Republic of the Philippines
Department of Finance
Securities and Exchange Commission
PICC Secretariat Building, PICC Complex, Pasay City

In re: BLACK CELL TECHNOLOGY, INC.,
BLACK SANDS CAPITAL, INC.,
BLACK CELL TECHNOLOGY LIMITED,
and KROPS

SEC CDO Case No. 01-18-046

ENFORCEMENT AND INVESTOR PROTECTION DEPARTMENT (EIPD),
Movant.

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RESOLUTION

This resolves the *Urgent Motion to Lift CDO* filed by BLACK CELL TECHNOLOGY, INC. ("BLACK CELL PH"), **BLACK SANDS CAPITAL, INC., BLACK CELL TECHNOLOGY LIMITED** ("BLACK CELL HK"), **and KROPS** (collectively "respondents") and the *Comment/Opposition on the Urgent Motion to Lift CDO* filed by the Commission's **ENFORCEMENT AND INVESTOR PROTECTION DEPARTMENT** ("EIPD").

FACTS

On **11 January 2018**, the Commission's Enforcement and Investor Protection Department (EIPD) filed a *Motion for Issuance of Cease and Desist Order* against **(1) BLACK CELL TECHNOLOGY, INC., (2) BLACK SANDS CAPITAL, INC., (3) BLACK CELL TECHNOLOGY LIMITED,** and **(4) KROPS.**

On **23 January 2018**, the Commission En Banc issued a *Cease and Desist Order* ("**CDO**") against **(1) BLACK CELL TECHNOLOGY, INC., (2) BLACK SANDS CAPITAL, INC., (3) BLACK CELL TECHNOLOGY LIMITED,** and **(4) KROPS** for *"engaging in activities of selling and/or offering for sale securities in the form of **KROPS Tokens and/or KropCoins** or any others of the same nature."* The CDO expressly stated that: "In accordance with the provisions of Sec. 64.3 of SRC and Sec. 4-3[1] of the 2016 Rules of Procedure of the Commission, the parties subject of this *Cease and Desist Order* may file a request for the lifting thereof **within five (5) days from receipt** hereof."

On **25 January 2018**, the CDO was served on the respondents.

On **30 January 2018**, respondents filed an ***Urgent Motion to Lift CDO*** with the EIPD. Respondents did not file any motion with the En Banc.

On **5 February 2018**, respondents' ***Urgent Motion to Lift CDO*** was formally transmitted by the EIPD to the En Banc via the Office of the General Counsel.

Also on **5 February 2018**, the Commission En Banc issued an **Order** directing the EIPD to file its **Comment** on the *Urgent Motion to Lift CDO* within **five (5)** days.

On **12 February 2018**, the EIPD filed its **Comment/Opposition** on the Urgent Motion to Lift.

On **13 February 2018**, the En Banc issued an **Order to Appear** at a Hearing at the Office of the General Counsel, SEC on 22 February 2018 to simplify the issues raised in respondents' *Urgent Motion to Lift CDO* and in EIPD's Comment/Opposition.

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[1] *See* **Part II, Rule IV. Cease and Desist Orders and Injunctions**, 2016 SEC Rules of Procedure.

On **22 February 2018**, from **2:00 to 4:00 PM**, a Hearing was held on the Urgent Motion to Lift and the Comment/Opposition. [2]

On **23 February 2018**, the Hearing was formally terminated and the matter was submitted to the En Banc for Resolution via an **Order**.

