Blockchain 101 for Lawyers

March 26, 2019

12:15 p.m. – 1:30 p.m.

CT Bar Association

New Britain, CT

CT Bar Institute, Inc.

CT: 1.0 CLE Credit (General)
NY: 1.0 CLE Credit (AOP)

Lawyers' Principles of Professionalism

As a lawyer I must strive to make our system of justice work fairly and efficiently. In order to carry out that responsibility, not only will I comply with the letter and spirit of the disciplinary standards applicable to all lawyers, but I will also conduct myself in accordance with the following Principles of Professionalism when dealing with my client, opposing parties, their counsel, the courts and the general public.

Civility and courtesy are the hallmarks of professionalism and should not be equated with weakness;

I will endeavor to be courteous and civil, both in oral and in written communications;

I will not knowingly make statements of fact or of law that are untrue;

I will agree to reasonable requests for extensions of time or for waiver of procedural formalities when the legitimate interests of my client will not be adversely affected;

I will refrain from causing unreasonable delays;

I will endeavor to consult with opposing counsel before scheduling depositions and meetings and before rescheduling hearings, and I will cooperate with opposing counsel when scheduling changes are requested;

When scheduled hearings or depositions have to be canceled, I will notify opposing counsel, and if appropriate, the court (or other tribunal) as early as possible;

Before dates for hearings or trials are set, or if that is not feasible, immediately after such dates have been set, I will attempt to verify the availability of key participants and witnesses so that I can promptly notify the court (or other tribunal) and opposing counsel of any likely problem in that regard;

I will refrain from utilizing litigation or any other course of conduct to harass the opposing party;

I will refrain from engaging in excessive and abusive discovery, and I will comply with all reasonable discovery requests;

In depositions and other proceedings, and in negotiations, I will conduct myself with dignity, avoid making groundless objections and refrain from engaging I acts of rudeness or disrespect;

I will not serve motions and pleadings on the other party or counsel at such time or in such manner as will unfairly limit the other party's opportunity to respond;

In business transactions I will not quarrel over matters of form or style, but will concentrate on matters of substance and content;

I will be a vigorous and zealous advocate on behalf of my client, while recognizing, as an officer of the court, that excessive zeal may be detrimental to my client's interests as well as to the proper functioning of our system of justice;

While I must consider my client's decision concerning the objectives of the representation, I nevertheless will counsel my client that a willingness to initiate or engage in settlement discussions is consistent with zealous and effective representation;

Where consistent with my client's interests, I will communicate with opposing counsel in an effort to avoid litigation and to resolve litigation that has actually commenced;

I will withdraw voluntarily claims or defense when it becomes apparent that they do not have merit or are superfluous;

I will not file frivolous motions;

I will make every effort to agree with other counsel, as early as possible, on a voluntary exchange of information and on a plan for discovery;

I will attempt to resolve, by agreement, my objections to matters contained in my opponent's pleadings and discovery requests;

In civil matters, I will stipulate to facts as to which there is no genuine dispute;

I will endeavor to be punctual in attending court hearings, conferences, meetings and depositions;

I will at all times be candid with the court and its personnel;

I will remember that, in addition to commitment to my client's cause, my responsibilities as a lawyer include a devotion to the public good;

I will endeavor to keep myself current in the areas in which I practice and when necessary, will associate with, or refer my client to, counsel knowledgeable in another field of practice;

I will be mindful of the fact that, as a member of a self-regulating profession, it is incumbent on me to report violations by fellow lawyers as required by the Rules of Professional Conduct;

I will be mindful of the need to protect the image of the legal profession in the eyes of the public and will be so guided when considering methods and content of advertising;

I will be mindful that the law is a learned profession and that among its desirable goals are devotion to public service, improvement of administration of justice, and the contribution of uncompensated time and civic influence on behalf of those persons who cannot afford adequate legal assistance;

I will endeavor to ensure that all persons, regardless of race, age, gender, disability, national origin, religion, sexual orientation, color, or creed receive fair and equal treatment under the law, and will always conduct myself in such a way as to promote equality and justice for all.

It is understood that nothing in these Principles shall be deemed to supersede, supplement or in any way amend the Rules of Professional Conduct, alter existing standards of conduct against which lawyer conduct might be judged or become a basis for the imposition of civil liability of any kind.

--Adopted by the Connecticut Bar Association House of Delegates on June 6, 1994

Table of Contents

ABOUT THE PROGRAM

This course will advise course participants what blockchains are, how blockchain databases are used, how to distinguish between cryptocurrency applications and enterprise applications of blockchain technology, and what to look out for

YOU WILL LEARN

- What a blockchain is and how it works, in plain English
- What a blockchain is not and what claims about blockchain should be regarded as suspect
- Common issues encountered in cryptocurrency practice, including securities, anti-money-laundering and counter-terrorist financing, and cross-border issues

WHO SHOULD ATTEND

Any attorney interested in learning about the basics of blockchain and cryptocurrency practice.

SPEAKER

Preston J. Byrne, Attorney, Byrne & Storm PC
Founder and former-COO, Monax (Blockchain legal tech company and first-ever enterprise blockchain company)

PROGRAM AGENDA

TIME	TOPIC
12:15 - 12:20	Speaker Introduction
12:20 - 12:30	Introduction to blockchains
12:30 - 12:40	Cryptocurrrencies
12:40 - 12:50	Non-cryptocurrency use cases (“enterprise blockchain”)
12:50 - 1:00	Brief rundown of commonly encountered issues in practice
1:00 - 1:05	Market structure and red flags
1:05 - 1:30	Question and answer

Faculty Biography

Preston J. Byrne is a dual-admitted lawyer in Connecticut and England and a partner at Byrne & Storm PC, where he advises telecommunications and cryptocurrency companies on cross-border legal issues. Prior to joining Byrne & Storm, Preston was an associate with Bryan Cave Leighton Paisner and Norton Rose Fulbright in London, England and, later, a founder and COO of Monax Industries, the company which invented the first permissioned/enterprise blockchain in 2014. That blockchain design is known today as Hyperledger Burrow, and serves as the Hyperledger consortium's only Ethereum Virtual Machine.

Blockchain 101 for Attorneys

(aka people who can't do math)

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Hello! I'm Preston Byrne.

- Solicitor (England and Wales) and attorney (Connecticut)
- Early career with BigLaw in London, UK
- Founded Monax Industries in 2014
- Monax == first non-cryptocurrency/"enterprise" blockchain application software stack, now a legal tech company
- College of Law of England and Wales (LL.B., 2009)
- UConn Law (LL.M., 2018)
- Currently: Partner at Byrne & Storm, P.C. (est. 1991)
  - Represent a mix of telecommunications, cryptocurrency and blockchain tech firms

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Structure of the talk

1. What's a blockchain?
2. What's a cryptocurrency?
3. How does an "enterprise blockchain" differ from a cryptocurrency?
4. What are common practice issues faced in each area?
5. What's the market structure like?
6. Red flags
7. Q&A

