



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

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DIVISION OF ENFORCEMENT

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November 16, 2018

Via Email (pgibbs@cooley.com / kenneth.lench@kirkland.com)

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Re: In re Kik Interactive (HO-13388)

This letter confirms the telephone conversation of November 16, 2018. In that conversation, we advised you that the staff of the Securities and Exchange Commission has made a preliminary determination to recommend that the Commission file an enforcement action against your clients, Kik Interactive Inc. and the Kin Ecosystem Foundation. This proposed action would allege violations of Sections 5(a) and 5(c) of the Securities Act. The recommendation may involve a civil injunctive action and may seek remedies that include a preliminary and permanent injunction, disgorgement, pre-judgment interest, and civil money penalties.

As described in Rule 5(c) of the Commission's Rules on Informal and Other Procedures, 17 C.F.R. § 202.5(c), we are offering your client the opportunity to make a Wells Submission. For further information, you may wish to review Securities Act Release No. 5310, "Procedures Relating to the Commencement of Enforcement Proceedings and Termination of Staff Investigations," which can be found at: <http://www.sec.gov/divisions/enforce/wells-release.pdf>.

If your client wishes to make a written or videotaped submission setting forth any reasons of law, policy, or fact why the proposed enforcement action should not be filed,

or bringing any facts to the Commission's attention in connection with its consideration of this matter, you should send the submission to me by December 7, 2018. Any written submission should be limited to 40 pages, and any video submission should not exceed 12 minutes. A submission that exceeds the applicable limitation on length or is sent after the above-referenced date may not be accepted by the staff. Please inform me by no later than November 23, 2018 whether your client will be making a Wells Submission. Any submission should be sent to:

Robert A. Cohen
Chief, Cyber Unit, Division of Enforcement
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If the staff makes an enforcement recommendation to the Commission in this matter with respect to your client, we will send to the Commission any submission that your client makes that complies with the terms in this letter. Wells submissions that are not accepted by the staff generally will not be provided to the Commission, although the staff may review and consider them.

The Commission may use the information contained in a submission as an admission, or in any other manner permitted by the Federal Rules of Evidence, or for any of the Routine Uses of Information described in Form 1662, "Supplemental Information for Persons Requested to Supply Information Voluntarily or Directed to Supply Information Pursuant to a Commission Subpoena." Form 1662 can be found at: <http://www.sec.gov/about/forms/sec1662.pdf>; paper copies are available upon request. The staff will not accept any submission that purports to limit (including by reserving the right to do so) its admissibility under the Federal Rules of Evidence or the Commission's ability to use the submission for any purpose identified in Form 1662. Nor will the staff accept a submission that contains or discusses a settlement offer. Offers of settlement should be in a separate document, and not combined with, or included in, Wells submissions. Any submission your client makes may be discoverable by third parties in accordance with applicable law.

If you have any questions, please contact me at 202.551.4869.

Sincerely,



Robert A. Cohen
Chief, Cyber Unit, Division of Enforcement

**WELLS SUBMISSION
OF KIK INTERACTIVE, INC.
AND THE KIN ECOSYSTEM FOUNDATION**

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I. INTRODUCTION

The Division of Enforcement (“Staff”) has indicated that it is considering recommending that the Securities and Exchange Commission (the “Commission” or “SEC”) bring an enforcement action against Kik Interactive, Inc. (“Kik” or the “Company”) and the Kin Ecosystem Foundation (the “Kin Foundation” or “Foundation”). The proposed enforcement action would allege that Kik and the Foundation violated Section 5 of the Securities Act of 1933 in connection with the offer and sale of a digital currency called “Kin.”

This decision puts the Commission at a crossroads. The Chair of the Commission has said repeatedly that the Commission does not want to squelch innovation in the blockchain and cryptocurrency industry or push development of these promising technologies overseas. But the Commission’s current approach to blockchain and cryptocurrency matters has had precisely those effects. Bringing the proposed enforcement action against Kik and the Foundation would amount to doubling down on a deeply flawed regulatory and enforcement approach.

The history of the Commission’s efforts in this space highlights the problem. Cryptocurrencies (including Bitcoin and Ether) have been gaining adoption for many years. Throughout this period, the Commission did not provide any meaningful, forward-looking guidance about the application of the federal securities laws in this space, nor did it develop a regulatory structure that would make sense for these emerging technologies. As cryptocurrency markets exploded in 2017, the Commission finally spoke on the matter, but even then, the Commission did not give industry participants a clear view of how or when the SEC believed the federal securities laws would apply to sales of cryptocurrencies. The DAO Report, for example, said only that sales of cryptocurrencies “may” involve sales of securities, and applied the *Howey* test to a token offering whose features were dramatically different from the sales of other tokens (including Kin). By the end of 2017, through the Munchee settlement order and a series of public comments by the Chairman, however, the Commission had mapped out a much more aggressive position, one that effectively threatens enforcement action against nearly all token offerings, even as the Commission has yet to approve of a single registration statement for a cryptocurrency, and has failed to approve of any trading platform for tokens.

This “regulation by enforcement” approach has had a dramatic and negative impact on the development of blockchain and cryptocurrency technologies in the United States as innovators have either directed their activities overseas or shelved their projects altogether. (*See* Anna Irrera, Michelle Price, *Cryptocurrency issuers clean up, shun U.S. investors as SEC gets tough*, Reuters, March 21, 2018.) Bringing the proposed enforcement action against Kik and the Foundation would be a further step down this path, one that would confirm for industry and market professionals that they should be looking outside the U.S. to further innovate and develop blockchain and cryptocurrency technologies. It is time for the Commission to take a different approach – one that is within the bounds of the Commission’s statutory authority – and thereby reopen the window for U.S. based innovation and development of these important technologies.

This is not special pleading, and the industry is not asking for the Commission to change the law to accommodate new technologies, as Chairman Clayton has suggested. (See Kate Rooney, *SEC Chief Says Agency Won't Change Securities Laws to Cater to Cryptocurrencies*, CNBC, June 8, 2018.) On the contrary, through its enforcement efforts, it is the Commission that has stretched the definition of a “security” – and, in particular, the definition of an “investment contract” that the Supreme Court adopted over 70 years ago in *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946) – beyond its original meaning and intent. In other words, in its attempt to assert regulatory authority over effectively all digital currencies (other than Bitcoin and Ether, whose apparent exemption from scrutiny by the Enforcement Division cannot be reconciled with the Division’s current approach), the Commission has strayed well beyond the scope of its statutory authority to regulate the offer and sale of securities. But the Commission’s attempt to water down the *Howey* analysis to expand its regulatory authority will not stand up to meaningful judicial scrutiny. To see this, one need only compare the relatively superficial “investment contract” analysis set forth in the Commission’s recent settlement orders in Airfox and Paragon Coin (as well as the Munchee settlement that preceded them) with the much more rigorous analysis that led a federal court to deny the Commission’s motion for a preliminary injunction for failure to show that the defendant offered or promised an investment opportunity to token purchasers. See *S.E.C. v. Blockvest, LLC*, 2018 WL 6181408, at n. 5 (S.D. Cal. Nov. 27, 2018).

For the reasons discussed in more detail below, the Staff’s proposed enforcement action against Kik and the Kin Foundation will likewise fail any rigorous analysis of whether offers and sales of Kin amounted to offers or sales of a “security” within the scope of Section 5 of the ’33 Act. Kin was designed, marketed, and offered as a currency to be used as a medium of exchange within a new digital economy. This takes it outside the statutory definition of a “security” under the federal securities laws, and gives it a consumptive use that is inconsistent with an investment purpose. Simply put, Kik did not offer or promote Kin as a passive investment opportunity. Doing so would have doomed the project, which could only succeed if Kin purchasers used Kin as a medium of exchange (rather than simply holding it as a passive investment). Accordingly, Kik marketed Kin, not as an investment opportunity, but rather as a way to participate in a fundamentally new way for consumers to access digital products and services, and for innovative developers, and their users, to be compensated for the value they provide. Consistent with Kik’s stated vision, Kin has been adopted, integrated, and used within over 30 digital applications. Excluding secondary market transactions, as of today, ***Kin exceeds Ether and Bitcoin in daily blockchain activity, demonstrating Kin’s wide acceptance and adoption.*** (See <https://blocktivity.info/>.) Indeed, of the over 2,000 tokens in circulation, Kin is ranked as having the fifth highest daily blockchain activity. (See *id.*) Such usage only continues to grow as Kin becomes one of the most used cryptocurrencies in the world.

The terms of the sale itself, moreover, are flatly inconsistent with an “investment contract”: in the sale, Kik transferred ownership of the Kin tokens to purchasers, who had full control over their tokens once received, and Kik did not assume any ongoing obligations to Kin

purchasers. As such, the offer and sale once delivered of Kin tokens did not involve or create any common enterprise between Kin purchasers and either Kik or the Kin Foundation. In sum, the offer and sale of Kin did not involve the type of passive investment opportunity that the term “investment contract” was intended to cover, and does not meet the definition that the Supreme Court adopted in *Howey*. The Foundation’s separate transfers of Kin tokens to app developers and users to incentivize further development of the ecosystem, many months after the token distribution event (“TDE”), are even further removed from the definition of an “investment contract” under the federal securities laws.