DISCUSSION

I. CDO states that Krop Tokens and/or KropCoins are Securities

Briefly, the CDO dated 23 January 2018 was issued by the En Banc because the Krop Tokens and/or KropCoins satisfy the definition of "securities" in **Section 3.1 of the Securities Regulation Code (SRC)** and the **4 elements of the Howey Test**,[3] used to evaluate "investment contracts," which are considered a type of securities, viz:

> Securities are defined in **Section 3.1 of the SRC**, viz:
>
> > **Section 3. Definition of terms.** –
> > **3.1 "Securities** are shares, participation or interests in a corporation or in a commercial enterprise or profit making venture and evidenced by a certificate, contract, instrument, whether written or electronic in character.
>
> Furthermore, **Section 3.1(g) of the SRC** contains **reserved power** conferred upon the Commission by the legislature to address future contingencies and circumstances, considering that the securities space is a fast evolving sphere and scammers are becoming more and more sophisticated and elaborate in their nefarious schemes, viz:
>
> > Other instruments as may in the future be determined by the Commission.
>
> Here, the **securities** are the **KROPS Tokens and/or KropCoins**, which are *interests* in a *profit-making venture* (KROPS), evidenced by *instruments* in *electronic form*.
>
> Moreover, the **KROPS Tokens and/or KropCoins** satisfy the four (4) elements of the ***Howey Test*** as laid down in the case of Power Homes Unlimited Corporation v. SEC,[4] viz:
>
> **(1) Investment of Money –**
> Respondents claim that the KROPS Tokens and/or KropCoins are being sold at **US$0.70/token Pre-Sale Price** (at 30% discount from the regular price of US$1.00/token). "Money" in the ***Howey Test*** refers to any ***valuable consideration***, as was highlighted in the Decentralized Autonomous Organization (DAO) Report of the U.S. SEC dated July 25, 2017.
>
> **(2) Common Enterprise –**
> Respondents state that KROPS as a technology-based "startup company" described as "a trailblazing agricultural hub that brings together sellers and buyers of the Philippines' agricultural products and eventually and potentially that of the whole world." The so-called "company" is not a registered corporation. Rather, it may be treated as an unincorporated ***profit-making venture***. It is evident from the alleged **"2,347,985.225461 tokens sold"** that there are multiple investors.
>
> **(3) Expectation of Profit –**
> Respondents claim that "KROPS' primary **value driver** is its market share or the value of its transactions it can capture on its marketplace.

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[2] Respondents were represented (A) by legal counsel, Chavez Miranda Aseoche Law Offices, in the persons of (1) Atty. Francisco C. Laiz III, (2) Atty. Don Carlo Ybanez, and (3) Atty. Luis Angel G. Aseoche,; as well as (B) by Mr. Joseph Calata.[2] On the other hand, EIPD was represented by Dir. Jose P. Aquino, Asst. Dir. Oliver O. Leonardo, Atty. Eretztrel B. Valle, and Mr. Bryant Symonds B. Chang.

[3] Power Homes Unlimited Corporation v. SEC, G.R. No. 164182, 26 February 2008.

[4] Id.

This will be highly dependent on the extent to which it can establish the active user base and promote repeat transactions." Investors are led to expect that their investment in KROPS Tokens and/or KropCoins will appreciate.

(4) Primarily from the Efforts of Others –
The increase in value of the KROPS Tokens and/or KropCoins, and even the KROPS profit-making venture as a whole, does not depend primarily on the efforts of the investor. Investors need not participate in the envisioned agricultural marketplace, e.g. as buyer or seller.

Incidentally, the Supreme Court has stated that:

> [I]n case of **laws patterned after or adopted from those of the United States**, decisions of United States courts construing similar laws are entitled to great weight.[5]

In this light, the ***Howey Test***—which has been used extensively to identify whether various investment contracts are securities—was recently used by the U.S. SEC to determine that an **Initial Coin Offering (ICO)**[6] was an offering of securities,[7] viz:

> Determining whether a transaction involves a security does not turn on labelling xxx but instead requires an assessment of "the ***economic realities*** underlying a transaction."[8]

II. Issues raised in *Urgent Motion to Lift* vis-à-vis *Comment/Opposition*

Respondents argue in their *Urgent Motion to Lift* that—

(1) KROPS is a <u>software application</u> owned and maintained by Black Cell HK.[9]