1. What's a blockchain?

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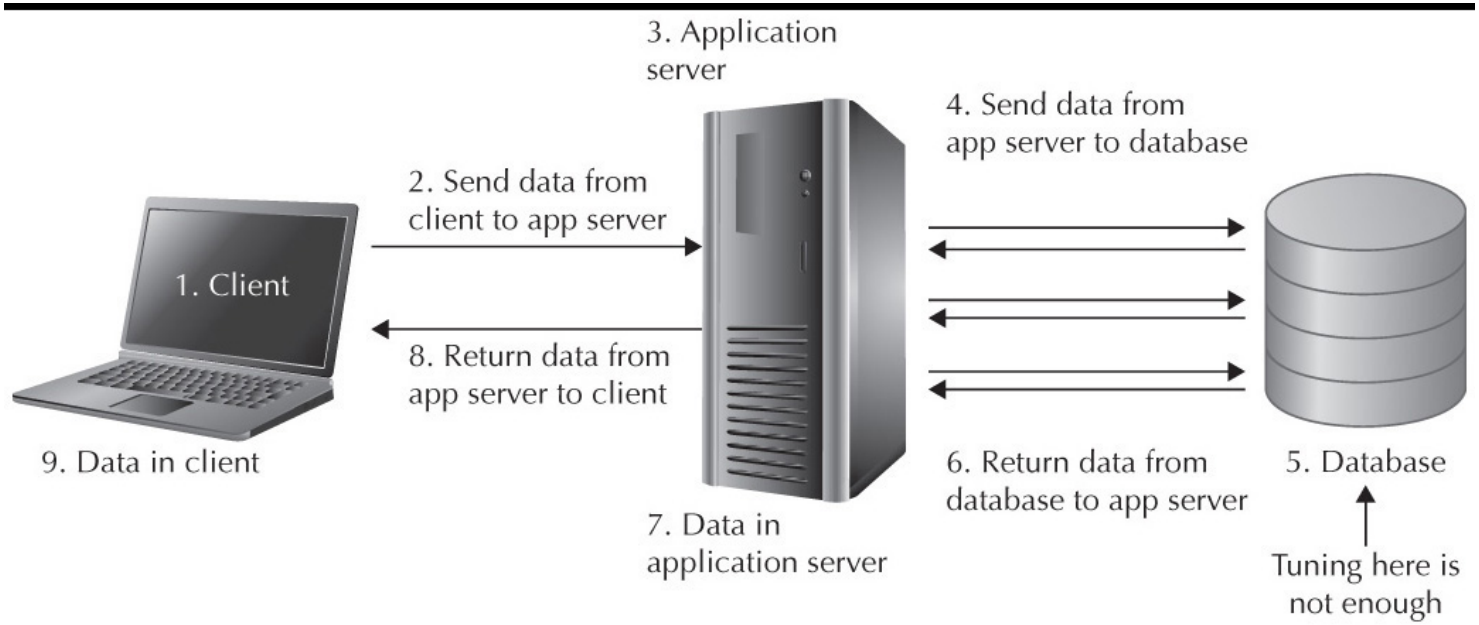
It’s a type of distributed database.

How the Internet is currently designed



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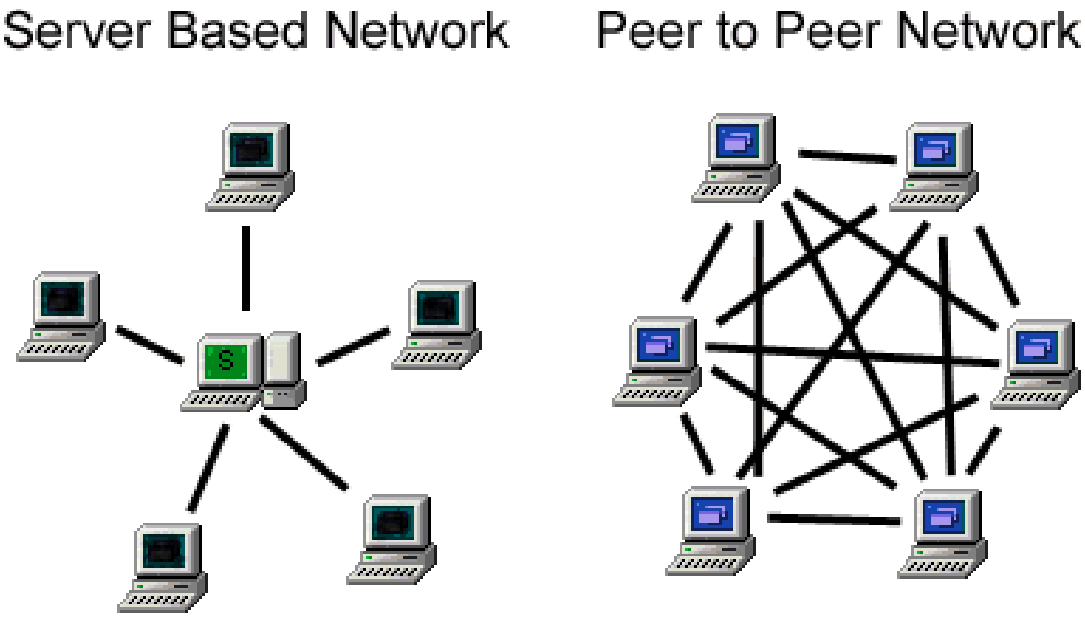
How blockchain networks are designed



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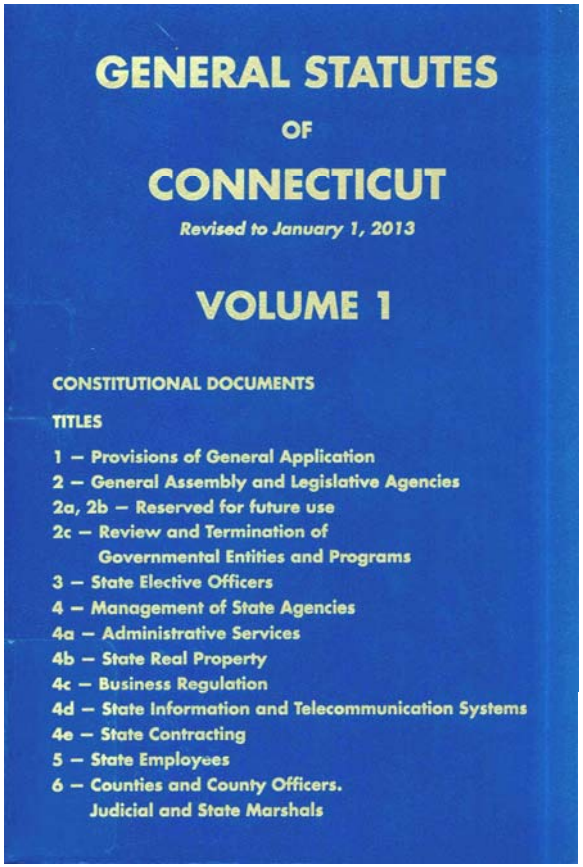
Blockchains agree on common rules just like lawyers do…

1) Distributed rulebooks

2) Which track changes made to them

3) Where changes will not occur unless someone with the requisite authority authorizes them

4) With the result that we can be fairly certain that if we find something on a blockchain, **it belongs there**



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…and all blockchains will have three core rules

1. Tell ‘em what you’re gonna say
2. Say it
3. Tell ‘em what you said

1. **Transaction/Signature Rules**: who has the ability to write particular messages to the database?
   - Elliptic curve digital signature algorithm (ECDSA) or Ed25519 if you’re really interested
2. **Network Rules**: how will we communicate the messages to one another?
   - Various peer to peer networking protocols over TCP-IP
3. **Consensus Rules**: how do we decide on transaction ordering and the approved transaction history?
   - Proof-of-work (mining), proof-of-stake (voting), Delegated proof-of-stake (proxy voting)

2. What's a cryptocurrency?

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Applying the analytical framework…

1. **Transaction/Signature Rules**:
    1. Varies by system
    2. Bitcoin and Ethereum, e.g., use ECDSA
    3. Bitcoin allows writes if you have an "unspent transaction output" (UTXO) plus the key which allows you to spend the unspent transaction output
    4. UTXO (transaction permission) + private key (signature permission) = you can spend the corresponding Bitcoin
2. **Network Rules**: how will we communicate the messages to one another?
    - Various peer to peer networking protocols over TCP-IP
    - Bitcoin uses handshaking; IPFS, Ethereum use libp2p
    - Lawyers don't really need to know about this

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3. Consensus rules

- Subject of much wailing and gnashing of teeth
- "Decentralization" is the key question
  - …but the term has no definite meaning and industry experts have no clear answers as to what it might mean
- "Mining" == uses electricity expenditure to ensure decentralization
- "Staking" = uses governance/buy-in of stakes in the system to ensure decentralization
- Neither is perfect and both can be (and have been) gamed with sufficient majorities of mining or staking power
- Objective is to prevent hostile chain re-organizations or "double-spending"
- These discussions are really the domain of mathematicians, security professionals and engineers

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3. What's an enterprise blockchain?