To be clear, Kik has always supported the Commission’s goal of protecting investors, including by applying the federal securities laws to cryptocurrency transactions that actually fall within the scope of the Commission’s statutory authority. But each cryptocurrency is different, and Kin, as it was offered and sold by Kik and then later transferred by the Foundation in various circumstances, is not within that scope. Nor is Kik opposed to appropriate regulation more generally. Kik takes compliance very seriously, and in preparing for the sale of Kin, Kik retained sophisticated counsel (both in the United States and internationally); hired a distinguished General Counsel; conducted know your customer (“KYC”), anti-money laundering (“AML”), and Office of Foreign Asset Control (“OFAC”) screening; worked hard to ensure the functionality of the Kin token before selling it; and received an opinion from its tax advisors that the sale proceeds should be treated as revenue (as from the sale of goods) rather than as a sale of securities. Without question, Kik and the Kin Foundation are good actors, with a strong record of compliance efforts.

Moreover, Kik has made serious efforts to resolve this matter in a way that would address the Commission’s stated concerns and would allow for the continued growth of the Kin ecosystem. This would be in the best interests of Kik, the Foundation, and all other stakeholders and participants in the Kin ecosystem. Unfortunately, in discussing potential resolutions, the Staff has consistently demanded an approach that would harm the interests of the very people that the Commission purports to represent – Kin buyers – as well as developers and other ecosystem participants. The Staff’s posture, in other words, has left Kik and the Foundation with no choice but to vigorously defend against any enforcement action, if one is approved by the Commission, and we believe we will prevail in any such action.

For that reason, and for the reasons set forth in more detail below, we urge the Commission to decline to bring the proposed enforcement action against Kik and/or the Kin Foundation.

II. FACTUAL BACKGROUND

A. Kik’s Business

Kik is a social media messaging company headquartered in Waterloo, Ontario, Canada. Founded by Ted Livingston and Christopher Best in 2009, Kik launched the first iteration of its messaging application (“Kik Messenger”) in 2010. Within two weeks, nearly one million users downloaded Kik Messenger. (*See* Matt Marshall, *Kik, the Skype of text messages, continues crazy*

growth (chart), VentureBeat, Nov. 5, 2010.¹) Kik’s popularity continued to grow, and by 2017, Kik Messenger had become one of the top 15 social media applications in the world, with 300 million registered users and millions of monthly active users. (Claire Brenner, *15 Most Popular Social Media Networks and Sites [+160 data points]*, G2 Crowd, July 18, 2018.²) With this growth and user engagement, Kik attracted substantial venture capital investments from sophisticated investors. In 2015, for example, the international internet and technology conglomerate Tencent led an investment round that valued the Company at \$1 billion. (See P. Heinke Tr. at 56:6–12; David George-Cosh and Douglas MacMillan, *Tencent Invests \$50 Million in Messaging App Kik*, The Wall Street Journal, Aug. 18, 2015.³)

B. The Advertising Problem

Despite its success, Kik faced significant challenges in monetizing its business, challenges that are shared to some extent by nearly all providers of digital products and services, except for a few dominant players. (See P. Heinke Tr. at 45:20–46:2; T. Philp Tr. at 18:23–19:6.) The problem faced by Kik and others is as follows: today’s dominant digital services have been organized primarily around an attention-based economy that monetizes through advertising. (SEC Ex. 2 at KIK_000002.) The more an application attracts user attention, the more advertising revenue it can generate. (*Id.*) This model encourages digital applications to provide content for free to attract the largest audience possible from a finite amount of consumer time and attention. (*Id.*) Inevitably, these platforms sell consumer attention and consumer data to advertisers and marketers. (*Id.*)

This model does not align with Kik’s philosophy for multiple reasons. First, when the Company launched Kik Messenger, Livingston and Best believed that user data should be protected, not exploited, and that remains one of Kik’s core values today. In other words, Kik is not willing to appropriate user data and sell it to advertisers and marketers, and especially not without the user’s consent and participation. This unwillingness to exploit user data puts Kik at a distinct disadvantage in the current digital advertising market. (See P. Heinke Tr. at 46:5–23; T. Philp Tr. at 18:19–19:6.) Second, as a function of time to market and network effects, a small number of very large companies hold a dominant position in the advertising market. (See *id.*; SEC Ex. 2 at KIK_000002.) Thus, despite having a substantial user base, Kik’s advertising reach (like that of other small, innovative companies) is dwarfed by that of the dominant players. (*Id.*) Even worse, this problem only intensifies over time, as the large, dominant players further solidify their position, and smaller players get driven out of the market entirely.

Beyond preventing Kik and other smaller developers from monetizing their businesses, this market dynamic has stifled competition for digital products and services. As smaller

¹ Available at <https://venturebeat.com/2010/11/05/kik-sms-growth/>.

² Available at <https://learn.g2crowd.com/social-media>.

³ Available at <https://www.wsj.com/articles/tencent-invests-50-million-in-messaging-app-kik-interactive-1439928079>.

companies like Kik introduce innovative products and features, the dominant players can simply copy those features, offer them for free, and attract even greater numbers of users, further widening the monetization gap, magnifying differences in scale, and making it even harder for new players to compete. In other words, the current digital advertising market operates like a moat, protecting a few dominant players from competition from smaller, innovative companies like Kik.

C. Kik Points

While struggling to compete with the dominant players, Kik began to experiment with other projects and business models. As one of those experiments, in 2014, the Company launched Kik Points to serve as a virtual currency within Kik Messenger. By completing polls and surveys, users earned Kik Points that they could spend on content within Kik Messenger, such as digital stickers (similar to emojis or emoticons). (T. Philp Tr. at 25:1–15.) Kik earned revenue by selling Kik Points to advertisers, who in turn paid consumers (with Kik Points) for answering surveys and polls within Kik Messenger. (*Id.* at 27:8–16.)

From a user engagement perspective, Kik Points was a big success, and the project validated, as a proof of concept, that users want to earn and spend a virtual currency within a digital application like Kik Messenger. During two and half years of Kik Points, users completed approximately 253 million earn experiences and made 74 million purchases. (SEC Ex. 2 at KIK_000010.) In fact, from 2014 through 2016, Kik Points generated an average of 300,000 transactions per day, reaching 2.6 million transactions per day at the peak, and its monthly transaction volume was nearly three times higher than Bitcoin's. (*Id.*) Kik Points thus demonstrated that people wanted to use virtual currency inside digital applications and that there is a substantial audience for an economy built around digital applications. Additionally, Kik Points showed that users did not need to be technologically savvy to use digital currency.

Unfortunately, although Kik Points was a success with users, it was not a complete solution to Kik's challenges in monetizing its business. Kik's lack of scale relative to the dominant players (who by then had only become more dominant) continued to hamper its efforts to attract advertising dollars through the sale of Kik Points. At the same time, the centralization of the Kik Points model made it less attractive to advertisers. In particular, because there was nothing to prevent Kik from creating more Kik Points, advertisers were concerned about future dilution or devaluation of the Kik Points they might buy. Similarly, because Kik could stop accepting Kik Points at any time, advertisers were concerned about Kik Points losing their value entirely. Moreover, by itself, Kik was unable to create enough spend experiences to keep up with demand, which further limited interest from advertisers.

From its experience with Kik Points, Kik learned that users were eager to earn and spend virtual currency within digital applications, but that a centralized currency, limited to a single application and under the control of a single company, was not a viable solution. Accordingly,

Kik discontinued Kik Points in 2016 and began looking for an alternative monetization model that would improve on the success of Kik Points but that would overcome Kik Points' limitations.

D. Kik's Vision for Kin and the Kin Ecosystem

In late 2016 and early 2017, as it digested the lessons learned from the Kik Points project, Kik explored a business model underpinned by a new cryptocurrency. Livingston had been intrigued by cryptocurrency since 2011, when he first learned about Bitcoin and then later attended a Bitcoin conference with other leaders in the space in 2012. (T. Philp Tr. at 54:6–23; *see also* P. Heinke Tr. at 77:8–78:21.)

The success of Kik Points within the app confirmed the Company's view that virtual currency held vast potential both within and outside of Kik. Moreover, a blockchain-based cryptocurrency could solve many of the limitations that Kik had observed in Kik Points. First, by its nature, a blockchain-based cryptocurrency can guarantee a fixed supply, which eliminates concerns about dilution or devaluation through increased supply. Second, unlike a centralized currency used only inside of Kik Messenger, a true cryptocurrency would be decentralized, and could be earned and spent across an unlimited number of digital applications, products, and services, from an unlimited number of developers. This would eliminate concerns about a single entity (like Kik) erasing value by deciding to stop accepting the currency. Third, with a decentralized cryptocurrency, anyone holding the currency would have an incentive to increase the use of the currency, because doing so would increase demand, which in turn would increase its value (given a fixed supply). Finally, by establishing a digital currency that could be incorporated into an unlimited number of digital applications, products, and services, Kik would no longer struggle to provide enough spend experiences to satisfy user demand. An entire ecosystem of developers, working independently of one another, would all have an incentive to offer valuable user experiences. In other words, the decentralization of the currency made it far more likely that a thriving new economy would develop around that currency.

As it developed, the ecosystem would become increasingly decentralized, offering a fair and open forum for developers to offer digital services and consumers to engage with them. (SEC Ex. 2 at KIK_000005.) To further stimulate development across a wide variety of independent developers, Kik envisioned a Kin Rewards Engine – initially administered by the Kin Foundation, but later gaining full autonomy – which would provide an economic incentive to ecosystem participants by transferring Kin tokens in exchange for value generating activity, thereby growing use and adoption of Kin. (*Id.* at KIK_000019.) As more independent participants entered the ecosystem, the network effects of their activity would mount, further increasing demand, and in turn encouraging new participants to engage. (*Id.* at KIK_000006.) In this vision, Kik would be just one of a vast number of participants in this new digital economy. (*Id.* at KIK_000023.)