"The laws of the Philippines only give the Commission jurisdiction over juridical persons that are in the Philippines. As aforementioned, Black Cell HK is not a domestic corporation."[10]

(2) The Krops Tokens <u>are not securities</u>[11]

"According to the "How[ey] Test," a contract is considered a security if it has the four following features: (a) There is an investment of money; (b) The investment is for a common enterprise; (c) The investment is done in expectation of a profit; and **(d) The said profit will be made primarily out of the effort of others.**[12] [Emphasis supplied]

"The fourth element is absent in the case at bar xxx

"Respectfully, oppositors submit that the Commission erred in this regard. KropCoins are the primary **medium of exchange** for the Krops ecosystem. A holder of the KropCoins may use the token to purchase commodities within the ecosystem. A registered seller may then accept KropCoins as mode of payment. Its value then is not determined solely by the value of the shares of Black Cell HK. **The market forces that control the value of the commodities being traded on the Krops platform may also dictate the value of the KropCoins.** This shows that the profits expected to be earned are not primarily from the efforts of others but by the *use* of the KropCoins and not merely holding KropCoins.[13] [Emphasis supplied]

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[5] Rafael A. Morales, <u>The Philippine Securities Regulation Code Annotated</u> (2005), p. 356 (citing **CAROLINA INDUSTRIES, INC. vs. CMS STOCK BROKERAGE, INC.**, G.R. No. L-46908, May 17, 1980).
[6] As defined by INVESTOPEDIA: "*Initial Coin Offering (ICO)* – an unregulated means by which funds are raised for a new cryptocurrency venture. An Initial Coin Offering (ICO) is used by startups to bypass the rigorous and regulated capital-raising process required by venture capitalists or banks. In an ICO campaign, a percentage of the cryptocurrency is sold to early backers of the project in exchange for legal tender or other cryptocurrencies." <u>https://www.investopedia.com/terms/i/initial-coin-offering-ico.asp</u>
[7] *See* <u>In the matter of Munchee Inc.</u>, Administrative Proceeding of the U.S. Securities and Exchange Commission, December 11, 2017.
[8] Id.
[9] Page 2 of *Urgent Motion to Lift CDO.*
[10] Id.
[11] Page 3 of *Urgent Motion to Lift CDO.*
[12] Id.
[13] Id.

"This matter is further bolstered by the fact that a holder of a KropCoin is not automatically entitled to a share in Black Cell HK."[14]

"This is in line with the **recent ruling of the United States Securities and Exchange Commission regarding the application of the Howey Test to the Initial Coins Offering of Bytom.** Last 27 October 2017, it was announced that Bytom was the first Non-Securities Public Blockchain Project in the USA. **According to the news reports, Bytom was not a security because 'it is evident that expected profits are gained from the use of BTM and not merely by holding BTM.'** This is similar to the instant case. The profits to be gained are not primarily from the mere holding of the Token by by its *use*."[15] [Emphasis supplied]

(3) Black Cell HK is conducting a "global offering" of its KropCoin Tokens.[16]

"The Commission, in its CDO, stated that the fact that **the sale of the tokens is accessible to people in the Philippines** tend to show that the sale is being made inside the country xxx [Emphasis supplied]

"To date, multiple ICOs are accessible by potential buyers in the Philippines xxx If the laws of a particular country prohibit the conduct of a coin offering, [and] a disclaimer similar to the one done by Black Cell HK for Krops Tokens is made part of the white paper, can it still be said that these ICOs are done in the Philippines?"[17]

"Verily, the offering is not an offering in the Philippines. To be clear, it is a global offering available to all purchasers from all parts of the globe, subject to the jurisdictional regulation on a per country basis. Hence, although the issuer is a Hong Kong company, the sale being done in Hong Kong SAR, would likewise be **available to all other countries, including the Philippines.** In other words, the mere fact that **the website of Black Cell HK is accessible to the Philippines** does not, by itself, mean that the Krops tokens are being "sold" here in the Philippines."[18] [Emphasis supplied]

Meanwhile, EIPD argues in their *Comment/Opposition* that—

(1) Respondents' White Paper as published on its website publicly refers to and presents KROPS as a start-up company.[19]

"As a matter of fact, the representations made by the respondents in their own white paper that KROPS is a start-up company belie their foregoing claims. As appearing in their white paper, respondents made the following representations:

> 'KROPS, a **start-up company**, is a mobile application that is owned by Black Cell Technology Limited.'