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Applying the analytical framework…

1. **Transaction/Signature Rules**:
    1. Transaction types highly variable, can really be anything that is expressible in code
    2. Signature algorithms usually ECDSA (Bitcoin or Ethereum forks, Hyperledger Fabric) or Ed25519 (Hyperledger Burrow, Sawtooth-Ethereum ("Seth"))

2. **Network Rules**: how will we communicate the messages to one another?
    - Again, not really legal turf; the only relevance is in determining when a message has been logged for the purpose of settlement finality/determining when an asset has moved out of a bankrupt's estate, which is unlikely to be an issue except in very rare edge cases

3. Consensus rules

- Whatever the application requires
- Objective of these systems is to create a high-security, highly automated transaction execution engine with a cryptographically verifiable, tamper-resistant record of events
- Can dole out particular permissions to particular validators and set requisite majorities for approving transactions (3-of-5 nodes, 7-of-10, 3 of 5 transaction participants plus a trustee, or whatever variation is agreed)
- Looks like any other web application, except that the backend is blockchain based
- Lawyers can be fairly useful in these discussions

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4. What are some key issues I should be aware of in practice?

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Hitting the high notes

1. Securities law
2. Money transmission
3. Typical startup issues
4. NY BitLicense
5. GDPR

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Securities law

- Regulatory non-compliance is NOT “just like Uber”
- Prospective clients may ask lawyers to write legal opinions that claim securities laws do not apply to their transaction
- Assume at point of issuance that all token sales must be registered or benefit from a specific exemption or issuance pathway (Reg S, Reg D/Rule 506(c), Reg A)
- Commodities regulation may be relevant but will not be at the point of issuance
- Pre-sales or pre-mines likely to trigger U.S. securities rules
- Criminal prosecutions for securities law violations are underway
- Required reading:
  - The DAO Report of Investigation
  - Paragon/AirFox orders (non-registration of securities by issuer)
  - EtherDelta order (non-registration as national securities exchange)
  - Crypto Asset Management, LP order (non-registration as investment adviser)
  - U.S. v. Ruja Ignatova indictment

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Money transmission

- Easy to fall foul of money transmission rules
- Small-time Bitcoin exchangers have been charged with operating unlicensed money transmission businesses under 18 U.S.C. § 1960
- Note FinCEN 2013 guidance distinguishing “users,” “administrators” and “exchangers”
- Lightning Network/“Layer 2” scaling solutions
  - Status not known, but current view is that use of a payment channel to buy or sell goods is a low risk of constituting money transmission, but that funding one for fees is a higher risk despite
  - Enforcement will be difficult given the decentralized nature of these programs, but legitimate businesses will seek to comply

Typical startup stuff

- Founders (usually) aren't lawyers
- Incorporation formalities frequently missing or deficient
- Early blockchain companies need generalists – compliance, IP, tax, data protection, corporate and venture financing
- Ability to provide legal input into system/software design is a bonus, seeing as most blockchain systems seek to automate obligations of some kind

New York Bitlicense

- Any New York nexus requires New York advice
- Required before one can operate a “virtual currency business” in New York State
- Only 14 issued to date
- Most companies block New York residents from using their services rather than seeking licensure
- Some companies elect to operate as a trust company or bank instead (see e.g. Paxos)
- Required for (per 23 NYCRR 200.3(a))
  - Receiving crypto for transmission *unless* for non-financial purposes *and* for a nominal amount
  - Storing, holding, maintaining custody of crypto
  - Buying and selling crypto as a customer business
  - Performing exchange services as a customer business
  - Controlling, administering or issuing (!) crypto

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GDPR

1. European data privacy law is crazy
2. Applies to anyone who is in the EU at the time that the data is processed by the data processor
3. If the application is public/consumer facing a GDPR analysis should be undertaken by EU counsel, particularly if the client is planning to have substantial European operations
4. There is a stronger coin-based blockchain ecosystem in Europe than the States due to favorable regulatory environment (chiefly, ICO tokens are not securities under the Prospectus Regulation)

5. What aspects of market structure are relevant to my practice?

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Crypto Winter

Source: CryptoCompare

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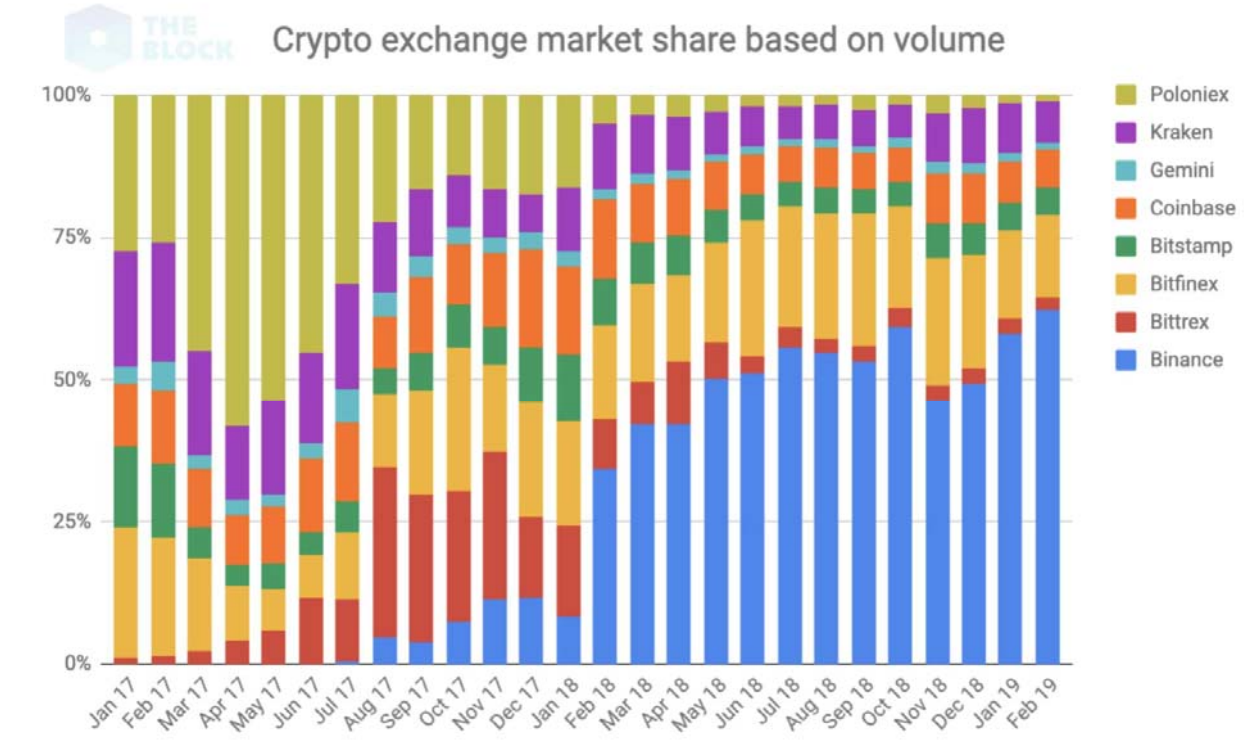
U.S. is a minor player in terms of volume



Source: CryptoCompare

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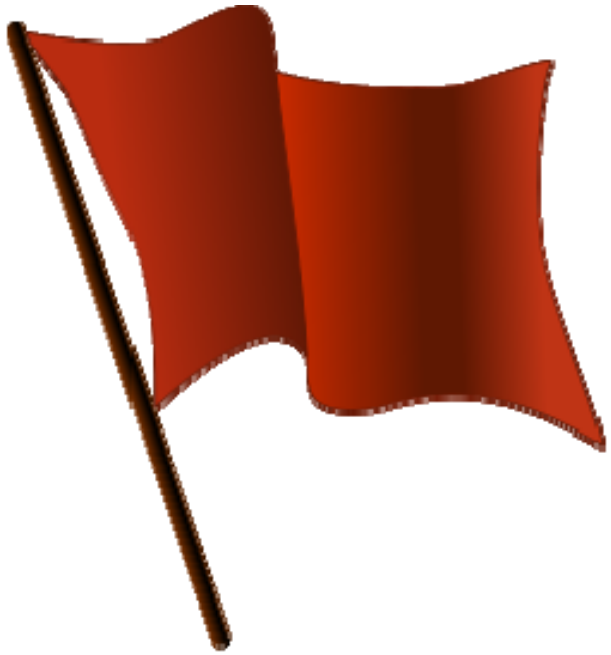
U.S. is a major player in terms of services + enterprise