If successful, the Kin project offered Kik – and other developers facing similar challenges – a way to monetize their businesses, despite their relative lack of scale, and without exploiting

user data. Moreover, the Kin model would allow users themselves to be rewarded for their own contributions to the ecosystem. The model would also allow developers to earn Kin both by offering spend opportunities to users (who might pay in Kin for user experiences developed by Kik), and by earning rewards from the Kin Rewards Engine.⁴ In addition, because it would own a substantial amount of Kin, Kik would also benefit from Kin maintaining or increasing in value.

Kik's management believed that this model would create an overall win for developers and users, the industry, and Kik alike. Developers would finally be compensated for their contributions irrespective of incumbent players' competitive advantages, allowing smaller industry players to bridge the gap and compete with dominant players. Kik itself would benefit – like any other developer – by offering spend opportunities and earning rewards and – like any holder of Kin – would benefit from holding the currency. Thus, after considering various strategies, in early 2017, the Kik Board approved Kik's plan to sell cryptocurrency. (SEC Ex. 25.)

E. Kik Promoted Kin as a Medium of Exchange for Digital Services

From the time of its public announcement through the TDE and today, in line with its vision, Kik has promoted Kin as both a currency for use in consumer's daily digital lives and as the basis for a new digital economy, anchored by the Kin ecosystem. (See SEC Ex. 88.) Kik first publicly announced its plan to sell Kin in May 2017. (*Id.*) In its first public announcement, Kik described Kin as “the transaction currency inside of the Kik app,” which, over time, by mainstream consumer adoption, would become “one of the most adopted and used cryptocurrencies in the world.” (*Id.*) Kik's whitepaper likewise emphasized the function of Kin as a medium of exchange for consumptive use, to be used in “everyday digital services such as chat, social media, and payments.” (SEC Ex. 2 at KIK_000008.)

This basic message – focused on the use of Kin as a digital currency that would enable an entirely new economy for digital products and services – continued throughout the process leading up to (and after) the TDE. Thus, for example, Kik stressed that Kin would “serve as a foundation for a decentralized ecosystem of digital services.” (SEC Ex. 88.) By providing an open and decentralized network of digital services, the Kin ecosystem would “foster[] direct economic relationships between developers, creators, and consumers, with value and governance shared among the participants.” (SEC Ex. 2 at KIK_000003.) Indeed, “users [would] be able to earn Kin by providing value to other members of the Kik digital community through curation, content creation, and commerce ... [and] [would] be able to spend Kin on products, services, and other valuable assets offered by merchants, developers, influencers, and other participants.” (*Id.* at KIK_000005–6.) The Company continued to highlight that “Kin [would] fuel new experiences in communications, information, and commerce inside of Kik, and [would] also serve as a foundation

⁴ The Rewards Engine is analogous to Bitcoin Mining Rewards. Bitcoin miners are rewarded for securing the network. Similarly, Kin ecosystem participants are rewarded by the Rewards Engine for contributing to the ecosystem and driving use and adoption.

for a new decentralized ecosystem of digital services, bringing a fair and sustainable business model to the market.” (SEC Ex. 93.)

The community, in turn, understood this message and showed excitement to use Kin. As one community member noted, “I may use KIN for my startup. So much to look forward to. We’re witnessing the birth of new economies.” (KIK_00004157.) Another Reddit poster stated that “KIN really [has] good potential from everyday use to, well, startups as you said. All other cryptos I’ve owned I only saw in exchanges and this is the first one that I might actually use in practice. I think it’s great.” (*Id.*)

Kik’s primary marketing message – focusing on the use of Kin as a medium of exchange in a new digital economy – was crucial to the success of the project, because the project could only succeed if Kin purchasers actually earned and spent Kin as a currency. If, instead, large numbers of Kin purchasers behaved like passive investors by simply holding Kin and waiting for its value to increase, the project would fail. Accordingly, Kik did not offer or characterize Kin as a passive investment opportunity. Nor did Kik emphasize any ability to sell Kin on secondary markets, let alone at what price. In fact, it was noted in response to a question, that whether exchanges listed Kin “[was] up to the exchanges.” (KIK_00006208 (Sept. 13, 2017 Tweet).)

F. Kik Described Itself as a “Participant Rather Than a Landlord” in the Kin Ecosystem

At all times, Kik made clear that, in the Kin ecosystem, Kik messenger would be “just one of thousands of services in the Kin ecosystem.” (Ted Livingston, *Announcing Kin, a Cryptocurrency for an Open Future*, Medium, May 25, 2017.⁵) Indeed, in this new digital economy, Kik would serve as a “participant rather than a landlord.” (SEC Ex. 2 at KIK_000005.) This meant that, for the Kin ecosystem to grow, many developers other than Kik would have to join the ecosystem by offering products and services in exchange for Kin: “As more partners join, the network effect of the Kin Ecosystem will grow.” (*Id.* at KIK_000006.) For example, “[o]n the supply side both bots or content creators will create unique experiences. On the demand side, users will consume these products or services.” (*Id.* at KIK_0000012.)

With that vision, Kik expressed that it wanted “as many people as possible to be able to participate in [the] project from the beginning.” (Ted Livingston, *Kin TDE*, Medium, Aug. 29, 2017.⁶) If it worked, the Kin ecosystem would provide “consumers a richer ecosystem of digital services while compensating them for the value they contribute” and also to “empower[]

⁵ Available at <https://medium.com/kinblog/announcing-kin-a-cryptocurrency-for-an-open-future-98f1da2f498a>.

⁶ Available at <https://medium.com/kinblog/kin-tde-if-you-want-to-participate-you-must-register-by-september-9-9-00-a-m-et-2f1304a4aa4b>.

developers to follow their passions while still ensuring they [could] make a fair living.” (*Id.*) As Livingston put it:

[the Kin ecosystem] is about a movement. A movement to build an ecosystem where people get fairly compensated for the value they provide to digital services. ... A movement where consumers get immersive and unique experiences catered to their interests and needs. A movement is only as strong as the people behind it, and ***a movement this ambitious needs as many people as possible.***

(Ted Livingston, *Why I Am Telling My Friends and Family That They Should Participate in the Kin TDE*, Medium, Sept. 6, 2017 (emphasis added).⁷)

Realizing the importance of bringing developers into the ecosystem, Kik promoted Kin to that community at conferences such as Botness and developer social media channels. (T. Philp Tr. at 99:4–23.) Livingston appealed directly to that community as well, stating: “[t]o all developers out there who are competing in a world increasingly controlled by giants, we invite you to check out Kin.” (Ted Livingston, *Announcing Kin, a Cryptocurrency for an Open Future*, Medium, May 25, 2017.)

Outside observers understood the vision that Kik and Mr. Livingston were describing, and they understood the critical role that developers other than Kik would play in the growth and development of the Kin ecosystem. Thus, as one journalist noted, the Kin digital currency was a direct attack on the consolidation “of power and influence to a few players.” (*See, e.g.*, Craig Daniels, *The Kin revolution, in Kik CEO Ted Livingston’s own words*, Communitel News, June 8, 2017.⁸) As these observers recognized, Kin had the potential to break down this consolidation by giving ***all*** developers (not just Kik) the opportunity to earn a living from the value they provided: “If you’re a developer, and your app generates plenty of users and adds value to the ecosystem, you get rewarded. If you write a story, share it, and others like it, you get paid. In Kin.” (Gerrit De Vynck, *Kik App Debuts Digital Currency Amid Bitcoin Boom*, Bloomberg Business, May 25, 2017.⁹)

G. The Pre-Sale and TDE

To implement its vision, Kik planned to sell Kin through (1) a pre-sale to accredited participants under Regulation D and (2) the TDE to the public. In the pre-sale, participants agreed

⁷ Available at <https://medium.com/kinblog/why-i-am-telling-my-friends-and-family-that-they-should-participate-in-the-kin-tde-5df7798df3ed>.

⁸ Available at <http://news.communitech.ca/news/the-revolution-of-kin-in-kik-ceo-ted-livingstons-own-words/>.

⁹ Available at <https://www.bloomberg.com/amp/news/articles/2017-05-25/kik-messenger-app-debuts-own-digital-currency-amid-bitcoin-boom>.

to a Simple Agreement for Future Tokens (“SAFT”) where they received the right to receive Kin at a discount, if and when there was a “Network Launch,” meaning when Kik sold Kin to the public. (SEC Ex. 5 at KIK000068.) Participants would receive 50% of their Kin at the time of Network Launch and the remaining 50% one year later. (*Id.* at KIK000067.) In consideration of various factors distinguishing the pre-sale from the TDE, Kik decided to structure the pre-sale as an exempt offering under Regulation D. Kik retained a third-party vendor to conduct diligence to ensure that each of the roughly 50 pre-sale participants were accredited. Kik filed its Form D with the SEC on September 11, 2017. (SEC Ex. 6.)

The Company received sufficient funds in the pre-sale alone to pursue the Kin project. (T. Livingston Tr. at 500:5–20.) Moreover, it turned down millions more in interest from pre-sale participants. (*See* SEC Ex. 115 (Pantera Capital requesting to contribute more and raise the allocation cap to \$75 million/\$25 million between the pre-sale and TDE, respectively).) But Kik capped the pre-sale at \$50 million to ensure that the public had the same opportunity to purchase Kin. (*See* Ted Livingston, *Why I Am Telling My Friends and Family That They Should participate in the Kin TDE*, Medium, Sept. 6, 2017; Ted Livingston, *Kin TDE*, Medium, Aug. 29, 2017 (“We want as many people as possible to be able to participate in this project from the beginning.”); *see also* P. Heinke Tr. at 341:21–342:1.)