"The [CDO] does not restrain BLACK CELL HK from owning and maintaining KROPS as an application. What the [CDO] restrains is the act of publicly offering and selling securities in the Philippines through an Initial Coin Offering of Kropcoins. The Initial Coin Offering is quite obviously intended to raise the necessary funds for the establishment of **an agricultural hub called KROPS which is publicly presented and referred to in the Black Cell White Paper as a start-up company."** [20] [Emphasis supplied]

"The totality of the claims made by respondents in the White Paper constitutes a clear conclusion that indeed KROPS, without discussing its nature as a mobile application, is likewise **an unregistered start-up company.**" [21]

(2) The tokenized shares referred to as KROPCOINS which are being publicly offered and sold by respondents are securities.[22]

"Respondents argue that Kropcoins are not securities by declaring that the profits do not arise primarily from the efforts of others but through the *use* of the Kropcoins. The

[14] Id.
[15] Page 4 of *Urgent Motion to Lift CDO.*
[16] Id.
[17] Id.
[18] Page 5 of *Urgent Motion to Lift CDO.*
[19] Page 3 of *Comment/Opposition.*
[20] Id
[21] Page 4 of *Comment/Opposition.*
[22] Id.

argument assumes that the Kropcoins are already in use as a medium of exchange which is obviously contrary to the representations made in the White Paper.

"Respondents have publicly declared in their White Paper published online that this is KROPS' initial coins offering (ICO) and that there is **no market that exists for KROPS tokens.** The argument that Kropcoins are not securities because they are used as a medium of exchange is thus clearly misplaced.[23] [Emphasis supplied]

"The White Paper similarly refers to the tokenized shares being publicly offered by respondents as crypto equity. It cannot be denied that **the advertised agricultural hub will be run by the Company and that the expected profits from owning Kropcoins as shares will come from the efforts of the Company** in what it claims to be a block chain technology based company. Kropcoins which are aptly referred to by respondents as tokenized shares or crypto equity are definitely securities."[24] [Emphasis supplied]

(a) The claim regarding the <u>ruling</u> of the US SEC on the application of the Howey Test to the ICO of Bytom <u>is false</u>.

"Respondents, in a desperate attempt to mislead the Commission **falsely cited** in its Urgent Motion "a recent ruling of the US Securities and Exchange Commission regarding the application of the Howey Test to the Initial Coin Offering of Bytom xxx

"The alleged '[US] SEC Decision' being cited is **merely a news item authored by Bytom** about an alleged 'Howey Test' report xxx released by a US San Francisco law firm. The **actual news item is copied** herein as follows xxx[25]

"If at all, **the '[US] SEC Decision' being cited was the mere opinion of a San Francisco law firm by the name of Velton Zelegman PC.** The theory subscribed to by respondents does not even count as a persuasive source of doctrine being a mere opinion of a single law firm. To dress this opinion as a '[US] SEC Decision' constitutes a patent deceit on the part of respondents xxx"[26]

(3) Respondents admit they are publicly offering and selling Kropcoins <u>in the Philippines.</u>

"Respondents argue that the offering of KropCoins is not limited to the Philippines, but is offered to the whole world xxx

"This is evidently an admission of the fact that the public offering and selling of Kropcoins is being done in the Philippines.

"We could not agree more. In fact, we fully subscribe to the contention that the offer was made to the whole world, **including the Philippines**. As such, in effect, respondents admit liability under the SRC as correctly found by the Commission xxx"[27]

(a) The illegal public offering and selling of securities through an ICO of Kropcoins is evidently a joint undertaking and collaborative effort of respondents.