- Home to the Hyperledger Consortium and most major participants (IBM, Intel, Microsoft, a smattering of banks)
- New York has a vibrant blockchain community, is an early leader in the automation of securities processing on blockchain tech
- San Francisco remains the most prominent global venture financing hub for blockchain investments
  - A16Z dedicated crypto fund, Multicoin/Polychain/Pantera funds

U.S. States undertaking blockchain statutory reforms

- Wyoming's efforts are highly regarded in the blockchain legal community
- Vermont: "Blockchain LLC" (very odd)
- Delaware: Early lead stalled after change in administration
- Arizona, California, Florida adding blockchain definitions to statutes
- Texas currently proposing draconian anti-money laundering provisions for cryptocurrency transactions requiring identity verification before any purchase made with cryptocurrency
- Generally, efforts to ease money transmitter licensing requirements and exempt *de minimis* transactions from taxes are viewed favorably by blockchain advocates and skeptics alike

6. Red flags



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Red flags

1. “Stablecoins”
2. Unaudited reserve-backed coins
3. ICOs that are not registered or do not avail themselves of a specific exemption to the registration requirements
4. Requests for quick and dirty legal opinions
5. Investment schemes that promise fixed rates of return
6. Any claim that U.S. law is not sufficiently advanced to encompass the transactions mediated by the invention / “it’s a new paradigm”

“Stablecoins”

- Financial products which claim to be able to maintain a coin price == $1
- “Algorithmic” – claims to achieve dollar parity through adjustment of coin supply. Examples:
  - Basis (raised over $100mm and failed), Carbon, KowalaUSD
- “Collateralized” – repackages exposure to an underlying cryptocurrency collateral contract
  - MakerDAO/Dai (peg broken, widely used), BitUSD (peg broken, unused)
  - Possibility of market manipulation on thinly-traded exchanges

Reserve-backed coins

- Convertibility = Parity
- Coins that audit (for avoidance of doubt, not a red flag): CircleUSD, Paxos, Gemini Dollar, TrustToken
- Banks: JP Morgan Chase (proposed)
- Tech companies: Facebookcoin (proposed)
- Public queries about coins that have not undergone audits but account for substantial portions (over 80% by some estimates) of Bitcoin's trading volume

Investment schemes promising consistent above-market rates of return

- A Ponzi scheme dressed up in technobabble is still a Ponzi scheme
- Trendon Shavers (pirateat40) – “Bitcoin Savings & Trust” (Scheme operated 2011-12, sentenced 2016)
- Joshua Homero Garza – “Hashlet” Bitcoin mining contracts, Paycoin stablecoin (scheme operated 2014-15, sentenced 2018)
- U.S. v. Konstantin Ignatov, Ruja Ignatova – OneCoin MLM (ongoing)
- Federal prosecutors have an array of statutory tools at their disposal – securities fraud, money laundering, wire fraud, and conspiracy feature heavily
- Clients looking for exposure to the sector should be steered to institutional players with robust diligence and security apparatuses, e.g. Fidelity Digital Assets and Bakkt

“It’s a new paradigm, you just aren’t knowledgeable enough to understand it”

- If a blockchain software concept can’t be explained in terms that a Golden Retriever could understand, this is a red flag
- At the end of the day this stuff is just software

7. Q&A

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Guidance

FIN-2013-G001
Issued: March 18, 2013
Subject: Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies

The Financial Crimes Enforcement Network ("FinCEN") is issuing this interpretive guidance to clarify the applicability of the regulations implementing the Bank Secrecy Act ("BSA") to persons creating, obtaining, distributing, exchanging, accepting, or transmitting virtual currencies.[1] Such persons are referred to in this guidance as "users," "administrators," and "exchangers," all as defined below.[2] A user of virtual currency is ***not*** an MSB under FinCEN's regulations and therefore is not subject to MSB registration, reporting, and recordkeeping regulations. However, an administrator or exchanger ***is*** an MSB under FinCEN's regulations, specifically, a money transmitter, unless a limitation to or exemption from the definition applies to the person. An administrator or exchanger is not a provider or seller of prepaid access, or a dealer in foreign exchange, under FinCEN's regulations.

Currency vs. Virtual Currency

FinCEN's regulations define currency (also referred to as "real" currency) as "the coin and paper money of the United States or of any other country that [i] is designated as legal tender and that [ii] circulates and [iii] is customarily used and accepted as a medium of exchange in the country of issuance."[3] In contrast to real currency, "virtual" currency is a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency. In particular, virtual currency does not have legal tender status in any jurisdiction. This guidance addresses "convertible" virtual currency. This type of virtual currency either has an equivalent value in real currency, or acts as a substitute for real currency.

[1] FinCEN is issuing this guidance under its authority to administer the Bank Secrecy Act. *See* Treasury Order 180-01 (March 24, 2003). This guidance explains only how FinCEN characterizes certain activities involving virtual currencies under the Bank Secrecy Act and FinCEN regulations. It should not be interpreted as a statement by FinCEN about the extent to which those activities comport with other federal or state statutes, rules, regulations, or orders.

[2] FinCEN's regulations define "person" as "an individual, a corporation, a partnership, a trust or estate, a joint stock company, an association, a syndicate, joint venture, or other unincorporated organization or group, an Indian Tribe (as that term is defined in the Indian Gaming Regulatory Act), and all entities cognizable as legal personalities." 31 CFR § 1010.100(mm).

[3] 31 CFR § 1010.100(m).

Background

On July 21, 2011, FinCEN published a Final Rule amending definitions and other regulations relating to money services businesses ("MSBs").[4] Among other things, the MSB Rule amends the definitions of dealers in foreign exchange (formerly referred to as "currency dealers and exchangers") and money transmitters. On July 29, 2011, FinCEN published a Final Rule on Definitions and Other Regulations Relating to Prepaid Access (the "Prepaid Access Rule").[5] This guidance explains the regulatory treatment under these definitions of persons engaged in virtual currency transactions.

Definitions of User, Exchanger, and Administrator

This guidance refers to the participants in generic virtual currency arrangements, using the terms "user," "exchanger," and "administrator."[6] A *user* is a person that obtains virtual currency to purchase goods or services.[7] An *exchanger* is a person engaged as a business in the exchange of virtual currency for real currency, funds, or other virtual currency. An *administrator* is a person engaged as a business in issuing (putting into circulation) a virtual currency, and who has the authority to redeem (to withdraw from circulation) such virtual currency.

Users of Virtual Currency

A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is ***not*** an MSB under FinCEN's regulations.[8] Such activity, in and of itself, does not fit within the definition of "money transmission services" and therefore is not subject to FinCEN's registration, reporting, and recordkeeping regulations for MSBs.[9]

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[4] *Bank Secrecy Act Regulations – Definitions and Other Regulations Relating to Money Services Businesses*, 76 FR 43585 (July 21, 2011) (the "MSB Rule"). This defines an MSB as "a person wherever located doing business, whether or not on a regular basis or as an organized or licensed business concern, wholly or in substantial part within the United States, in one or more of the capacities listed in paragraphs (ff)(1) through (ff)(7) of this section. This includes but is not limited to maintenance of any agent, agency, branch, or office within the United States." 31 CFR § 1010.100(ff).

[5] *Final Rule – Definitions and Other Regulations Relating to Prepaid Access*, 76 FR 45403 (July 29, 2011),

[6] These terms are used for the exclusive purpose of this regulatory guidance. Depending on the type and combination of a person's activities, one person may be acting in more than one of these capacities.

[7] How a person engages in "obtaining" a virtual currency may be described using any number of other terms, such as "earning," "harvesting," "mining," "creating," "auto-generating," "manufacturing," or "purchasing," depending on the details of the specific virtual currency model involved. For purposes of this guidance, the label applied to a particular process of obtaining a virtual currency is not material to the legal characterization under the BSA of the process or of the person engaging in the process.

[8] As noted above, this should not be interpreted as a statement about the extent to which the user's activities comport with other federal or state statutes, rules, regulations, or orders. For example, the activity may still be subject to abuse in the form of trade-based money laundering or terrorist financing. The activity may follow the same patterns of behavior observed in the "real" economy with respect to the purchase of "real" goods and services, such as systematic over- or under-invoicing or inflated transaction fees or commissions.

[9] 31 CFR § 1010.100(ff)(1-7).