Thus, by the time of the TDE, Kik did not need additional cash to sustain its business. It sold Kin to the public, ***not because it needed the money***, but rather to allow for an immediate and broad community centered around Kin, in line with its vision. Broad adoption and contribution by consumers and developers would foster a “virtuous cycle in which the ecosystem grows in both size and quality.” (Ted Livingston, *Announcing Kin, a Cryptocurrency for an Open Future*, Medium, May 25, 2017.) Indeed, with the understanding that the project would only succeed if Kin purchasers actually used the token as a medium of exchange, Kik structured the TDE to encourage broad participation and to discourage speculation. To that end, Kik capped the amount of tokens a participant could purchase, meaning that within the first 24 hours, purchasers could only buy up to approximately \$4,400 worth of Kin to “ensure all registered participants had a fair chance to purchase,” and participate within the ecosystem. (P. Heinke Tr. at 217:4–12; SEC Ex. 94; KIK_00006213 (Sept. 13, 2017 Tweet).)

The cap worked to prevent small numbers of large purchasers from monopolizing allocations to the exclusion of others who were interested in using Kin and developing on the platform. And, unlike the vast majority of other token sales at around this time, Kik required no minimum purchase amount, meaning that a participant could pay \$1 and receive Kin. (P. Heinke Tr. at 215:2–5; *see also* KIK_001188 (participants paid as little as \$0.09 for Kin).) In fact, around 50% of participants purchased \$1,000 or less worth of Kin – amounts that are simply inconsistent with an investment purpose. (*Id.*) Further, and in accordance with its treatment of Kin as a currency, Kik required participants to pass rigorous KYC, AML, and OFAC screening, by submitting personal information, such as government issued photo identification, passport photos, addresses, and a self-portrait to verify their identities. (P. Heinke Tr. at 417:13–420:21.)

In the TDE, Kik sold Kin to around 10,000 participants for approximately \$49.176 million in Ether. Kik’s independent auditor, KPMG LLP (“KPMG”) determined that the money received should be treated as revenue, analogous to the receipts from sales of inventory. (P. Heinke Tr. at 436:6–21; *see also* KIK_00101616 (email to the Quebec Securities Commission attaching KPMG’s assessment of Kin as a currency from a financial reporting and tax standpoint).) The Company also paid taxes on the sale proceeds in accordance with the Canadian Revenue Agency’s view that the proceeds were income. (P. Heinke Tr. at 435:20–436:21.) Otherwise, the proceeds would have been treated as a debt or equity instrument and would not have been taxed.

H. Kik Integrated Kin Within Its Messenger at the Time of the TDE

Kik distinguished itself from other token issuers at the time by planning to launch a minimum viable product (“MVP”) at the time of the TDE.¹⁰ (SEC Ex. 2 at KIK000023 (emphasizing in its whitepaper that the TDE would occur “once Kik has completed the technology upgrade to integrate with Kin and the cryptocurrency can be used functionally within Kik,” meaning that Kin would only be distributed once functionality was established).) The Company believed that it was important for participants to start using Kin immediately and show developers the viability of Kin working inside an application. (*See* T. Philp Tr. at 274:3–19.)

At the time of the TDE, participants could link their Ethereum wallets to their Kik accounts and display their Kin balances, which was important to show status within the chat community. (*See* P. Heinke Tr. at 472:14–20.) Participants also had the ability to use tokens to access tiered premium content, such as sticker packs, that were unlocked depending on the amount of Kin owned. (T. Philp Tr. at 223:11–15.) Kik’s experience with Kik Points and internal research had taught Kik that stickers, emojis, and other expressive content were valuable to users. (*Id.* at 60:11–17.¹¹) In fact, participants immediately recognized this utility and applauded the Company for implementing Kin into Kik. (*See* KIK_0003658; KIK_0003665 (“Awesome! That’s what happens when you have a real app already in place and devs ready to implement the new features!”); KIK_00003773 (“12 hours an[d] we already see a product implemented in the app ...”).)

Kik devoted substantial resources to creating an MVP prior to the TDE and delayed its

¹⁰ Launching an MVP is common in all technology companies – there is first a research phase, then a preliminary validation phase, and then testing the launch of the MVP. (E. Clift Tr. at 90:22–91:15; *see also* T. Philp Tr. at 264:22–265:3.)

¹¹ LINE, a Japanese messaging application, earned hundreds of millions of dollars in revenue in sticker sales alone. (T. Philp Tr. at 60:17–22; *see also* Zachary M. Seward, *Line sold \$268 million worth of stickers last year amid Asia’s messaging boom*, Quartz, June 12, 2016, available at <https://qz.com/704768/line-sold-268-million-worth-of-stickers-last-year-amid-asias-messaging-boom/>; Kif Leswing, *Snapchat just introduced a feature it paid more than \$100 million for*, Business Insider, July 19, 2016, available at <https://www.businessinsider.com/snapchat-just-introduced-a-feature-it-paid-more-than-100-million-for-2016-7>.) Further, anyone could use Kin as a medium of exchange outside of Kik on the Ethereum blockchain. (T. Philp Tr. at 228:4–5.)

TDE at least three times from April to September 2017 to ensure functionality.¹² (See SEC Ex. 16A at KIK_00106727; P. Heinke Tr. at 333:11–16.) Given the importance of stickers and status within the community, Kik expended significant resources to develop and execute the MVP. (See P. Yang Tr. at 21:13–26:20 (describing the rigorous content development process); SEC Ex. 102 (analyzing which stickers should be available at certain levels based on research).) Shortly after the TDE, nearly 20% of the participants linked their wallets to Kik, showing substantial use within the application. (See KIK_001188.) Users can now earn Kin within Kik by answering polls and surveys and spend it within the app on stickers and chat themes. Kik users can also send Kin peer-to-peer within the app.

I. Kin Is a Thriving Medium of Exchange

Since the TDE, use of Kin as a currency has continued to increase as developers and consumers use it within the ecosystem. In fact, *excluding secondary market transactions, as of today, Kin exceeds Ether and Bitcoin (which Director Hinman does not believe are securities) in daily blockchain activity, demonstrating Kin’s wide acceptance and adoption.* (See <https://blocktivity.info/>.) Indeed, of the over 2,000 tokens in circulation, Kin is ranked as having the fifth highest daily blockchain activity.

Further, while not specifically designed for physical goods, Kin can be used to buy items such as sunglasses and vehicles. (See Mrs. Shivas, *ThirdEyeSunglasses.com Will Now Accept Kin Coin*, Third Eye Sunglasses, Jan. 2, 2018¹³; see also Spectrum Auto Sales interview with “the Kin Realist,” (accepting Kin for vehicles).¹⁴) Moreover, there is a publicly available, open-sourced software developer kit (“SDK”) that allows any developer to integrate Kin within his or her application. Notably, Kin in Kinit, discussed below, was the first cryptocurrency approved to be earned and spent in an Apple iOS application. Both the Google Play and Apple App Stores allow Kin to be used as a currency within their respective platforms, where Kin has also been adopted, integrated, and used in over 30 digital applications (the vast majority of which were not developed

¹² The Staff has suggested that Kik’s development of an MVP was a superficial attempt to bolster Kik’s argument that Kin were not securities. But the evidence supports a different conclusion: that from the time Kik published its whitepaper through the TDE, Kik worked towards developing a useful, general-purpose cryptocurrency, and the MVP was the first step in showing developers and users the viability of Kin. (See SEC Ex. 2 at KIK_000008; T. Philp Tr. at 274:3–19.) Kik repeatedly noted that the ecosystem too would succeed only if it had a broad base of *users and developers*, which was only possible if developers and users believed Kin could work inside applications. (See, e.g., Ted Livingston, *Why I Am Telling My Friends and Family That They Should Participate in the Kin TDE*, Medium, Sept. 6, 2017; SEC Ex. 2 at KIK000008.) Given that Kin purchasers used the MVP, its functionality cannot be disputed, and Kik should not be punished just because part of the reason for the initial product was to support compliance.

¹³ Available at <https://www.thirdeyesunglasses.com/blogs/third-eyesunglasses/thirdeyesunglasses-com-will-now-accept-kin-coin>.

¹⁴ Available at <https://www.youtube.com/watch?v=VoYwaXFluBg>.

by Kik), including (*see Appendix A* for a full list of applications that have adopted Kin):

- **Perfect365** – Perfect365 is the top-rated augmented reality beauty application in the world with over 100 million users. It allows users to virtually try on different makeup and hair styles. Kin can be used to purchase premium features within the app, and also allows users to earn Kin. (*See How you can earn Kin cryptocurrency in the Perfect365 app*, Perfect365, 2018.¹⁵)
- **Kinny** – Users can tip each other on Reddit and Twitter for content that they like such as posts and comments. Users can also earn Kin by completing surveys and polls through a third-party polling service. (*See Michelle, Kin Developer Program Apps – Live in Week One*,” Medium, Oct. 25, 2018.¹⁶)
- **Nearby** – Nearby, with millions of users, is one of the most popular apps for meeting new people. Kin will replace the existing Nearby Points system, and users can earn Kin by messaging new users to incentivize participation in the Nearby network. Users will be able to use Kin to tip other users, send virtual gifts, and increase their posts’ visibility. Thousands of users have created Kin wallets and have transacted in Kin within Nearby. (Caroline Edwards, *Kin Developer Program Q&A: Nearby*, Medium, Nov. 9, 2018.¹⁷)
- **Kinit** – Users can earn Kin by answering surveys and spend Kin on gift cards from brands such as Amazon, AMC Theaters, and Google Play. Kinit also allows users to send Kin to each other. (Michael K. Spencer, *Kik Messaging App Launches Kinit Wallet for “Kin” Token*, Medium, July 21, 2018.¹⁸)
- **Swelly** – Swelly is a social network survey platform used in many chat applications, such as Facebook Messenger, allowing brands to receive feedback from target audiences, while keeping users’ data anonymous. Swelly also has its own standalone app and allows brands and users to create and post their own surveys (e.g. “this or that”), called “Swells,” to crowdsource opinions. In August 2018, Swelly offered users a way to earn Kin in Kinit, and more recently, users can now use Kin within Swelly’s standalone app to give Kin to content creators they like. (Noa Kessler, *Swelly Goes Live With Kin*, Medium, Nov. 19, 2018.¹⁹)

Notably, roughly half the applications that have integrated Kin were built specifically for Kin, showing that Kin has created the foundation for not only existing businesses to monetize, but for

¹⁵ Available at <https://www.perfect365.com/kin-cryptocurrency/>.

