract.

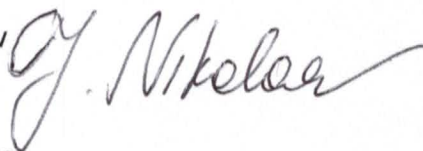
IV. CONCLUSION

Based on the current regulatory and case law and our analysis above, we believe that it is unlikely that the VIN Tokens will be deemed to represent a security, subject to the specific facts, circumstances, and characteristics of the VIN Token itself and provided that the company

complies with all of our recommendations and edits to the White Paper, Token Purchase Agreement, FAQ, and other company materials. Rather, given our thorough analysis above, it should be characterized as a simple contract not subject to the U.S. SEC regulations.

Sincerely,

Julia Z. Nikolaev

A handwritten signature in black ink, appearing to read "J. Nikolaev", written over the typed name.

Managing Partner
Crypto Law Group