Administrators and Exchangers of Virtual Currency

An administrator or exchanger that (1) accepts and transmits a convertible virtual currency or (2) buys or sells convertible virtual currency for any reason ***is*** a money transmitter under FinCEN's regulations, unless a limitation to or exemption from the definition applies to the person.[10] FinCEN's regulations define the term "money transmitter" as a person that provides money transmission services, or any other person engaged in the transfer of funds. The term "money transmission services" means "the acceptance of currency, funds, or other value that substitutes for currency from one person *and* the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means."[11]

The definition of a money transmitter does not differentiate between real currencies and convertible virtual currencies. Accepting and transmitting anything of value that substitutes for currency makes a person a money transmitter under the regulations implementing the BSA.[12] FinCEN has reviewed different activities involving virtual currency and has made determinations regarding the appropriate regulatory treatment of administrators and exchangers under three scenarios: brokers and dealers of e-currencies and e-precious metals; centralized convertible virtual currencies; and de-centralized convertible virtual currencies.

a. E-Currencies and E-Precious Metals

The first type of activity involves electronic trading in e-currencies or e-precious metals.[13] In 2008, FinCEN issued guidance stating that as long as a broker or dealer in real currency or other commodities accepts and transmits funds solely for the purpose of effecting a *bona fide* purchase or sale of the real currency or other commodities for or with a customer, such person is not acting as a money transmitter under the regulations.[14]

However, if the broker or dealer transfers funds between a customer and a third party that is not part of the currency or commodity transaction, such transmission of funds is no longer a fundamental element of the actual transaction necessary to execute the contract for the purchase or sale of the currency or the other commodity. This scenario is, therefore, money

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[10] FinCEN's regulations provide that whether a person is a money transmitter is a matter of facts and circumstances. The regulations identify six circumstances under which a person is not a money transmitter, despite accepting and transmitting currency, funds, or value that substitutes for currency. 31 CFR § 1010.100(ff)(5)(ii)(A)–(F).

[11] 31 CFR § 1010.100(ff)(5)(i)(A).

[12] Ibid.

[13] Typically, this involves the broker or dealer electronically distributing digital certificates of ownership of real currencies or precious metals, with the digital certificate being the virtual currency. However, the same conclusions would apply in the case of the broker or dealer issuing paper ownership certificates or manifesting customer ownership or control of real currencies or commodities in an account statement or any other form. These conclusions would also apply in the case of a broker or dealer in commodities other than real currencies or precious metals. A broker or dealer of e-currencies or e-precious metals that engages in money transmission could be either an administrator or exchanger depending on its business model.

[14] *Application of the Definition of Money Transmitter to Brokers and Dealers in Currency and other Commodities*, FIN-2008-G008, Sept. 10, 2008. The guidance also notes that the definition of money transmitter excludes any person, such as a futures commission merchant, that is "registered with, and regulated or examined by…the Commodity Futures Trading Commission."

transmission.[15] Examples include, in part, (1) the transfer of funds between a customer and a third party by permitting a third party to fund a customer's account; (2) the transfer of value from a customer's currency or commodity position to the account of another customer; or (3) the closing out of a customer's currency or commodity position, with a transfer of proceeds to a third party. Since the definition of a money transmitter does not differentiate between real currencies and convertible virtual currencies, the same rules apply to brokers and dealers of e-currency and e-precious metals.

b. Centralized Virtual Currencies

The second type of activity involves a convertible virtual currency that has a centralized repository. The administrator of that repository will be a money transmitter to the extent that it allows transfers of value between persons or from one location to another. This conclusion applies, whether the value is denominated in a real currency or a convertible virtual currency. In addition, any exchanger that uses its access to the convertible virtual currency services provided by the administrator to accept and transmit the convertible virtual currency on behalf of others, including transfers intended to pay a third party for virtual goods and services, is also a money transmitter.

FinCEN understands that the exchanger's activities may take one of two forms. The first form involves an exchanger (acting as a "seller" of the convertible virtual currency) that accepts real currency or its equivalent from a user (the "purchaser") and transmits the value of that real currency to fund the user's convertible virtual currency account with the administrator. Under FinCEN's regulations, sending "value that substitutes for currency" to another person or to another location constitutes money transmission, unless a limitation to or exemption from the definition applies.[16] This circumstance constitutes transmission ***to another location***, namely from the user's account at one location (e.g., a user's real currency account at a bank) to the user's convertible virtual currency account with the administrator. It might be argued that the exchanger is entitled to the exemption from the definition of "money transmitter" for persons involved in the sale of goods or the provision of services. Under such an argument, one might assert that the exchanger is merely providing the service of connecting the user to the administrator and that the transmission of value is integral to this service. However, this exemption does not apply when the only services being provided are money transmission services.[17]

The second form involves a *de facto* sale of convertible virtual currency that is not completely transparent. The exchanger accepts currency or its equivalent from a user and privately credits the user with an appropriate portion of the exchanger's own convertible virtual currency held with the administrator of the repository. The exchanger then transmits that

[15] In 2011, FinCEN amended the definition of money transmitter. The 2008 guidance, however, was primarily concerned with the core elements of the definition – accepting and transmitting currency or value – and the exemption for acceptance and transmission integral to another transaction not involving money transmission. The 2011 amendments have not materially changed these aspects of the definition.
[16] See footnote 11 and adjacent text.
[17] 31 CFR § 1010.100(ff)(5)(ii)(F).

internally credited value to third parties at the user's direction. This constitutes transmission ***to another person***, namely each third party to which transmissions are made at the user's direction. To the extent that the convertible virtual currency is generally understood as a substitute for real currencies, transmitting the convertible virtual currency at the direction and for the benefit of the user constitutes money transmission on the part of the exchanger.

c. De-Centralized Virtual Currencies

A final type of convertible virtual currency activity involves a de-centralized convertible virtual currency (1) that has no central repository and no single administrator, and (2) that persons may obtain by their own computing or manufacturing effort.

A person that creates units of this convertible virtual currency and uses it to purchase real or virtual goods and services is a user of the convertible virtual currency and not subject to regulation as a money transmitter. By contrast, a person that creates units of convertible virtual currency and sells those units to another person for real currency or its equivalent is engaged in transmission to another location and is a money transmitter. In addition, a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.

Providers and Sellers of Prepaid Access

A person's acceptance and/or transmission of convertible virtual currency cannot be characterized as providing or selling prepaid access because prepaid access is limited to real currencies.[18]

Dealers in Foreign Exchange

A person must exchange the currency of two or more countries to be considered a dealer in foreign exchange.[19] Virtual currency does not meet the criteria to be considered "currency" under the BSA, because it is not legal tender. Therefore, a person who accepts real currency in

[18] This is true even if the person holds the value accepted for a period of time before transmitting some or all of that value at the direction of the person from whom the value was originally accepted. FinCEN's regulations define "prepaid access" as "access to funds or the value of funds that have been paid in advance and can be retrieved or transferred at some point in the future through an electronic device or vehicle, such as a card, code, electronic serial number, mobile identification number, or personal identification number." 31 CFR § 1010.100(ww). Thus, "prepaid access" under FinCEN's regulations is limited to "access to funds or the value of funds." If FinCEN had intended prepaid access to cover funds denominated in a virtual currency or something else that substitutes for real currency, it would have used language in the definition of prepaid access like that in the definition of money transmission, which expressly includes the acceptance and transmission of "other value that substitutes for currency." 31 CFR § 1010.100(ff)(5)(i) .

[19] FinCEN defines a "dealer in foreign exchange" as a "person that accepts the currency, or other monetary instruments, funds, or other instruments denominated in the currency, of one or more countries in exchange for the currency, or other monetary instruments, funds, or other instruments denominated in the currency, of one or more other countries in an amount greater than $1,000 for any other person on any day in one or more transactions, whether or not for same-day delivery." 31 CFR § 1010.100(ff)(1).

exchange for virtual currency, or *vice versa*, is not a dealer in foreign exchange under FinCEN's regulations.