¹⁶ Available at <https://medium.com/kinblog/kin-developer-program-apps-live-in-week-1-876c181ced7d>.

¹⁷ Available at <https://medium.com/kinblog/kin-developer-program-q-a-nearby-678b31e26623>.

¹⁸ Available at <https://medium.com/futuresin/kik-messaging-app-launches-kinit-wallet-for-kin-token-e3ac949986c>.

¹⁹ Available at <https://medium.com/kinblog/swelly-goes-live-with-kin-fbe7d7fdb8c4>.

new businesses as well. Such usage only continues to grow as Kin moves towards being the most widely used cryptocurrency in the world.

III. THE PROPOSED ENFORCEMENT ACTION AGAINST KIK AND THE KIN FOUNDATION EXCEEDS THE COMMISSION'S STATUTORY AUTHORITY

The Staff proposes to file an enforcement action against Kik and the Kin Foundation for allegedly violating Section 5 of the Securities Act. (Letter from Robert Cohen, Chief of the SEC Enforcement Division's Cyber Unit, to Kik (Nov. 16, 2018).) As we understand it, the Staff contends that sales of Kin in the pre-sale and in the TDE, as well as transfers of Kin after the TDE, amounted to offers or sales of "investment contracts," which should have been registered with the Commission under Section 5. The Staff has never suggested to us that offers or sales of Kin involved any fraud or other intentional misconduct. As such, the issue in dispute is whether any sales or transfers of Kin amounted to offers or sales of a "security" – in other words, whether sales or transfers of Kin are within the scope of the Commission's regulatory authority at all. For the reasons discussed below, we believe the proposed enforcement action would exceed the Commission's statutory authority and, as such, would fail.

As an initial matter, it is worth emphasizing that the Commission's regulatory authority is not unlimited, but rather is bounded by the statutes that the Commission is charged with enforcing. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 213 (1976). Moreover, the Commission may not unilaterally define, much less expand, the scope of its statutory authority. *Business Roundtable v. S.E.C.*, 905 F.2d 406, 408 (D.C. Cir. 1990). Rather, the statutes that define the scope of the Commission's authority are to be interpreted by the courts.

To date, the Commission's attempt to regulate cryptocurrencies under the rubric of "investment contracts" has faced only limited judicial scrutiny. There have been a handful of preliminary decisions, all of which involved allegations of fraud, unlike this case. *See, e.g., S.E.C. v. PlexCorps*, 2017 WL 6398722, at *2 (E.D.N.Y. Dec. 14, 2017); *U.S. v. Zaslavskiy*, 2018 WL 4346339, at *1–9 (E.D.N.Y. Sept. 11, 2018); *but see Blockvest*, 2018 WL 6181408, at *4 (denying preliminary injunction and holding that "[b]ecause they [*i.e.*, the tokens] are not securities, Plaintiff's causes of action fail"). Beyond that, the Commission has issued a number of unilateral statements purporting to define the scope of its authority, and has gotten a handful of small companies to agree to settled cease-and-desist orders that reflect a similar approach."²⁰ In all of these efforts, the Commission has relied on a superficial application of the Supreme Court's decision in *Howey*, one that would effectively expand the scope of the Commission's authority in this area beyond its statutory limits. Indeed, in one recent case where the court applied a more

²⁰ *See, e.g., Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO*, Exchange Act Release No. 81207, at 4–5 (July 25, 2017) (hereinafter referred to as the "DAO Report"); *Munchee Inc.*, Securities Act Release No. 10445, at 6 (Dec. 11, 2017); *Paragon Coin, Inc.*, Securities Act Release No. 10574, at 6–7 (Nov. 16, 2018); *CarrierEQ, Inc., d/b/a AirFox*, Securities Act Release No. 10575, at 3–5 (Nov. 16, 2018).

rigorous application of the *Howey* test, the court flatly rejected the Commission’s claim that a sale of a cryptocurrency amounted to an “investment contract.” *See Blockvest*, 2018 WL 6181408, at *4.

For the reasons discussed below, we believe the Staff’s proposed enforcement action against Kik and the Kin Foundation would fail any similarly rigorous application of the definition of “investment contract” as interpreted by the Supreme Court in *Howey*.

A. Kin, as a “Currency,” is Exempt from the Definition of a “Security” Under the Federal Securities Laws

As a threshold matter, Kin is exempt from the federal securities laws. Courts have long recognized that the definition of a “security” under the Securities Act and the Exchange Act are “virtually identical.” *See, e.g., Reves v. Ernst & Young*, 494 U.S. 56, 61 (1990); *see also Great Rivers Co-op. of Southeastern Iowa v. Farmland Indus., Inc.*, 198 F.3d 685, 698 (8th Cir. 1999). In that regard, the definition of “security” in the Securities Act does not include the term “currency” (15 U.S.C. § 77b(a)(1)), and the Exchange Act expressly *excludes* “currency” from the definition of a “security.” *See* 15 U.S.C. § 78c(a)(10) (“The term ‘security’ means . . . but **shall not include currency.**” (emphasis added)).

“Currency” is not defined under the federal securities laws, but the term has long been understood to mean a store of value or a “medium of exchange.” (*See Black’s Law Dictionary* (an item that circulates “as a medium of exchange”).) On that point, cryptocurrencies can be used for peer-to-peer transactions, are convertible to other currencies, including Kin, and have been widely accepted by digital applications and retailers. (*See Merriam Webster* (cryptocurrency is “any form of currency that only exists digitally, that usually has no central issuing or regulating authority but instead uses a decentralized system to record transactions and manage the issuance of new units”).) Further, for purposes of the federal securities laws, “currency” need not be legal tender, or recognized by the United States or any other foreign country. *See generally Sea Pines of Va., Inc. v. PLD, Ltd.*, 399 F. Supp. 708, 711–12 (M.D. Fla. 1975) (promissory note, as a “cash substitute,” was “within the exclusion for currency,” and therefore not a security).

In any event, courts and federal agencies have repeatedly characterized cryptocurrencies as “currencies.” Earlier this year a federal court explained that “[v]irtual currencies are generally defined as ‘digital assets used as a medium of exchange.’” *Commodity Futures Trading Comm’n v. McDonnell*, 287 F. Supp. 3d 213, 218 (E.D.N.Y. 2018); *see also Commodity Futures Trading Comm’n v. My Big Coin Pay, Inc. et al*, 2018 WL 4621727, at *5 (D. Mass. Sept. 26, 2018) (Memorandum of Decision) (quoting *In re BFXNA Inc.*, CFTC Docket 16–19, at 5–6 (June 2, 2016)) (“[V]irtual currencies are . . . properly defined as commodities.”). This interpretation is consistent with enforcement actions and guidance issued by the United States Financial Crimes Network (“FinCEN”), the Internal Revenue Service (“IRS”), and OFAC, which describe virtual currencies as “a medium of exchange, a unit of account, and/or a store of value.” *See* FIN-2013-

G0001, *Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies* (Mar. 18, 2013); IRS Notice 2014-21; *FinCen Fines Ripple Labs, Inc. in First Civil Enforcement Action Against a Currency Exchanger*, FinCEN (May 5, 2015); OFAC *Frequently Asked Questions* (2018-11-28).

Kin possesses all the characteristics of a currency like Bitcoin and Ether (which Director Hinman acknowledges are not securities). They are blockchain-based tokens that serve as a medium of exchange. From the time Kik first announced its token offering, the Company made clear its vision for Kin was that anyone “[would] be able to spend [it] on products, services, and other valuable assets offered by merchants, developers, influencers, and other participants.” (SEC Ex. 2 at KIK00005–6.) This vision has been realized, as Kin can be used to pay for goods and services on both the Ethereum and Kin blockchains. Indeed, not only has Kin been accepted for physical goods, such as sunglasses, but it is now available for use in over 30 digital applications in the Google and Apple stores, and that number is only increasing. These include well-established applications, such as Perfect 365 (which has 100 million users), as well as new concepts, such as Kinny, which allows Twitter and Reddit users to tip each other with Kin for posts and comments that they like. Excluding secondary market sales, as of today, Kin earn and spend transactions within digital applications currently reflect a higher blockchain activity than that of Bitcoin and Ethereum.

Precisely because it understood Kin to be a currency, Kik required every purchaser to undergo KYC, AML, and OFAC screening, which law enforcement authorities and regulatory agencies have consistently encouraged. Further, Kik’s independent auditor, KPMG, analyzed the sales and concluded that Kin functioned like a currency. KPMG thus determined that the proceeds from the TDE should be booked as revenue, analogous to selling commodities. (SEC Ex. 168 at KIK_00144671.) As such, Kin paid income taxes on the proceeds of Kin sales, which it would not have done if Kin sales had been accounted for as sales of debt or equity instruments.

B. The Pre-Sale and TDE Do Not Constitute “Investment Contracts”

Setting aside the statutory exemption for “currency,” Kin does not otherwise meet the definition of a “security” under the Securities Act. The Staff has taken the position that the pre-sale and the TDE involved sales of “investment contracts.” But the Staff’s position in that regard stretches the existing definition of “investment contracts” beyond its original meaning and intent.

