

GUAPCOIN LEGAL OPINION

From: Jason M. Lamb, Attorney at Law*

Date: June 21, 2020

RE: Whether Guapcoin Is a Security under U.S. Securities Law**

WHETHER GUAPCOIN IS A SECURITY UNDER U.S. SECURITIES LAW

Introduction and Background

Before proceeding with the legal analysis of Guapcoin, it is important to first introduce the different cryptocurrencies that exist and how the cryptocurrency industry has evolved over time.

Classic cryptocurrencies, such as Bitcoin, have features that mirror that of traditional money because they act as a unit of account, a store of value and a medium of exchange. Money functions as a unit of account if it is a standard numerical unit of measurement of the market value of goods, services, and other transactions, and it is a) divisible into smaller units without loss of value, b) fungible (meaning one unit or piece must be perceived as equivalent to any other), and c) a specific weight or size to be verifiably countable. Money acts as a store of value if it can be reliably saved, stored, and retrieved, and if its value remains stable over time. Money acts as a medium of exchange if it can be used to intermediate the exchange of goods and services.

Cryptocurrencies share many of these characteristics but are digital and virtual in nature. The key innovative feature of Bitcoin was that it was the first decentralized currency powered by open public ledger technology that recorded and validated all transactions through public-key cryptography, called the Blockchain¹.

As Bitcoin matured and began to gain users, other categories of cryptocurrency were created including tokens and so-called alternative cryptocurrency coins (“altcoins”). Altcoins are cryptocurrencies are independent blockchain based coins that aim to be an alternative to Bitcoin, and which are usually built based on the foundation of its open-sourced protocol and code (typically differing in underlying code and in key features). A token is often a representation of a particular asset, which is fungible and tradeable, and resides on top of an existing blockchain. The key difference between cryptocurrencies and tokens is that with tokens there is no need to create or modify any underlying code, since tokens are created on top of an existing blockchain platform (such as Ethereum and its ERC-20 tokens) and are

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** The legal opinions contained herein are based on i) U.S. Securities Law as of the date of this letter, ii) on guidance published by the U.S. Securities and Exchange Commission regarding the interpretation and application of U.S. Securities Laws as of the date of this letter, and iii) on facts regarding the structure, configuration and features of the Guapcoin network as described and presented in the Guapcoin wallet applications, documentation and open source code publicly accessible and published at <https://github.com/guapcrypto/Guapcoin> and at <https://www.guapcoin.org/> as of the date of this letter.

¹ Blockchain Explained, Investopedia, <https://www.investopedia.com/terms/b/blockchain.asp> (last modified Feb 1, 2020).

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powered by smart contracts. The main differentiating factor between a cryptocurrency and token can be narrowed down to whether the coin in question is intended to act as a separate currency with its own separate blockchain, or whether it was created on top of an already existing blockchain platform.

Another crucial differentiating factor between tokens and cryptocurrencies is that the creation of tokens are centralized (meaning a single central entity creates and offers the tokens to the public) while cryptocurrencies are decentralized in nature and are the consequence of mining (for proof of work coins like bitcoin) or minting (for proof of stake coins like Dash, PIVX, Guapcoin etc.), therefore cryptocurrencies are much less likely to be influenced by a central controlling body the way that tokens are and are largely subject to market forces.

Guapcoin's Design

Based on the criteria laid above Guapcoin falls under the definition of a cryptocurrency because it was designed to act as an alternative cryptocurrency asset, on its own blockchain platform, with innovative features based on Bitcoin's open source code. Guapcoin is as a decentralized open-source cryptocurrency that can be used by anyone, and its decentralized nature greatly minimizes the influence of any single individual or body of individuals on the cryptocurrency as a whole. Like Bitcoin, Guapcoin is a decentralized cryptocurrency controlled by market forces. Due to the fact that the codebase of Guapcoin is open-sourced, all users are equal in the ability to create any services or applications in with which this cryptocurrency will be used, and all user are equal in the ability to obtain Guapcoins either via an exchange or through minting.