* * * * *

Financial institutions with questions about this guidance or other matters related to compliance with the implementing regulations of the BSA may contact FinCEN's Regulatory Helpline at (800) 949-2732.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 10574 / November 16, 2018

ADMINISTRATIVE PROCEEDING
File No. 3-18897

In the Matter of **Paragon Coin, Inc.,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, MAKING FINDINGS, AND IMPOSING PENALTIES AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") against Paragon Coin, Inc. ("Paragon" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") that the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant To Section 8A of the Securities Act of 1933, Making Findings, and Imposing Penalties and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

Paragon is an online entity that was purportedly established to implement blockchain technology in the cannabis industry. From August 2017 through October 2017, Paragon offered

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

and sold digital tokens ("PRG" or "PRG tokens") to be issued on a blockchain, or a distributed ledger (the "offering"). Paragon conducted the offering of PRG tokens to raise capital to develop and implement its business plan to add blockchain technology to the cannabis industry and work towards legalization of cannabis. In connection with the offering, Paragon described the way in which PRG tokens would increase in value as a result of Paragon's efforts and stated that PRG tokens would be traded on secondary markets. Paragon raised approximately $12 million worth of digital assets during the offering. Paragon did not register the offering pursuant to the federal securities laws, nor did it attempt to qualify for an exemption to the registration requirements.

Based on the facts and circumstances set forth below, PRG tokens were securities pursuant to *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946), and its progeny, including the cases discussed by the Commission in its *Report of Investigation Pursuant To Section 21(a) Of The Securities Exchange Act of 1934: The DAO* (Exchange Act Rel. No. 81207) (July 25, 2017) (the "DAO Report"). A purchaser in the offering of PRG tokens would have had a reasonable expectation of obtaining a future profit based upon Paragon's efforts, including to develop Paragon's "ecosystem" using the proceeds from the sale of PRG tokens, and to take steps to control and increase the value of PRG. Paragon violated Sections 5(a) and 5(c) of the Securities Act by offering and selling these securities without having a registration statement filed or in effect with the Commission or qualifying for exemption from registration with the Commission.

Respondent

Paragon is a Delaware Corporation. Neither Paragon nor its securities are registered in any capacity.

Facts

1. Paragon is an entity, established in July 2017, to "deploy a suite of blockchain enabled products to organize, systematize and bring verification and stability to the cannabis industry."

2. On August 15, 2017, Paragon released a White Paper (the "White Paper") on its website and social media websites describing its planned business model and upcoming token sale.

3. The White Paper described Paragon's mission as seeking to "pull the cannabis community from marginalized to mainstream by building blockchain into every step of the cannabis industry and by working toward full legalization." The White Paper described five different segments of the planned Paragon business model, including "ParagonChain," "ParagonCoin," "ParagonSpace," "ParagonOnline," and "ParagonAccelerator." ParagonChain would facilitate the creation of "an immutable ledger for all industry related data." ParagonCoin would "offer payment for industry related services and supplies." ParagonSpace would "establish niche co-working spaces via ParagonSpace." ParagonOnline would "organize and unite global legalization efforts." And ParagonAccelerator would "bring standardization of licensing, lab testing, supply chain and ID verification through apps."

4. Paragon's White Paper described the terms of an upcoming token sale that would raise funds to build the various Paragon business segments.

5. Paragon and its agents control the content on multiple web pages, including but not limited to its website, a Twitter account, a Facebook page, and posts on various blogs and message boards (collectively, the "Paragon Web Pages").

Paragon's Offer and Sale of PRG To The General Public

6. On August 15, 2017, Paragon announced, via the White Paper, that it would launch an "initial token crowdsale" to offer "ParagonCoins," or "PRG," to the general public, to run from September 15, 2017 through October 15, 2017 ("the PRG crowdsale"). Paragon released the White Paper on its website, and posted it to various social media platforms. The White Paper described, *inter alia*, the details of the offering, the offering process, how Paragon would use the proceeds of the offering to develop its business, the ways in which Paragon would control the supply of PRG to increase the value of tokens, and the ability for PRG token holders to trade PRG on secondary markets after the offering.

7. Paragon also offered a pre-sale (the "pre-sale") to investors prior to the PRG crowdsale, from August 15, 2017 through September 15, 2017, offering 10-25% discounts on PRG tokens during that period, with the earlier investors receiving bigger discounts.

8. PRG tokens were advertised as being available for purchase by individuals in the United States and worldwide through websites and social media pages including, but not limited to, the Paragon Web Pages.

9. Paragon also sold PRG tokens to at least 7 investors via private agreements during the offering.

10. Per the White Paper, a total of 200,000,000 PRG tokens were to be generated, and there would be "no further production of tokens so, over time, the tokens in circulation shall reduce in number and increase demand." The White Paper delineated a schedule for production of the PRG tokens, as "the distributed value and frequency of token production influence[s] token price." 100,000,000 PRG tokens were to be sold in the offering; 50,000,000 tokens would be for sale at a later unspecified date; 40,000,000 tokens would be allotted for a "Paragon controlled reserve to maintain price support of the PRG tokens"; and 10,000,000 tokens were to be placed in community-controlled reserve to be used for start-up ventures "voted on by the community."

11. Proceeds from the offering would be used for the development and implementation of the business model contemplated by the White Paper, and to build an "ecosystem" around the token. The White Paper also stated that the "lion's share" of the offering proceeds would be spent on real-estate acquisition for the contemplated "ParagonSpace" co-working spaces. Paragon described its contemplated co-working spaces to be similar to other well-known co-working spaces, where cannabis-related businesses could rent space, and pay for space and other amenities using PRG tokens. Since the offering, Paragon has purchased and opened a ParagonSpace co-working space that is currently operational.

12. Paragon described a timeline that provided for various development milestones in 2017 and 2018, including the "listing" of PRG tokens on "major exchanges" within one month of the close of the offering, "initial functionality," and the purchasing and renovating of buildings to be used in the "ParagonSpace" venture.

13. Paragon engaged a celebrity to promote the offering. Before and during the offering, Paragon directed the celebrity to release statements on various social media sites promoting Paragon and the offering. Paragon also told potential investors that the celebrity was on Paragon's "Advisory Board."

14. Principals of Paragon also interacted with potential investors on various internet sites and forums. On August 27, 2017, principals of Paragon hosted a public question and answer forum on Reddit.com, known as "Ask Me Anythings" or "AMAs," in which potential investors were invited to ask questions regarding Paragon and its token sale, titled "AMA w/Paragon Coin Execs" ("Paragon AMA"). (Paragon hosted an earlier AMA with potential investors on August 20, 2017).

15. The PRG crowdsale ran from September 15, 2017 through October 15, 2017. During the pre-sale and crowdsale, PRG tokens could be purchased only in exchange for other digital assets, including Bitcoin, Ether, Litecoin, Dashcoin, Zcash, Ripple, Monero, Ethereum Classic, and Waves. PRG tokens could not be purchased with fiat currency.

16. Through the offering, Paragon raised a total of $12,066,000, as measured in the U.S. Dollar equivalent of these various digital assets at the close of the offering. Approximately 8,323 investors purchased PRG tokens, including investors in the United States.

17. PRG tokens were distributed to purchasers on October 22, 2017, on the Ethereum blockchain using the ERC-20 protocol.

18. Before and after the PRG tokens were distributed to investors, Paragon sought to have PRG tokens "listed" on various secondary trading platforms. Following the offering, PRG tokens were traded on multiple digital asset trading platforms.

19. Following the offering, Paragon communicated with token holders via Slack and Telegram channels, and also via e-mail. Presently, Paragon continues to communicate with investors via Telegram and e-mail.

Paragon's Plan To Create An "Ecosystem" And Take Other Steps To Control and Increase The Value Of PRG

20. Paragon offered PRG tokens in order to raise capital to build a profitable enterprise. Paragon stated that it would use the offering proceeds to establish its planned business, including the purchase of real estate for its "ParagonSpaces" business segment.

21. Paragon stated repeatedly, in the White Paper, marketing materials, internet forums and elsewhere, that it was planning to use the offering proceeds to build an "entire ecosystem" around the PRG tokens that would increase the value of the PRG tokens. In the Paragon AMA, for example, a principal of Paragon stated that Paragon, "will be using this money to build an entire ecosystem around our token that we're expecting to bring much more value to the token than what[sic] it's offered at right now." In the same forum, the principal also stated that PRG tokens were "a product that we're expecting to appreciate in value due to it[s] limited supply and the ecosystem we're building around to build a strong demand."

22. While Paragon told potential purchasers that they would be able to use PRG tokens to buy goods or services in the future after Paragon created an "ecosystem," no one was able to buy any good or service with PRG before or during the offering other than pre-ordering Paragon merchandise.