As interpreted by the Supreme Court, an “investment contract” is “a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.” *Howey*, 328 U.S. at 298–99. In assessing whether a particular contract or transaction meets this standard, courts consider the terms of the operative contract and the facts and circumstances underlying the transaction, including any promotional materials and the character of the item purchased. Although courts do consider purchasers’ subjective intent, they focus on what purchasers were “offered or promised,”

irrespective of whether purchasers had a subjective investment intent. *See Warfield v. Alaniz*, 569 F.3d 1015, 1021 (9th Cir. 2009) (“[W]hile the subjective intent of the purchasers may have some bearing on the issue of whether they entered into investment contracts, ***we must focus our inquiry on what the purchasers were offered or promised.***” (emphasis added)).

In any event, in performing this analysis, courts should keep in mind that the term “investment contract” is not a boundless catch-all that encompasses everything the SEC would like to regulate, but instead “***has the limited purpose of identifying unconventional instruments that have the essential properties of a debt or equity security.***” *See Wals v. Fox Hills Dev. Corp.*, 24 F.3d 1016, 1018 (7th Cir. 1994) (emphasis added). In fact, the term “investment contract” is supposed to encompass scenarios where a passive investor entrusts his or her money to managers of a business venture to exert entrepreneurial efforts to make the investor more money. *See Piaubert v. Sefrioui*, 2000 WL 194149, at *4 (9th Cir. Feb. 17, 2000) (agreeing with the District Court that “[t]o be an investment contract, one of the characteristics is that the investor is passive and relies on others to make money (or not)”); *Steinhardt Group Inc. v. Citicorp*, 126 F.3d 144, 155 (3d Cir. 1997) (finding that because “[defendant] was not a passive investor, we need not consider whether the securitization here constituted a common enterprise”). That framework does not fit the circumstances here.

1. There Is No Common Enterprise Between Kik and/or the Kin Foundation and TDE Participants

Sales of Kin, whether in the pre-sale, the TDE, or after the TDE, do not constitute “investment contracts” because no common enterprise exists between Kik and/or the Kin Foundation, on the one hand, and Kin purchasers, on the other hand.

As an initial matter, the Staff has taken the remarkable position that *Howey* test does not require proof of a “common enterprise,” which would surely come as a surprise to the Supreme Court and the Circuit Courts of Appeal that have uniformly held that it does. *See e.g., United Housing Found., Inc. v. Forman*, 421 U.S. 837, 852 (1975) (“The touchstone [of an investment contract] is the presence of an investment in a ***common venture*** premised on a reasonable expectation of profit to be derived from the entrepreneurial or managerial efforts of others.” (emphasis added)); *see also Milnarik v. M-S Commodities, Inc.*, 457 F.2d 274, 276 (7th Cir.1972) (judicial analyses of the question whether particular investment contracts are ‘securities’ within the statutory definition have ***repeatedly stressed the significance of finding a common enterprise.***” (emphasis added)). More recently, the Staff has equivocated on this question. (*See* Dec. 4, 2018 Letter from B. Mitchell.) But in any event, to date, the Staff has never actually identified or described any specific “common enterprise” between owners of Kin and either Kik or the Kin Foundation. This stands in stark contrast with the many cases finding “investment contracts” under the *Howey* framework, which uniformly involve some kind of identifiable entity or business venture – things like the management of the orange grove in *Howey*.

In fact, this case involves no comparable entity or business venture. Kin holders do not hold any ownership interest in either Kik or the Kin Foundation, and they have no claims (contractual or otherwise) to the assets or any future profits of either Kik or the Kin Foundation.²¹ As such, there is no basis for suggesting that either of those entities is the “common enterprise” at issue. The Staff may argue that a “common enterprise” exists simply because participants in the Kin ecosystem all own Kin, and therefore all stand to benefit from any increase in Kin’s value. But, without more, simply owning a common asset whose value rises and falls depending on market forces does not give rise to a “common enterprise” for purposes of *Howey*. See *Woodward v. Terracor*, 574 F.2d 1023, 1025 (10th Cir. 1978). This is especially true where, as here, the relationships between the parties lack any other features of a “common enterprise.” For example, many courts have held that when a transaction involves a mere transfer of a property interest, with no ongoing contractual or other obligations on the part of the transferor, there is no common interest under *Howey*. See, e.g., *Terracor*, 574 F.2d at 1025; see also *Alumni v. Dev. Res. Grp., LLC*, 445 F. App’x 288 (11th Cir. 2011).

In *Terracor*, for example, the plaintiffs purchased undeveloped plots of a development, with no intent to build on the land, but rather to sell the subdivisions for a profit in reliance on the defendant’s promotional materials. Such representations touted plans to develop the community by building “shopping centers, health and cultural facilities, transportation facilities, and abundant recreational opportunity, including a golf course and lake.”²² *Id.* The Court found no common enterprise because:

the mere fact that the plaintiffs bought lots from Terracor does not mean that by such acquisition they were thereafter engaged in a common venture or enterprise with Terracor. ***The only contractual agreement between plaintiffs and Terracor was the Uniform Real Estate Contract. Terracor was under no contractual obligation to the plaintiffs other than to deliver title once purchase terms were met. Unlike Howey, Terracor was not under any collateral management contract with the purchasers of its land. In short, the record in the instant case simply shows the purchase by the plaintiffs of lots in a real estate development.*** Though it is possible

²¹ The lack of a common enterprise – and the fact that Kin holders have no interest in Kik’s financial performance – further illustrates why the federal securities laws are inapplicable here. Had Kik filed a registration statement under the Securities Act as the Staff believes was required, Kin holders would have received among other things, Kik’s financial statements and disclosures relating to Kik Messenger, all of which would have been both irrelevant and potentially misleading.

²² A purchaser’s subjective investment intent has been found to be insufficient to create a common enterprise. See *Hart v. Pulte Homes of Mi. Corp.*, 735 F.2d 1001, 1003 (6th Cir. 1984) (no common enterprise for model home purchases despite investment intent).

that the plaintiffs may have a common-law remedy against the defendants arising out of the purchase of the lots, such does not mean that the transaction itself is an “investment contract,” thereby invoking the provisions of the federal securities laws.

Id. (emphasis added).

Other courts have held that a sale of property, without more, cannot give rise to a common enterprise, irrespective of the purchasers’ intent. *See Alunni*, 445 F. App’x 288. Indeed, even when the seller does agree to ongoing contractual obligations to the buyer that may increase the value of the transferred property, the transaction does not necessarily constitute an investment contract. *Id.* In *Alunni*, for example, there was no common enterprise where a condo seller in Florida agreed to provide rental and management services to buyers for a year to generate profit. The seller promoted the condos as “passive investment[s].” *Id.* at 292. The purchasers did not live in Florida and relied exclusively on the seller to oversee the condo and generate rental revenues. *Id.* at 297. Even that reliance on the seller to engage in conduct that would increase value was not enough to show a common enterprise because the operative contract only required management services for a year, and thereafter buyers would have complete control over their condos and could use and/or rent them in any way they pleased. *Id.* at 293. The Court made clear that “representations – at [] workshops or otherwise – were not a part of the parties’ agreement. The parties’ actual written agreement demonstrated that it was a real estate purchase agreement . . .” *Id.* at 298.

Like the developer in *Terracor*, Kik’s only contractual obligation to TDE purchasers was to deliver Kin tokens, precluding any common enterprise between Kik and Kin purchasers. (*See* SEC Ex. 8.) Kik’s position is even stronger than the condominium seller in *Alunni*, in that purchasers obtained complete control over their tokens **at the time of the TDE**, irrespective of Kik or the Kin Foundation. The Terms of Use made that point clear:

KIN IS AN INTANGIBLE DIGITAL ASSET. KIN TOKENS EXIST ONLY BY VIRTUE OF THE OWNERSHIP RECORD MAINTAINED IN THE ETHEREUM NETWORK. ANY TRANSFER OF TITLE THAT MIGHT OCCUR IN ANY KIN TOKENS OCCURS ON THE DECENTRALIZED LEDGER WITHIN THE ETHEREUM PLATFORM. KIK DOES NOT GUARANTEE THAT KIK OR ANY KIK PARTY CAN EFFECT THE TRANSFER OF TITLE OR RIGHT IN ANY KIN TOKENS.

(SEC Ex. 8 at KIK_000089.)

These Terms of Use were **the only** terms governing the relationship between Kik and Kin purchasers. As in *Alunni*, the Terms of Use contained a merger clause, stating that “[t]his Agreement constitutes the entire agreement between you and Kik relating to your access and use

of the Sites, and content and your purchase and use of the Kin Tokens.” (*Id.*) Thus, there is no common enterprise between Kik and/or the Kin Foundation and Kin purchasers.

2. Kin Purchasers Were Not Led to Expect Profits from the Efforts of Others

Moreover, the Commission will be unable to show that purchasers expected to profit from the entrepreneurial or managerial efforts of Kik or the Kin Foundation. In applying *Howey*, courts center their analysis on what was “*offered or promised*” to potential purchasers to determine whether the promoter held out an investment opportunity. See *Blockvest*, 2018 WL 6181408, at *6. Indeed, determining whether there was a reasonable expectation of profits hinges on “an objective inquiry into the character of the instrument or transaction offered based on what the purchasers were ‘led to expect.’” See *Warfield*, 569 F.3d at 1021 (quoting *Howey*, 328 U.S. at 298–99). For example, there is no expectation of profits where purchasers are *primarily* led to expect an item for use or consumption, even in the future. *Forman*, 421 U.S. at 852–53. Nor is there a reasonable expectation of profits merely because the promoter mentions that an item could increase in value or that the purchaser could profit. See *Alunni*, 445 F. App’x at 292 (no investment contract in purchase of condominiums where promotional materials stated that purchasers would receive immediate income and did not have to manage their units); *Revak v. SEC Realty Corp.*, 18 F.3d 81, 84 (2d Cir. 1994) (no investment contract where condominiums were marketed for “the income to be derived from rentals, and the prospect of capital appreciation”); *Hart*, 735 F.2d at 1003 (no investment contract for model home purchases where promotional materials touted “the potential for excellent appreciation in value during the holding period”).