US SECURITIES LAWS AND REGULATIONS

Background

By way of a background, the U.S. Securities and Exchange Commission ("SEC") has a three-part mission: 1) protection of investors, 2) maintenance of fair, orderly and efficient markets and 3) facilitation of capital formation². In order to implement its mission, the SEC has broad authority in the regulation of securities as defined under federal securities law. The term "security" includes an "investment contract," as well as other instruments such as stocks, bonds, and transferable shares.

Some tokens and cryptocurrencies have been deemed securities by the SEC and made subject to SEC regulatory action. On 25 July 2017, the SEC issued an investigative report concluding that DAO tokens were, in fact, securities³. The DAO was designed to be a decentralized autonomous venture fund, and the SEC concluded that DAO tokens were securities that are subject to SEC jurisdiction and regulation because the enterprise was essentially a pooled investment vehicle. The primary reason being the nature of the DAO token that gave investors a right to vote on the projects that should be funded, receive profits from those projects as a return on their investments, and that the token itself had no function outside of this investment function.

² What We Do, U.S. Securities and Exchange Commission, <https://www.sec.gov/Article/whatwedo.html#:~:text=The%20mission%20of%20the%20U.S.,markets%2C%20and%20facilitate%20capital%20formation> (last modified June 10, 2013).

³ The DAO Report, <https://www.sec.gov/news/press-release/2017-131>.

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Under U.S. Securities Law⁴ the SEC has the authority to regulate the transactions that relate to an investment instrument, but not necessarily the investment instrument itself. The existence of a security does not run afoul of SEC regulations per se, but the offering and distribution of those securities to the public is what the SEC is tasked to monitor and regulate. It is therefore crucial to analyze whether a transaction may involve a security by way of applying the Howey Test⁵ described below. If under the Howey Test a transaction or offering has been deemed to be an offering or transaction of securities, then that offering and/or transaction must be registered, or fall under one of the available securities exemptions. Registration, in turn, entails disclosure of certain information including description of the security being offered and information about the offering company's management, all with the goal of protecting the public from fraudulent investment opportunities with insufficient information available.

The SEC in 2019 published its "Framework for "Investment Contract" Analysis of Digital Assets"⁶ in which it stated that "engaging in the offer, sale, or distribution of a digital asset[s]" may be governed and regulated by U.S. federal securities laws and that a "threshold issue is whether the digital asset is a "security" under those laws." In other words, if the threshold inquiry of whether a digital asset is a security is found to not be true, then the analysis is concluded and the offering does not fall under SEC regulation. In its framework the SEC gives guidance as to how to apply the Howey Test, which we will follow below.

Is Guapcoin a Security?

In the context of cryptocurrencies, initial coin offerings (ICO), and initial exchange offerings (IEO), the relevant test applied by the U.S. Courts is the Howey Test. The SEC's framework states that "[t]he U.S. Supreme Court's Howey case and subsequent case law have found that an "investment contract" exists when there is the investment of money in a common enterprise with a reasonable expectation of profits to be derived from the efforts of others." It further states that "[t]he so-called "Howey test" applies to any contract, scheme, or transaction, regardless of whether it has any of the characteristics of typical securities" and "[t]he focus of the Howey analysis is not only on the form and terms of the instrument itself (in this case, the digital asset) but also on the circumstances surrounding the digital asset and the manner in which it is offered, sold, or resold (which includes secondary market sales)."

The seminal Supreme Court case for determining whether an instrument meets the definition of security, and from where we get the Howey Test, is *SEC v. Howey*, 328 U.S. 293 (1946)⁷. The Supreme Court has reaffirmed the Howey analysis as recently as 2004. Not every contract or agreement is an "investment contract" and the supreme Court developed a three-part test to determine whether an agreement constitutes an investment contract and therefore a security.