23. In the White Paper, internet forums and elsewhere, Paragon and its agents further emphasized that the company would build an "ecosystem" in a way that would cause PRG tokens to rise in value. A Paragon representative stated, in the Paragon AMA: "[p]eople are buying a token, which is a product. And the more money our company has to build an ecosystem around this token, the more valuable the token is going to be." In an e-mail exchange with a potential investor, who asked about the benefits of investing in the PRG crowdsale, a Paragon representative responded:

> It's important to understand that price of any token depends on the supply and demand. We are building an ecosystem around the tokens — online and offline that is much needed in the legal cannabis industry. We expect much more demand with more and more features and business development activities introduced on the Paragon platform.

24. Paragon and its representatives also repeatedly emphasized, in the White Paper, marketing materials and elsewhere, its built-in "deflation algorithm" which was designed to decrease supply of PRG tokens and in turn, increase the value of PRG tokens. Per the White Paper, this reduction in supply of PRG was part of "Paragon's plan to encourage PRG price stability and growth . . . ensur[ing] a growth of PRG purchasing power over time."

25. Paragon reiterated its "built-in internal deflation algorithm to decrease supply" in its marketing materials and in e-mails with potential investors. In a marketing presentation, Paragon noted:

> **Fixed number of coins in circulation**
> **Coins return to us as payments for co-working space, commissions, accumulation**
> **We release coins into circulation if needed, to keep the price at reasonable level**
> **Harboring of coin to effectuate supply, while intermittently taking proceeds to further expand the ecosystem**
> **Deflation occurs**

26. Paragon also told investors, in the White Paper and in e-mail communications, that it would "burn" tokens that were not sold by the end of the offering, which "means that at that point, instantly, all allocated coins will immediately gain value due to scarcity." Tokens "used for community self-governing and for downvoting" would also be burned, per the White Paper. Further, Paragon told investors that it would charge a "transaction" fee for "transactions within the blockchain," but that half of those fees "will be burned, decreasing the amount of coins in circulation. More adoption = less coins, more value."

27. Paragon also maintained, as part of its core business model outlined in the White Paper, a "Controlled Reserve Fund" to keep the price of PRG "stable." If the price of PRG tokens were to drop significantly, the Controlled Reserve Fund would "intervene by buying back PRG in an effort to stabilize the market price." Conversely, the Controlled Reserve Fund would "[r]elease PRG to the markets if PRG deflates too fast and pushes token prices up too rapidly."

28. Paragon also stated, in the White Paper and in communications with investors, that PRG tokens would be tradeable on secondary markets. In the White Paper, Paragon stated that, "post crowdsale, people will also be able to purchase and sell PRG on exchanges," and that it planned to "[l]ist tokens on major exchanges" by November 15, 2017. In e-mail communications with potential investors, Paragon representatives confirmed that Paragon was "expecting PRG to be listed on many major exchanges and a few big ones have already confirmed," and discussed the likely liquidity of PRG tokens on those platforms: "I can't make such promises, but based on what I see there is a lot of liquidity with most tokens that were recently sold through crowdsale."

Paragon Promoted PRG Tokens And Purchasers Had A Reasonable Expectation Of Obtaining A Future Profit

29. Paragon made statements on internet forums, blogs, e-mails and social media indicating that the PRG token offering was an opportunity to profit.

30. For example, the White Paper stated that "PRG is designed to appreciate in value as our solutions are adopted throughout the cannabis industry and around the world. Our model incentivizes PRG owners to hold their tokens as long term growth assets, in addition to spending PRG on any of our platforms." Paragon also noted in its White Paper that it wanted "to keep the value of PRG strong and growing."

31. In the White Paper and elsewhere, Paragon also touted it's "deflationary algorithm," "Controlled Reserve Fund, " and "burning" mechanism that were designed expressly to control and increase the price of PRG on the open market, and provide investors with an opportunity to profit:

> A gradual reduction in circulating supply is part of Paragon's plan to encourage PRG price stability and growth, but above all, a solid price development over time. This ensures a growth of PRG purchasing power over time. While 1,000 PRG may pay for a month's rent now, in the future, it might pay for a year's rent.

32. Paragon also highlighted the potential for profit in e-mail and online chat communications with investors. For example, when asked by a potential investor what the price of PRG would be in several months, a Paragon representative responded "[w]e cannot speculate on the future exchange prices after we are listed, though we do believe the future is very optimistic for Paragon and PRG."

33. Paragon also stated, in the White Paper and elsewhere, that PRG tokens would be listed on "major" secondary platforms following the offering. Paragon also assured potential investors of these listings in e-mail and online chat communications. For example, when asked by a potential investor how they would be able to "sell the stock" after "investing," a Paragon

representative reiterated that "PRG will be listed on the major exchanges in the mid of November."

PRG Token Purchasers Reasonably Expected They Would Profit From The Efforts Of Paragon And Its Agents

34. Paragon also made statements indicating that Paragon and its agents would expend significant efforts to develop an "ecosystem" that would increase the value of their PRG tokens.

35. Paragon highlighted the credentials, abilities and management skills of its agents and employees. For example, in the White Paper and elsewhere, Paragon highlighted that its team brought "a depth of experience across business, technology, blockchain, smart contracts, and the cannabis industry."

36. The White Paper, in fact, emphasized the direct correlation between Paragon's ability to create the planned "ecosystem" and the future value of PRG tokens. In a lengthy "Risks" section of the White Paper, Paragon noted, for example:

- "The value of, and demand for, the PRG Tokens hinges heavily on the performance of the PARAGONCOIN platform and the continuous active engagement of its users and success of its contemplated business lines . . . the development of the PARAGONCOIN platform and launch of the anticipated PARAGONCOIN future business lines may not be completed and there is no assurance that it will be launched at all. As such, distributed PRG Tokens may hold little worth or value."

- "The PARAGONCOIN platform is developed, operated, and maintained by ParagonCoin, Inc. Any events or circumstances which adversely affect ParagonCoin, Inc. or any of its successor operating entities may have a corresponding adverse effect on the PARAGONCOIN platform and any future business line. . . Such adverse effects would correspondingly have an impact on the utility, liquidity, and the trading price of the PRG tokens.

- "ParagonCoin, Inc. may be materially and adversely affected if it fails to effectively manage its operations as its business develops and evolves . . . Any adverse effects affecting ParagonCoin, Inc.'s business or technology are likely to also adversely impact the utility, liquidity, and trading price of the PRG Tokens."

- "Although the Company will use reasonable endeavors to seek the approval for availability of the PRG Tokens for trading on a cryptocurrency exchange, there is no assurance that such approval will be obtained."

37. As discussed above, Paragon stated in its White Paper and elsewhere that it would (i) distribute PRG tokens on a specified schedule, because "the distributed value and frequency of token production influence token price"; (ii) use the "Controlled Reserve Fund" to buy or sell PRG tokens to "stabilize the market price," (iii) "burn" unsold tokens and tokens spent in transaction fees to decrease supply and increase value of the PRG tokens, and that these efforts would increase

the value of PRG tokens. Purchasers would have also reasonably expected to obtain a profit from their purchase of PRG tokens based on Paragon's claimed ability to control the price of PRG, and keep it "stable."

Legal Analysis

38. Under Section 2(a)(1) of the Securities Act, a security includes "an investment contract." *See* 15 U.S.C. § 77b. An investment contract is an investment of money in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. *See SEC v. Edwards*, 540 U.S. 389, 393 (2004); *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946); *see also United Housing Found., Inc. v. Forman*, 421 U.S. 837, 852-53 (1975) (The "touchstone" of an investment contract "is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."). This definition 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." *Howey*, 328 U.S. at 299 (emphasis added). The test "permits the fulfillment of the statutory purpose of compelling full and fair disclosure relative to the issuance of 'the many types of instruments that in our commercial world fall within the ordinary concept of a security.'" *Id.* In analyzing whether something is a security, "form should be disregarded for substance," *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967), "and the emphasis should be on economic realities underlying a transaction, and not on the name appended thereto." *Forman*, 421 U.S. at 849.