But even if purchasers reasonably expect profits, such expectation must be based on the “undeniably significant” entrepreneurial or managerial efforts of the promoter. *S.E.C. v. Glenn W. Turner Enters., Inc.*, 474 F.2d 476, 482 (9th Cir. 1973). These efforts must be value generating, which excludes foundational efforts, such as building infrastructure. See, e.g., *Terracor*, 574 F.2d at 1025. And profits from resale on the secondary market based on market forces similarly falls outside the scope of *Howey*. Importantly, if the purchaser has complete control over the item or interest purchased, he or she does not expect profits *from the efforts of others*. See *Alunni*, 445 F. App’x 288.

a. Kin purchasers were led to expect consumptive use, not profits

When a promoter sells an item for consumptive use rather than as a passive investment, the federal securities laws do not apply. *Forman*, 421 U.S. 858. Courts have found no investment contract even where, unlike Kin, the consumptive use of the item in question is not available at the time of purchase. See, e.g., *Terracor*, 574 F.2d 1023. This is true, moreover, even where the seller is the only entity who can create the eventual use. *Id.* In other words, a delay in the ability to “consume” the product after purchase is not determinative.

The Supreme Court’s decision in *Forman* is instructive. There, a one-time purchase of shares proportional to the number of rooms in a housing co-op was not an investment contract despite the fact that the co-op was not ready for move-in at the time of the transaction. *Forman*, 421 U.S. 837. Even though purchasers did not hold legal title to the apartments and could not “consume” the product for years until the project was complete, the transactions were not “investment contracts.” *Id.* Indeed, the Commission’s prior enforcement determinations reinforce this reading of *Forman*. For example, in the *Spring Park Life Care Community* no action letter, the Staff recommended no enforcement action where purchasers bought bonds that financed the construction of a retirement center for purchasers to occupy *in the future*. 1985 WL 54240, S.E.C. No–Action Letter (May 17, 1985). Cases involving undeveloped lots are no different, as courts have determined that purchasing such undeveloped land does not constitute an “investment contract.” *See Terracor*, 574 F.2d 1023. Kik and the Kin Foundation are not aware of case law holding that a transaction is an investment contract just because the contemplated use of the underlying item would not exist until the future. As a result, any consumptive use argument will not be isolated to the use cases available at the time of the TDE, but instead will require an analysis of Kik’s promotion of future use as well as the actual use cases available at the time of any dispositive motion and/or trial.

Here, Kik and the Kin Foundation have an even stronger consumptive use argument than those set forth in *Forman* and *Spring Park* because Kin was *immediately* integrated into Kik Messenger at the time of the TDE, and Kin has been and continues to be widely adopted by developers and users alike. In its whitepaper, Kik made clear that the TDE would occur “once Kik has completed the technology upgrade to integrate with Kin and the cryptocurrency can be used functionally within Kik,” meaning that Kin would only be distributed once functionality was established. (SEC Ex. 2 at KIK_000023.) Upon receiving Kin, TDE participants could link their Kin wallets to their Kik accounts, view their Kin account balances in Kik, unlock status levels that displayed in their user profiles, and access or send exclusive sticker packs only available to TDE participants. Shortly after the TDE, nearly 20% of the TDE participants linked their wallets to Kik, showing verifiable use within Kik. (*See* KIK_001188.) Further, when some Kik users saw the exclusive sticker and status levels after the TDE, they asked Kik to be placed on a waitlist for Kin. (*See* KIK_00078629 (participant requesting to be added on the waitlist); KIK_00077401; *see also* KIK_00017256.)

During testimony, the Staff focused heavily on a survey conducted by CoinFund LLC in February 2017, seven months prior to the TDE, to suggest that TDE participants purchased to “invest” as opposed to “use” tokens. However, the survey only included CoinFund community members (and an extremely limited number at that), which CoinFund acknowledged was not necessarily representative of “average” cryptocurrency purchasers. The Staff also ignores that a fairly large percentage of survey participants said that they would lean towards being “users of the platform,” with only 21% leaning towards being speculators. (KIK_00106681.) Most importantly, the Staff ignores that the survey was conducted *well before Kik had ever said*

anything publicly about the Kin project, and therefore revealing *nothing* about what anyone was “led to expect” by Kik’s statements about Kin. See *Blockvest*, 2018 WL 6181408, at *5 (denying SEC’s request for a preliminary injunction on the basis that the SEC had failed to establish that tokens were “securities,” noting that courts should evaluate what was “offered or promised” to purchasers).

Indeed, Kik’s promotional materials emphasized Kin’s intended *future use* in “everyday digital services such as chat, social media, and payments.”²³ (SEC Ex. 2 at KIK000008.) The whitepaper stated that “users will be able to earn Kin by providing value to other members of the Kik digital community through curation, content creation, and commerce ... [and] will be able to spend Kin on products, services, and other valuable assets offered by merchants, developers, influencers, and other participants.” (*Id.* at KIK00005–6.) Third party journalists reiterated that users could potentially “use the new currency to buy games, live video streams and other digital products.” (Gerrit De Vynck, *Kik App Debuts Digital Currency Amid Bitcoin Boom*, Bloomberg Business, May 25, 2017.²⁴) The community also expressed excitement to use Kin, noting that “KIN really [has] good potential from everyday use to, well, startups as you said. All other cryptos I’ve owned I only saw in exchanges and this is the first one that I might actually use in practice. I think it’s great.” (KIK_00004157.) Notably, participants purchased as little as \$0.09 worth of Kin, which is at odds with an investment purpose.

In line with Kik’s vision, and as discussed above, Kin is being used by both developers and users at a rapid pace. Not only has Kin been accepted for physical goods, such as sunglasses, but it is now available for use in over 30 digital applications in the Google and Apple stores. These include well-established applications, such as Perfect 365 with 100 million users, as well as new concepts, such as Kinny. Excluding secondary market sales, Kin earn and spend transactions within digital applications, as of today, has surpassed the daily blockchain activity of Ether and Bitcoin. Such consumptive use is wholly inconsistent with a finding that Kin purchases are “investment contracts.”

²³ The Staff has informed Kik and the Foundation that it has spoken to pre-sale and TDE participants, who subjectively purchased to “invest” in Kin. Notably, the Staff refused to provide any transcripts or interview notes, or to inform Kik or the Kin Foundation how many purchasers they talked to, let alone who they were. Nonetheless, the Commission cannot dispute on the other hand that some purchasers bought Kin to participate in the ecosystem as a developer and/or consumer. Because it would be unduly burdensome to query each of the over 10,000 Kin purchasers what their intent was *at the time* of purchase, the key determination is what were purchasers “led to expect.” *Howey*, 328 U.S. at 301. Evaluated in the broader context, purchasers were led to expect that they would receive Kin, a medium of exchange for consumptive use within the Kin ecosystem.

²⁴ Available at <https://www.bloomberg.com/amp/news/articles/2017-05-25/kik-messenger-app-debuts-own-digital-currency-amid-bitcoin-boom>.

b. To the extent purchasers expected profits, they did not expect such profits based on the entrepreneurial or managerial efforts, of Kik or the Kin Foundation, as defined under *Howey*

In any event, to the extent that any TDE participants expected to profit from their purchases of Kin, the Commission will be unable to show that they expected to profit from the “undeniably significant” *entrepreneurial or managerial* efforts of either Kik or the Kin Foundation, as required under *Howey* and its progeny. *Glenn W. Turner*, 474 F.2d at 482.²⁵

As an initial matter, courts have held that where a contract involves a sale of a commodity and expected profits arise primarily from resale on the secondary market, the final prong of *Howey* is not satisfied. *See Noa v. Key Futures, Inc.*, 638 F.2d 77, 79 (9th Cir. 1980) (no expectation of profits from the efforts of others under *Howey* because, once the commodity was purchased, the profits of the investor depended on market fluctuations, not the managerial efforts of the defendant); *see also S.E.C. v. Belmont Reid & Co., Inc.*, 794 F.2d 1388, 1391 (9th Cir. 1986) (same). As in *Noa* and *Belmont Reid*, any fluctuation of Kin’s value is a consequence of market forces, as opposed to any entrepreneurial or managerial efforts of Kik or the Kin Foundation, as required under *Howey*.

The Second Circuit’s decision in *Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 756 F.2d 230, 241 (2d Cir. 1985), does not change this analysis. In *Gary Plastic*, the Second Circuit found that investors in certificates of deposit (which were established investment vehicles) expected profits from Merrill Lynch’s efforts because the bank had promised to create and operate a secondary market for the certificates, and agreed to re-purchase the certificates if interest rates decreased. As such, purchasers “bought an opportunity to participate in the CD Program and its secondary market. And, they are paying for the security of knowing that they may liquidate at a moment’s notice free from concern as to loss of income or capital, while waiting for FDIC or FSLIC insurance proceeds.” *Id.* Unlike Merrill Lynch, in *Gary Plastic*, neither Kik nor the Kin Foundation has guaranteed liquidity for Kin purchasers, nor have they promised to create and operate an exchange or to re-purchase Kin. Indeed, when asked about exchange trading, Kik noted that it “[was] up to the exchanges.” (KIK_00006208 (Sept. 13, 2017 Tweet).) Under those facts, there is no expectation of profits from the essential “managerial or entrepreneurial efforts” of either Kik or the Foundation.