"[Black Cell PH] is headed by its President, Joseph Calata, who at the same time is Founder of KROPS which is presented both as a software application and **a** start-up company owned by [Black Cell HK]. This shows that [Black Cell PH], KROPS, and [BLACK CELL HK] are **all identified with and under the leadership or control of Joseph Calata.**"[28] [Emphasis supplied]

"In the attempt of respondents to treat [Black Cell HK] as a separate entity from [Black Cell PH] and KROPS by having it registered in Hongkong is an indication that **the veil of corporate fiction is being used to commit a violation** of the [SRC]."[29] [Emphasis supplied]

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[23] Page 5 of *Comment/Opposition.*
[24] Id.
[25] Pages 7-8 of *Comment/Opposition.*
[26] Page 10 of *Comment/Opposition.*
[27] Page 5 of the *Comment/Opposition.*
[28] Page 4 of the *Comment/Opposition.*
[29] Id.

III. Hearing on Urgent Motion to Lift and Comment/Opposition

The issues raised and admissions made during the Hearing on 22 February 2018 was summarized in the En Banc's **Order dated 23 February 2018**, viz:

> The Hearing focused on **two main issues**: (1) whether the Krop Tokens and/or Krop Coins may be considered "securities" under Section 3.1 of the SRC and the Howey Test; and (2) *assuming arguendo* that these are securities, whether these are subject to registration in the Philippines and thus within the jurisdiction of the Commission.
>
> Respondents argued that: (1) the Krop Tokens and/or Krop Coins are not securities because they do not satisfy the 4th Element of the Howey Test ("primarily from the efforts of others") because their value depends on the ***use*** by the owner himself, not other people; and (2) that these are not subject to registration because the issuer is a ***foreign entity***.
>
> EIPD argued that: (1) the Krop Tokens and/or Krop Coins satisfy the 4th element because these appreciate in value as an ***investment*** based on market forces independent of the owner; and (2) that these are subject to registration because the Commission may regulate public offering or sale of securities ***"within" the Philippines***, even if the issuer is a foreign entity, and such public offering is deemed to occur within the Philippines if the sale can be availed of through the internet by a buyer in the Philippines.
>
> The record of the Hearing contains **admissions** made by Mr. Joseph Calata, despite being repeatedly advised to speak only through legal counsel, that (a) he is the majority owner of Black Cell HK, and (b) that the ICO, even if initiated by a foreign entity, may be accessed via the internet by prospective buyers here in the Philippines.

It was also established at the Hearing that the Bytom "Howey Test" relied upon by respondents was indeed merely the opinion of the law firm Velton Zelegmen PC. Upon being shown the quoted article by EIPD, counsel for respondents affirmed that they read the same article, but were unable to demonstrate that the source was indeed a "ruling" of the [US] SEC.

IV. Conclusion

The Krop Tokens and/or KropCoins are unregistered **securities** that are being offered and/or **sold within** the Philippines through the joint efforts of respondents.

Krop Tokens and/or KropCoins satisfy the 4th element of the *Howey Test*

The CDO states that Krop Tokens and/or Krop Coins satisfy the description of "securities" in Section 3.1 of the SRC as well as the 4 elements of the *Howey Test*. The terms "commercial enterprise or profit-making venture" (Section 3.1) as well as "common enterprise" (Howey Test) are descriptive of KROPS, an unincorporated "**start-up company**" as shown by respondents' own admission in the White Paper.

Respondents' argue that Krop Tokens and/or KropCoins do not satisfy the 4th element of the *Howey Test* (*i.e.* [increase in value] primarily from the efforts of others), because they increase in value primarily because of *use* by the owner himself and not primarily because of the efforts of other persons.