39. As the Commission discussed in the DAO Report, tokens, coins or other digital assets issued on a blockchain may be offerings of securities under the federal securities laws, and, if they are, issuers and others who offer or sell these securities in the United States must register the offering with the Commission or qualify for an exemption from registration.

A. The PRG Token Offering Was an Offering of Securities

40. The offering was an offer and sale of "securities" as defined by Section 2(a)(1) of the Securities Act because it constituted the offer and sale of investment contracts.

41. Paragon offered and sold PRG tokens in a general solicitation that included investors in the United States. Investors purchased their PRG tokens in exchange for other digital assets. Such investment is the type of contribution of value that can create an investment contract. *See* DAO Report; *In re Munchee Inc.*, Securities Act Release No. 10445 (December 11, 2017).

42. PRG token purchasers had a reasonable expectation of profits from their investment in the Paragon enterprise. Purchasers had a reasonable expectation that they would obtain a future profit from buying PRG tokens if Paragon were successful in its entrepreneurial and managerial efforts to develop its business. Paragon primed purchasers' reasonable expectations of profit through statements on internet forums, blogs, e-mails and social media. The proceeds of the PRG token offering were intended to be used by Paragon to build an "ecosystem" that would create demand for PRG tokens and make PRG tokens more valuable. Paragon stated its plans to build the "ecosystem" around PRG tokens, including all 5 of its planned business segments, purchase and renovate real estate for ParagonSpaces, pursue the listing of PRG on secondary trading platforms,

"develop[], operate[] and maintain[]" the Coin Paragon platform, control and increase the value of PRG tokens through its deflation algorithm, Controlled Reserve Fund and token "burning," among other things. The investors reasonably expected they would profit from any rise in the value of PRG tokens created by these efforts. In addition, Paragon highlighted that it would ensure a secondary trading market for PRG tokens would be available shortly after the completion of the offering and prior to the creation of the "ecosystem."

43. Investors' profits were to be derived from the significant entrepreneurial and managerial efforts of others – specifically Paragon and its agents – who were to create the "ecosystem" that would increase the value of PRG (through both an increased demand for PRG tokens by users and Paragon's specific efforts to cause appreciation in value, such as by utilizing the Controlled Reserve Fund, the deflationary algorithm, and burning PRG tokens), and support secondary markets.

44. Investors' expectations were primed by Paragon's marketing of the PRG token offering. To market the offering, Paragon and its agents created the Paragon Web Pages and the White Paper and then posted on message boards, blogs, social media and other outlets. They described how Paragon would build an "ecosystem" that would create demand and increase value for PRG tokens. Because of the conduct and marketing materials of Paragon and its agents, investors would have had a reasonable belief that Paragon and its agents could be relied on to provide the significant entrepreneurial and managerial efforts required to make PRG tokens a success.

B. Paragon Offered And Sold PRG Tokens In Violation Of The Securities Act

45. As described above, Paragon offered and sold securities to the general public, including investors in the United States. No registration statements were filed or in effect for the PRG token offers and sales and the offering did not qualify for any exemption from registration.

46. As a result of the conduct described above, Paragon violated Section 5(a) of the Securities Act, which states that unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

47. Also as a result of the conduct described above, Paragon violated Section 5(c) of the Securities Act, which states that it shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security.

Paragon's Remedial Actions

48. In determining to accept the Offer, and to not impose greater civil penalties, the Commission considered remedial acts undertaken by Respondent and cooperation afforded the

Commission staff.

Undertakings

Respondent makes the following undertakings:

49. Within fourteen (14) days from the date of this Order, Respondent will issue a press release, in a form not objected to by Commission staff, notifying the public of this Order, containing a link to the Order, and containing a link to the "Claim Form" (as defined in Paragraph 50.b. below). The press release, among other things, will also notify the public that Respondent will "Distribute" (as defined in Paragraph 50.b. below) the Claim Form on the "Effective Date" (as defined in Paragraph 50.b. below). At the same time, Respondent will prominently post the press release, link to the Order, and Claim Form on Paragon's company website and maintain it there until the "Claim Form Deadline" (as defined in Paragraph 50.b. below).

50. Within 90 days of the date of this Order, Respondent will:

a. File a Form 10 to register under Section 12(g) of the Securities Exchange Act of 1934 ("the 1934 Act Registration") the PRG tokens as a class of securities;

b. On a date no later than sixty (60) calendar days after the date of the filing of the 1934 Act Registration, or on the date of the 1934 Act Registration becomes effective, whichever date is sooner (the earlier date being the "Effective Date") distribute by electronic means reasonably designed to notify each potential claimant ("Distribute"), a notice and a claim form (the "Claim Form"), both of which shall be in a form not objected to by Commission staff, informing all persons and entities that purchased PRG tokens from Respondent before and including October 15, 2017, of their potential claims under Section 12(a) of the Securities Act, including the right to sue "to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if [the purchaser] no longer owns the security" and informing purchasers that they may submit a written claim on the Claim Form directly to Respondent at an address indicated on the Claim Form of a purchaser's assertion of rights under Section 12(a) of the Securities Act, and that such claims must be submitted within three (3) months from the Effective Date ("Claim Form Deadline"); and

c. Maintain such 1934 Act Registration and make timely filings of all reports required by Section 13(a) of the Securities Exchange Act of 1934 for at least one year from the Effective Date of the 1934 Act Registration and until such time as Respondent is eligible to terminate its registration pursuant to Rule 12g-4 under the Securities Exchange Act of 1934.

51. Respondent will pay the amount due under Section 12(a) of the Securities Act to

any person or entity that purchased PRG tokens from Respondent before and including October 15, 2017, and that submitted a written claim to Respondent by the Claim Form Deadline using the Claim Form. Within three (3) months from the Claim Form Deadline, Respondent will make all payments due to purchasers who submitted the Claim Form by the Claim Form Deadline. Respondent may require that a claimant submit documentation supporting that the claimant is entitled to receive payment under Section 12(a) of the Securities Act and paragraph 50.b above. For any claims not paid, Respondent will provide the claimant with a written explanation of the reason for non-payment.

52. Respondent will submit to Commission staff a monthly report of the claims received and the claims paid under paragraph 51 above, including (a) identifying information about each claimant; (b) the amount of each claim; (c) the resolution of each claim, including the amount of each payment; (d) identification of all claims not paid and the reasons for all non-payment of claims; and (e) a list of all complaints received and how Respondent addressed each complaint. Respondent will provide Commission staff with any related additional information or documentation reasonably requested by Commission staff, such as documentation submitted by the claimant and documentation supporting Respondent's decision regarding the claim. In response to any objections by Commission staff to Respondent's handling of one or more claims, Respondent will reconsider its decision(s) in light of the objection and will provide a written explanation to Commission staff of its decision following reconsideration.

53. Within seven (7) months from the Effective Date, Respondent will submit to Commission staff a final report of its handling of all claims received under Paragraph 51 above, including all information listed in paragraph 52 above.

54. Respondent will certify, in writing, compliance with the undertakings set forth above within thirty (30) days of their completion. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Robert A. Cohen, Chief, Cyber Unit, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549, or such other person or address as the Commission staff may provide, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

55. Respondent will retain all records and communications relating to the Paragon offering for a period of at least one year after the date it submits the certification of compliance as described in Paragraph 54, above, or until such time as otherwise required by law.

56. Respondent may apply to Commission staff for an extension of the deadlines described above before their expiration and, upon a showing of good cause by Respondent, Commission staff may, in its sole discretion, grant such extensions for whatever time period it deems appropriate.

57. In determining whether to accept the Offer, the Commission has considered these undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act, Respondent cease and desist from committing or causing any violations and any future violations of Section 5(a) and (c) of the Securities Act.

B. Respondent shall pay a civil money penalty in the amount of $250,000.00 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). Payment shall be made in the following installments:

1. Within thirty (30) days of the entry of this Order, Respondent will pay $100,000.

2. Within one hundred and twenty (120) days of the entry of this Order, Respondent will pay $75,000.

3. Within two hundred and forty (240) days of the entry of this Order, Respondent will pay $75,000.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of the civil penalty, plus any additional interest accrued pursuant to 31 U.S.C. 3717 shall be due and payable immediately, without further application.

Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying

Paragon as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Robert A. Cohen, Chief, Cyber Unit, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549, or such other person or address as the Commission staff may provide.

C. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary