

# BLOCKCHAIN PRACTICE GROUP

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# How to Launch STO

Things to consider when structuring  
and launching STO in the US

# ABOUT US

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DILENDORF  
KHURDAYAN

## Blockchain, VC/PE & Real Estate

Dilendorf & Khurdayan offers practical and effective legal solutions to innovators and visionaries in the blockchain, real estate and private capital space.

We guide our clients through issuing (STOs), marketing and re-selling digital tokens in the US, tokenizing assets, setting-up crypto funds and operating DLT projects.

Our clients - blockchain startups, individual investors, funds, family offices, real estate owners/operators, art collectors, high net worth individuals and FinTech firms. We help these clients navigate multiple regulatory regimes and laws in the industry that changes by the second.

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# TOPICS

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- **What is STO?**
- **How to launch STO in the U.S. and some issues to consider**
- **Dual token sale structures**

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# WHAT IS AN STO?

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## STO – Security Token Offering

- A way to describe a token offering that is compliant with US securities regulations
- Security Token Offering  $\neq$  Offering of Tokenized Securities
  - Much broader scope, including revenue sharing tokens, asset-backed tokens, fund tokens, etc. **and** even SEC-compliant ICOs

# SECURITY TOKENS

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We refer to all tokens that meet the legal definition of security as  
**“security tokens”**



# WHAT IS A SECURITY?

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- The infamous *Howey* test: U.S. law defines “security” broadly → **any contract, transaction, or scheme** whereby:
  - A person **invests money** or anything else of value
  - In a **common enterprise** (which different courts define differently)
  - And is led to **expect profits**
  - Predominantly from **the efforts of others** (central management).
- It doesn't matter what you call a token, whether it serves a function on a platform, whether or not it entitles the holder to a share in profits — **if it meets the test for a security, it's a security.**

**THUS, SECURITY TOKENS ARE NOT JUST  
TOKENIZED SECURITIES**

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# TYPES OF SECURITY TOKENS

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- **Equity Tokens**
- **Debt Tokens**
- **Asset-Backed Tokens**
- **Fund Tokens**
- **Utility Token**



# OUR FOCUS TODAY

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## NON-UTILITY TOKENS

- Equity/Debt
- Asset-backed
- Fund tokens, etc.

**AND**

**STRUCTURING TOKEN SALES FOR SUCH  
NON-UTILITY TOKENS**

# WHY TOKENIZE?

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- Access to capital on a global scale
- Liquidity
- Fractionalization of ownership
- Access to assets with traditionally high barriers to entry
- Attractive to both traditional and crypto investors

# MOST COMMON STO STRUCTURES

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## ➤ **SPV / trust**

*Example: Thelephant, BrickBlock*

## ➤ **Fund / GP**

*Example: 22x, Science Blockchain*

## ➤ **Hybrid**

*Example: Property Coin*

## ➤ **Tied to Equity**

*Example: Minthealth, St. Regis REIT, EpigenCare,  
OriginClear, Finova Financials*

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# SALE OF SECURITY TOKENS IN THE US

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- **General Rule:** You must register a security with the SEC before you can offer or sell it.
  - Consequence of selling unregistered securities: **Strict liability.**
- **However:** Even if a token is a security, it may qualify for **an exemption from registration.**
  - As a practical matter, there is usually no need to register because you can almost always structure an STO to qualify for an exemption.

# EXEMPTIONS FROM REGISTRATION

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- If your security qualifies for an exemption, you don't need to register it.
- **Examples of federal exemptions from registration:**
  - 3(a)(10)                      – Regulation D: Rule 504                      – Regulation A+
  - 3(a)(11)                      – Regulation D: Rule 506(b)                      – Regulation CF
  - 4(a)(2)                      – Regulation D: Rule 506(c)                      – Regulation S



# GOOD FOR STO?

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## MOST COMMONLY USED EXEMPTIONS

- 506(c) under Regulation D
  - Regulation S
  - Regulation CF
- Regulation A+ (maybe)

# REGULATION D – 506(c)

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## ➤ Overview of Reg. D - Rule 506(c)

- No restrictions on advertising—**general solicitation** is permitted
- **No prospectus required** (although issuers generally release a private-placement memorandum)
- Issuers can raise an **unlimited amount of funds**
- **No financial reporting requirements** for the issuer
- State securities laws are **pre-empted** (no need to seek registration or exemption on a state level)
- Only **accredited investors** may participate in the sale
- Purchasers **cannot transfer their securities for one year** (subject to certain exceptions)
- **Form D must be filed** with the SEC after the sale (but doesn't need SEC approval)

# U.S. ACCREDITED INVESTORS

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- **ACCREDITED ≠ PROFESSIONAL:** Accredited investors do not have to be professional or institutional investors.
  - An “**accredited investor**” includes a **natural person who:**
    - **Earned income that exceeded \$200,000** (or \$300,000 together with a spouse) **in each of the prior two years**, and reasonably expects the same for the current year; **or**
    - **Has a net worth over \$1 million**, either alone or together with a spouse (excluding the value of the person’s primary residence)
  - An “accredited investor” may also be an entity such as a bank, partnership, corporation, nonprofit, or trust, when the entity satisfies certain criteria.
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# REGULATION S

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## ➤ Overview

- Rule 901 says that “offers and sales that **occur outside the United States**” don’t have to be registered.
  - **BEWARE:** The SEC has never clearly explained when an offer and sale occur outside the United States, so you shouldn’t rely on Rule 901 alone.
- Fortunately, Rule 903 provides a **safe harbor**—if an offer and sale satisfy the following requirements, they are deemed to occur outside the United States:
  - Offer and sale made in an **offshore transaction**;
  - No **directed selling efforts** are made in the United States; and
  - **Certain other requirements** described in 903(b) are satisfied.

# CONCURRENT REGULATION D + S

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- Although not as well-known as Regulation D, token sponsors should structure a **concurrent offering under Regulation S** for non-U.S. investors.
  - **Advantage:** Non-U.S. investors under Regulation S do not have to undergo the same accreditation process as U.S. investors under Regulation D.
    - If you don't use Regulation S for foreigners, **you must accredit all your investors** under Regulation D—not just U.S. investors.
  - **Advantage:** Non-U.S. investors who are not **distributors or affiliates** of the issuer or its distributors can **resell immediately** to other non-U.S. investors **or be subject to lower holding requirements** (depending on the category of Regulation S securities).
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# BUT - INTEGRATION DOCTRINE

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- **What is it?** The SEC can treat multiple offerings under different exemptions as a single offering. In other words, **using one exemption might destroy your ability to use another, and both offerings might fail.**
- **Example:** Rule 506(c) (Regulation D) says you can openly advertise your security in the United States, but Rule 903 (Regulation S) says you can't make "directed selling efforts" in the U.S. **These rules present a potential conflict between Regulation D and Regulation S.**
  - Although the SEC has said concurrent offerings are OK, it hasn't provided clear guidance on that conflict, or what sorts of activities might cross the line and require integration of the offerings.
- How to avoid integration goes beyond the scope of this presentation—just remember you need to take certain steps to ensure you properly run concurrent offerings.



# COMPLIANT STO UNDER REG D + S

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- How long does it take? **4-8 weeks.**
  
  - What's involved? **At a minimum:**
    - Determination corporate structure and sale structure
    - Implementation of the appropriate corporate/governance structure
    - Preparation of a private placement memorandum
    - Preparation of a purchase agreement
    - Preparation of necessary investor and disqualification questionnaires
    - AML/KYC checks and investor verifications
    - Filing Form D with the SEC
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# STOs – ANYTHING ELSE?

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## ➤ **Additional things to consider:**

- Advisory and marketing arrangements
- Arrangements with STO platforms
- Broker-dealer issues
- Team compensation and restrictions
- 2,000 shareholder rule
- Special rules for certain asset-backed tokens (e.g., tokenized asset-backed securities or fractional undivided interests in oil, gas or other mineral rights are not eligible for Reg A+)

# REGULATION CROWDFUNDING (REG CF)

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## ➤ Overview of Reg. CF

- \$1,070,000 of securities max. during any 12 months
- Only available to US issuers
- **Must use a registered funding portal (member of FINRA)**

*Funding portal examples:*

- StartEngine*
- KickStarter*
- Indiegogo*

- All advertising and marketing through the funding portal
  - Both accredited and non-accredited investors allowed, but limits on the investment amount
  - All types of traditional securities/security tokens
  - Concurrent Rule 506(c) offerings may be allowed (provided compliance with Reg CF solicitation rules)
  - State registration preempted
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# DUAL TOKEN STRUCTURE – WHY?

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## ➤ TWO TOKENS

1. Security token
2. “Utility” token

## ➤ WHY?

### ➤ **Currently grey areas:**

- when a security token stops being security (if ever);
- if holders of security tokens can be precluded from using them on the platform

- ### ➤ **Dual token sale structure **may** mitigate these risks for issuers and end-users allowing issuer to (1) raise capital and (2) launch and operate platform/ecosystem.**

# CURRENT DUAL TOKEN STRUCTURES

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## ➤ RATE and DATE

### —Real Agreement for Tokens and Equity

- Equity + perk (utility) token
- Equity token + perk (utility) token

### —Debt Agreement for Tokens and Equity

- Convertible note + perk (utility) token
- Debt token + perk (utility) token

## ➤ **Problem:** just because you offer 2 tokens, doesn't mean that one of them will be a utility.

- You have to look at the features of the token, and the facts and circumstances of the sale and... If the token has features of a security – once again, it is a security. In the examples above – the second token will most likely be a security as it is essentially pre-sold at the fundraising stage (like an investment contract).



# DUAL TOKEN STRUCTURES CONT'D

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- **SEPARATE SECURITY AND UTILITY TOKENS**
    - Security token is issued at fundraising stage
    - Utility token is not issued, offered as bonus or pre-sold at fundraising stage and had no connection to security token. Utility token is used as in-app currency and has no features of security.
  - **DIVIDEND MODEL**
    - Again, two separate tokens are issued.
    - Security tokens provide for the right to receive dividends from the income generated by utility token-based transactions on the platform. Potentially, such dividends could be paid in utility tokens as well.
  - **Always a key consideration: non-security status of the second token must be maintained from day 1.**
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# EXAMPLES

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## ➤ *MintHeath*

- Security Tokens: tokenized non-voting preferred stock with dividend rights
- Utility Tokens: not connected to security tokens and not issued at fundraising stage

## ➤ *EpigenCare*

- Security Tokens: tokens with revenue share rights and equity conversion option
- Utility Tokens: not connected to security tokens and not issued at fundraising stage

## ➤ compare to *NYNJA*

- Class B common stock shares + utility tokens as perk
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# SUMMARY

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# DISCLAIMER

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This presentation outline and the presentation itself are for *general* educational purposes only and are not intended to provide *specific* guidance or legal advice about what to do or not to do in any particular case. You should not rely on this general information and should seek the assistance of an attorney to help you resolve any issues.

Thank you.

# THANK YOU!

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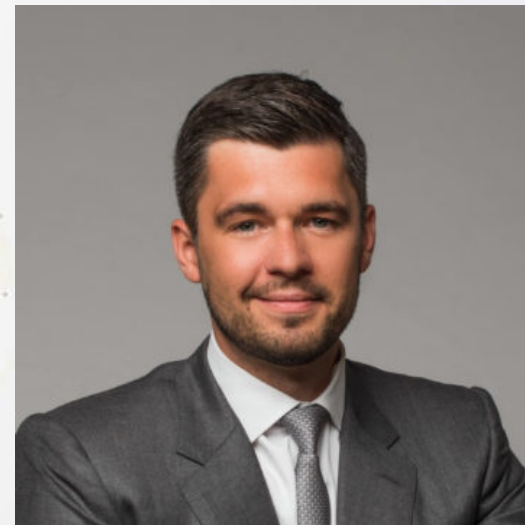


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