In the case of *United Housing Foundation, Inc. v Forman* (1975)⁸, The U.S. Supreme court summarized the test the following way:

⁴ Securities Act of 1933 is 15 U.S.C. § 77a et seq.; the Securities Act of 1934 is 15 U.S.C. § 78a et seq.; the Investment Company Act of 1940 is 15 U.S.C. § 80-1 et seq.; and the Investment Adviser Act is 15 U.S.C. §80b-1 et seq.

⁵ *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) ("*Howey*"). See also *United Housing Found., Inc. v. Forman*, 421 U.S. 837 (1975) ("*Forman*"); *Tcherepnin v. Knight*, 389 U.S. 332 (1967) ("*Tcherepnin*"); *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344 (1943) ("*Joiner*").

⁶ Framework for "Investment Contract Analysis of Digital Assets, U.S. Securities and Exchange Commission, <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets>.

⁷ *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) ("*Howey*").

⁸ *United Housing Found., Inc. v. Forman*, 421 U.S. 837 (1975) ("*Forman*").

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“the basic test for distinguishing the transaction from other commercial dealings is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others. . . . This test, in shorthand form, embodies the essential attributes that run through all of the Court's decisions defining a security. The touchstone 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. By profits, the Court has meant either capital appreciation resulting from the development of the initial investment, . . . or a participation in earnings resulting from the use of investors' funds, . . . In such cases, the investor is "attracted solely by the prospects of a return" on his investment. . . . By contrast, when a purchaser is motivated by a desire to use or consume the item purchased. . . - the securities laws do not apply.”

Based on the above and later cases, that have expanded the term “money” to include investments of assets other than money, we have the following key inquiries within the Howey test:

1. Is it an investment of money or other tangible or definable consideration?
2. Is the investment of money in a common enterprise?
3. Is there an expectation of profits from the investment, which comes solely from the entrepreneurial or managerial efforts of others?

Applying the test above to Guapcoin, we find the following:

1. Is it an investment of money or other tangible or definable consideration?

The SEC’s framework states that “[t]he first prong of the Howey test is typically satisfied in an offer and sale of a digital asset because the digital asset is purchased or otherwise acquired in exchange for value, whether in the form of real (or fiat) currency, another digital asset, or other type of consideration.” It is important to note with Guapcoin, which is a stand-alone decentralized open source blockchain platform, new coins can be minted directly through use of a Guapcoin wallet application interacting with the Guapcoin network, and creation of new coins is not controlled by any central entity. Meaning that creation of new Guapcoins is decentralized. One can obtain Guapcoins without the investment of any money or other tangible or definable consideration, but by employing know-how and computing power. While Guapcoins can be obtained through an exchange, or via airdrops (two methods the SEC has found to meet this prong of the test), these are not the only ways of obtaining the cryptocurrency and therefore the first prong of the Howey Test is only partially satisfied. With respect to obtaining coins through an exchange or airdrops, according to the SEC framework, Guapcoin does meet the first prong of the Howey Test, but with respect to obtaining coins through activity on the Guapcoin blockchain (i.e. through staking rewards and masternode rewards received through a Guapcoin wallet application) Guapcoin does not meet the first prong of the test. The first prong of the Howey Test is only partially satisfied.

2. Is the investment of money in a common enterprise?

The law on the “common enterprise” prong of the Howey Test is somewhat unclear. However, the SEC in its framework states that “[b]ased on our experiences to date, investments in digital assets

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have constituted investments in a common enterprise because the fortunes of digital asset purchasers have been linked to each other or to the success of the promoter's efforts. See *SEC v. Int'l Loan Network, Inc.*, 968 F.2d 1304, 1307 (D.C. Cir. 1992).⁹ Given this strict interpretation it would seem that most digital assets, including Guapcoin, would constitute an investment in a common enterprise, despite the decentralized nature of Guapcoin.

3. Is there an expectation of profits from the investment, which comes solely from the entrepreneurial or managerial efforts of others?

Often, the main issue in analyzing a digital asset under the Howey Test is whether a purchaser has a reasonable expectation of profits (or other financial returns) derived from the efforts of others.