Meanwhile, EIPD argues that **market forces independent of the owner**, i.e. the **efforts of others**, are primarily responsible for changes in the value of the Krop Token and/or KropCoins. EIPD adds that Black Cell HK would be primarily responsible for increase in value of the Krop Tokens and/or KropCoin, viz:

> It cannot be denied that **the advertised agricultural hub [KROPS] will be run by the Company [Black Cell HK] and that the expected**

> **profits from owning Kropcoins as shares will come from the efforts of the Company [Black Cell HK]** xxx[30] (Emphasis supplied)

The Krop Tokens and/or Krop Coins will increase in value if the agricultural hub (KROPS) succeeds due to the efforts of Black Cell HK and market participants. Respondents admit this when they stated that: "**The market forces that control the value of the commodities being traded on the Krops platform may also dictate the value of the KropCoins.**"[31]

Therefore, the disputed 4th element of the *Howey Test* is satisfied and consequently the Krop Tokens and/or KropCoins may be considered securities.

Krop Tokens and/or KropCoins are being offered and/or sold within the Philippines through the joint efforts of respondents

Respondents and EIPD agree that the offering is made to the whole world, including the Philippines. They also agree that even though offer was initiated by a Hong Kong company, it is accessible via the internet to buyers in the Philippines, viz:

> Respondents: "To be clear, it is a global offering available to all purchasers from all parts of the globe, subject to the jurisdictional regulation on a per country basis. Hence, although the issuer is a Hong Kong company, the sale being done in Hong Kong SAR, would likewise be **available to all other countries, including the Philippines.**"[32]
>
> EIPD: "[W]e fully subscribe to the contention that the offer was made to the whole world, **including the Philippines.**"[33]

Rule 3.1.17 of the 2015 Implementing Rules of the SRC provides that a "public offering" may by made via "*announcement on xxx electronic communications [or] information technology.*" In this light, we interpret internet access by a buyer in the Philippines to the offer/sale of unregistered securities which may have been initiated abroad as an offer/sale "within the Philippines."

Where the corporate shield is used to evade an obligation, such as *registration of securities* under the SRC, the corporate veil may be pierced, and the respondents may be treated as just an aggregate of individuals.[34] Respondents are acting in concert, viz: two domestic corporations, parent [Black Sands] and subsidiary [Black Cell PH], are affiliated through common ownership with a foreign juridical entity [Black Cell HK] which is selling securities in the Philippines, in the form of interests in an unincorporated profit-making venture [KROPS]. These are all owned and controlled[35] by the same Joseph Calata. Respondents are attempting to evade an obligation to register with the Commission by claiming that the ICO is the sole act of Black Cell HK. Piercing the corporate veil is thus proper and the Respondents may all be held liable.

Therefore, by their own admission, respondents are offering unregistered securities for sale "within" the Philippines.

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[30] Page 5 of the *Comment/Opposition.*
[31] Page 3 of *Urgent Motion to Lift CDO.*
[32] Page 5 of the *Urgent Motion to Lift CDO.*
[33] Page 5 of the *Comment/Opposition.*
[34] Villanueva and Tiansay, Philippine Corporate Law (2013), at 108-109 (citing Villa Rey Transit, Inc. v. Ferrer, 25 SCRA 845 [1968]).
[35] Simultaneously (1) the Majority Owner of Black Cell HK, (2) the Director/President of Black Cell PH, (3) the Director/President of Black Sands, and (4) the Founder of KROPS (an unincorporated "start-up company").

WHEREFORE, premises considered, the respondents' *Urgent Motion to Lift CDO* is hereby **DENIED**. The CDO dated 23 January 2018 is declared **PERMANENT**.

SO ORDERED.

Pasay City, Philippines; 2 March 2018.

TERESITA J. HERBOSA
Chairperson

ANTONIETA F. IBE*
Commissioner

EPHYRO LUIS B. AMATONG
Commissioner

BLAS JAMES G. VITERBO**
Commissioner

EMILIO B. AQUINO
Commissioner

*On leave
**Resigned effective February 21, 2018