According to the SEC's framework whether or not "a purchaser is relying on the efforts of others" is determined by two key inquiries:

- 1) Does the purchaser reasonably expect to rely on the efforts of an active participant in the Guapcoin network?, and
- 2) Are those efforts the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise, as opposed to efforts that are more ministerial in nature?

In addressing these two points the SEC has offered the following, among several, as key factors:

- An active participant(s) provides essential managerial efforts that affect the success of the enterprise, and investors reasonably expect to derive profit from those efforts.
 - The Guapcoin network consists of dispersed Guapcoin network nodes (or wallets) that are typically run and managed by individual users of the network, or at the direction of individual users, and is not managed by any one person or group. While some Guapcoin users are endeavoring to form a nonprofit foundation, whose purpose is to market the use of Guapcoin as a virtual currency, the foundation will have no more power to 'manage' the Guapcoin network than any other user or group of users on the Guapcoin network. Any increase in value of Guapcoins, and thus any derivation of profit by investors, would be primarily be the result of Guapcoin's utility and increased use of Guapcoin by real world consumers and producers of goods and services.
- An active participant(s) has a continuing managerial role in making decisions about or exercising judgment concerning the network or the characteristics or rights the digital asset represents.
 - The Guapcoin network, and the fundamental rights and characteristics of the Guapcoin network, are set in the open source code that underlies the network, and no one user, or group of users, exercises control over them. Regarding network upgrades, rollout and implementation of new features, and the overall

⁹ *SEC v. Int'l Loan Network, Inc.*, 968 F.2d 1304, 1307 (D.C. Cir. 1992).

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direction of the Guapcoin code, the founder of Guapcoin does manage the open source repository that holds and publishes the Guapcoin source code, and she also oversees the acceptance of changes and contributions to that code base. This function is planned to be transitioned to a network wide voting mechanism whereby new functionality is proposed, voted on, accepted or rejected, and even funded directly through the Guapcoin network itself. While currently a central managerial role does exist with respect to the addition of new features on top of the base Guapcoin network functionality, even that light managerial role has a planned transition to a decentralized structure.

- An active participant(s) is responsible for the development, improvement (or enhancement), operation, or promotion of the network, particularly if purchasers of the digital asset expect an active participant to be performing or overseeing tasks that are necessary for the network or digital asset to achieve or retain its intended purpose or functionality (especially relevant where the network or the digital asset is still in development and the network or digital asset is not fully functional at the time of the offer or sale).
 - The Guapcoin network is fully realized and operational and therefore no purchaser is reasonably relying on future work or development to create value. Any increase in value of Guapcoins would be the result of its utility and increased use of Guapcoin by real world consumers and producers of goods and services.

- There are essential tasks or responsibilities performed and expected to be performed by an active participant(s), rather than an unaffiliated, dispersed community of network users (commonly known as a "decentralized" network).
 - The Guapcoin network is a decentralized open source platform that is designed to be maintained by its community of users.

- An active participant(s) creates or supports a market for, or the price of, the digital asset. This can include, for example, an active participant(s) that: (1) controls the creation and issuance of the digital asset; or (2) takes other actions to support a market price of the digital asset, such as by limiting supply or ensuring scarcity, through, for example, buybacks, "burning," or other activities.
 - Within the Guapcoin network coin supply is determined by its open source code, coins are produced in a deterministic way through the network according to the code, and there is no user, group of users, or entity which engages in actions to control the creation or issuance of Guapcoins.

The SEC's framework goes on to state that in addition to the above factors the following are other factors whose presence make it "less likely" that a digital currency would be deemed a security under the Howey Test:

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- The distributed ledger network and digital asset are fully developed and operational.
 - The Guapcoin network is fully realized and operational.
- With respect to a digital asset referred to as a virtual currency, it can immediately be used to make payments in a wide variety of contexts, or acts as a substitute for real (or fiat) currency. Meaning that it is possible to pay for goods or services with the digital asset without first having to convert it to another digital asset or real currency, and that the digital asset actually operates as a store of value that can be saved, retrieved, and exchanged for something of value at a later time.
 - Mechanisms for providers of goods and services to accept Guapcoin in exchange for those goods and services are already in place through the Guapcoin wallet applications which are available on several platforms and allow for the transfer of Guapcoins from wallet to wallet. Through the Guapcoin wallet application(s) users can save, retrieve and transfer Guapcoins to others.
- Any economic benefit that may be derived from appreciation in the value of the digital asset is incidental to obtaining the right to use it for its intended functionality.
 - Guapcoin is designed as a virtual currency first and foremost, with its greatest utility as a complementary currency to tradition fiat currencies, serving the needs of local and regional communities underserved by traditional banking institutions. Appreciation in the value of Guapcoin is incidental to that utility.
- The digital asset is marketed in a manner that emphasizes the functionality of the digital asset, and not the potential for the increase in market value of the digital asset.
 - Guapcoin is designed as a virtual currency first and foremost, with its greatest utility as a complementary currency to tradition fiat currencies, serving the needs of local and regional communities underserved by traditional banking institutions.
- Potential purchasers have the ability to use the network and use (or have used) the digital asset for its intended functionality.
 - The Guapcoin network is fully realized and operational.
 - Mechanisms for providers of goods and services to accept Guapcoin in exchange for those goods and services are already in place through the Guapcoin wallet applications which are available on several platforms and allow for the transfer of Guapcoin from wallet to wallet.

Guapcoins are designed to be used as a virtual currency, which can be traded on an exchange, and aim to function as a part of the global ecosystem of digital assets. It is an autonomous cryptocurrency, which can be minted and not just purchased for consideration. It is a stand-alone blockchain network based on open source code, and is free for any user to take part in. For these reasons, and the factors

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applied above to Guapcoin, I conclude there is no reasonable expectation of profits from the investment which comes solely from the entrepreneurial or managerial efforts of others.

Summary

Guapcoin has a low risk of falling under the definition of security according to U.S. Securities Law due to a) the decentralized nature of the Guapcoin network (meaning the nodes/wallets that make up the Guapcoin network), b) the Guapcoin network is an open source platform that can be used and extended by any user, c) that there is no central entity or authority managing the network of nodes/wallets that make up the Guapcoin network, d) that creation of new Guapcoins is controlled through the network itself and the open source code underlying the network, e) that Guapcoins can be obtained through minting as an alternative to purchasing on an exchange, and f) that the Guapcoin network is fully realized and operational as a virtual currency and medium of exchange.


Whether a digital asset is deemed a security is determined by applying the Howey Test from the US Supreme Court case SEC v. W.J. Howey Co., 328 U.S. 293 (1946). By analyzing Guapcoin through the Howey Test it can be concluded that 1) the first prong of the test, “whether there is an investment of money or other tangible or definable consideration” is only partially satisfied because Guapcoins can be obtained through minting as an alternative to purchasing (i.e. making an investment), that 2) the second prong of the test, “whether there is an investment of money in a common enterprise”, is likely satisfied based on the strict interpretation employed by the SEC, and that 3) the third prong, “whether there is an expectation of profits from the investment, which comes solely from the entrepreneurial or managerial efforts of others” is likely not satisfied because of the decentralized nature of the network of nodes/wallets that make up the Guapcoin network, that the Guapcoin network is fully realized and operational, and that there is no central entity or authority managing the network of nodes/wallets that make up the Guapcoin network.

In order for a virtual currency such as Guapcoin to be considered a security under U.S. Securities Law all three prongs of the Howey Test must be satisfied. Guapcoin does not satisfy all three therefore there is a low risk that Guapcoin will fall under the definition of security under U.S. Securities Law.

CONCLUSION

In order for a virtual currency such as Guapcoin to be considered a security under U.S. Securities Law all three prongs of the Howey Test must be satisfied. Based on the above analysis I find that Guapcoin is a decentralized cryptocurrency which does not satisfy all three prongs of the Howey Test, therefore there is a low risk that it would fall under the definition of security under U.S. Securities Law.

Regards,



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