To be sure, Kik and the Kin Foundation have exerted meaningful efforts within the Kin ecosystem, and they will continue to do so. But both before and after the TDE, Kik has made clear that Kik would be just one of many developers offering products and services in the Kin ecosystem, and that this participation by both users and by many other would be critical to creating value.

²⁵ The Commission will also face the challenge of showing that *objectively* any speculative intent was the *primary* motivation of purchasers. *See, e.g., S.E.C. v. SG Ltd.*, 265 F.3d 42, 54 (1st Cir. 2001).

That is why Kik described itself as “a participant, not a landlord” in the ecosystem, and that is why Mr. Livingston has stressed that “*a movement this ambitious needs as many people as possible.*” (Ted Livingston, *Why I Am Telling My Friends and Family That They Should Participate in the Kin TDE*, Medium, Sept. 6, 2017.) Consistent with that vision, the Company repeatedly stated that, for the ecosystem to succeed, applications and content would need to be created by “merchants, developers, influencers, and other participants” (not just Kik), and users would need to use Kin within those applications. (SEC Ex. 2 at KIK000006.) In fact, with respect to value generating applications aside from Kik Messenger and Kinit, Kik and the Kin Foundation have had virtually no involvement in creating content for the over 30 applications that have integrated Kin, including Perfect 365’s almost eight years of development, which boasts 100 million users.

Kik and the Foundation have also exerted efforts in developing the infrastructure for the Kin ecosystem, and in testimony, the Staff has focused a great deal of questions on that work. But that infrastructure work by Kik and the Foundation is not the kind of essential “entrepreneurial or managerial” efforts that *Howey* requires. Rather, those efforts are analogous to the efforts of the respondent in *Ticket Reserve, Inc.*, S.E.C. No-Action Letter, 2003 WL 22195093 (Sept. 11, 2003), or the efforts of the condominium seller in *Alunni*. In *Ticket Reserve*, for example, the respondent argued that the Ticket Reserve’s operation of the platform was not sufficiently “entrepreneurial or managerial” to support the existence of an “investment contract” because users themselves decided when to buy and sell. *Id.* at *7. In response, the Commission took no action. *Id.* Similarly, in *Alunni*, a condominium seller contractually agreed to manage and generate rental revenues for a year, but because the buyer obtained complete control over the condominium after a year, the seller did not provide the requisite managerial efforts. *See Alunni*, 445 F. App’x 288. Here, as in *Ticket Reserve* and *Alunni*, neither Kik nor the Kin Foundation have provided the “undeniably significant” entrepreneurial or managerial efforts, as defined by *Howey*, and Kin buyers themselves have complete control over whether and when to exchange their Kin for products and services or for cash. Those facts do not show an expectation of profits from the essential “managerial or entrepreneurial efforts” of either Kik or the Foundation, as *Howey* requires.

Indeed, although notable, the efforts of Kik and the Kin Foundation are also analogous to those of the Ethereum Foundation, which seeks to “promote and support [the] Ethereum platform and base layer research,” including making software available and releasing protocol updates. (*See* Ethereum Foundation Mission Statement.²⁶) Director Hinman has expressed his view that Ethereum is “sufficiently decentralized” to fall outside the scope of the federal securities laws, meaning that the Ethereum Foundation is not providing essential entrepreneurial or managerial efforts, despite exerting significant efforts generally. (*See* *When Howey Met Gary (Plastic)*, (June 14, 2018).) Kik and the Kin Foundation are no different.

²⁶ Available at <https://www.ethereum.org/foundation>.

3. Any Claims Against the Kin Foundation Are Baseless

On the November 16, 2018, Wells call, over a year into the Staff’s investigation, the Staff informed counsel – for the first time – that the Staff is considering claims against the Kin Foundation.

Notably, the Staff did not explain in any meaningful detail its basis for such allegations, including (for example) whether the proposed claims against the Foundation would be based on the pre-sale or the TDE (neither of which involved the Foundation in any way), or instead would be limited to transfers of Kin long after the TDE had concluded. Nor did it answer even the most basic questions regarding whether it considers Kin tokens in and of themselves to be “securities,” and if not, how post-TDE transfers of Kin by the Foundation could possibly constitute offers or sales of “investment contracts.” But whatever theory the Staff is considering asserting against the Foundation, any Section 5 claim will fail.

As an initial matter, there is clearly no basis to assert Section 5 claims against the Foundation with respect to the pre-sale and/or the TDE. The Foundation was not even formed until two weeks before the TDE, and it certainly had not been involved in the marketing or promotion of Kin. And, there is absolutely no evidence that the Kin Foundation had any direct contact with pre-sale or TDE purchasers, let alone that it has sold or transferred any Kin as part of the pre-sale or the TDE.

As for transfers of Kin by the Foundation many months (and, now, over a year) after the TDE, a Section 5 claim against the Foundation for those transfers would be deeply misguided. In the months since the TDE, the Foundation has transferred Kin to various developers to integrate within their digital applications and use it to pay users who earn Kin. Further, the Foundation plans to reward other developers and users who contribute to the ecosystem through the Kin Rewards Engine.

We know of no basis for the Staff to argue that any Kin token transferred by the Foundation is, in and of itself, a “security.” Thus, any Section 5 claim against the Foundation for post-TDE transfers of tokens would require proof that those transfers amounted to “investment contracts” under *Howey*. But, to our knowledge, the Staff has not gathered any meaningful evidence about the facts and circumstances of any post-TDE Kin transfers by the Foundation. If and when they do, however, the evidence will not support a claim that those transfers amounted to offers or sales of “investment contracts.”

First, the Commission will be unable to show that the Foundation “offered or promised” an investment opportunity to the developers and users who are receiving Kin distributions. In many cases, the Foundation has granted Kin to developers so that the developers can integrate it within their apps for users to earn and spend. The nature of such distributions leads recipients to expect to use Kin as a medium of exchange. Users also receive Kin from the Foundation for participating in earn experiences, such as answering surveys and polls, and therefore through using

the ecosystem as intended. This is clear from the fact that over 30 digital applications have integrated Kin for earn and spend experiences where Kin's daily blockchain activity (as of today) exceeds that of Bitcoin and Ether (both of which Director Hinman does not believe are securities). Simply put, with regard to the post-TDE Kin transfers by the Foundation, the Commission will be unable to point to any marketing or promotional materials or contracts that hold Kin out as an investment opportunity. Accordingly, there can be no dispute that the Foundation did not lead developers or users to expect profits.

Second, even setting that issue aside, the Commission likewise will be unable to show that the Foundation led anyone to expect profits *from the entrepreneurial or managerial efforts of Kik or the Foundation*. Quite the contrary, if any of these developers or users expected to profit, they would have expected those profits to come, not from the Foundation's (or Kik's) efforts, but rather from market forces (as discussed above) and/or from their own efforts. In particular, the developers receiving Kin from the Foundation are exerting efforts to incorporate Kin into their applications to allow consumers to earn and spend Kin. In fact, the Kin Foundation has not created a single application that has integrated Kin. As such, it is clear that the Kin Foundation is not building value generating properties within the ecosystem.

Third, there is no common enterprise between the Foundation and any of the developers and users who receive Kin from the Foundation. The Foundation has made no contractual obligations to developers and users other than to deliver Kin when milestones are reached or when users complete earn experiences.

IV. EVEN IF THE COMMISSION DOES NOT AGREE WITH KIK AND THE FOUNDATION ON THE MERITS, IT SHOULD EXERCISE PROSECUTORIAL DISCRETION AND DECLINE TO BRING THE ACTION

If the Commission disagrees with Kik and the Foundation with respect to the central legal issue, it should nonetheless use its discretion and decline to bring an enforcement action. The Company took substantial measures to comply with the law. Further, any action will not only harm Kin purchasers, who the Commission purports to protect, but it will carry the ill effects of regulating through enforcement.

A. Kik Took Substantial Measures to Comply With the Federal Securities Laws Based on Existing Guidance

Kik made significant efforts to comply with all applicable laws and regulations with respect to the pre-sale and TDE, including the federal securities laws.²⁷ Kik retained United States and international outside counsel, hired a distinguished General Counsel, conducted KYC, AML, and

²⁷ Kik and the Kin Foundation acknowledge that Section 5 does not require scienter or even negligence, but the Commission should weigh the Company's good faith when deciding whether to exercise discretion. And in any event, Kik's evident good faith will be a significant issue at trial that will weigh in Kik and the Kin Foundation's favor.

OFAC screening, launched a functional product at the time of the TDE, and received guidance from its third-party auditor that Kin was analogous to “inventory,” therefore booking the proceeds from the sale of Kin as revenue and paying taxes on it. (KIK_0010118.)

Based on the totality of the circumstances and guidance available at the time, Kik felt confident that the TDE would not be construed as a sale of unregistered securities.²⁸ When Kik began contemplating the sale of a new cryptocurrency in early 2017, cryptocurrencies (such as Bitcoin and Ether) had existed for nearly 10 years, and yet no court, government agency, or fact-finder had deemed *any* sale of cryptocurrency to be a sale of securities. Before the TDE, the Commission’s only enforcement activity in this area had asserted that Bitcoin is “money” and involved investments in a fund that was fraudulently advertised as entitling individuals to up to 1% daily interest. *See S.E.C. v. Shavers*, 2014 WL 12622292 (E.D. Tex. Aug. 26, 2014). However,

²⁸ During Testimony, the Staff has focused on discussions between Kik and the Ontario Securities Commission (“OSC”) before the TDE. The Staff appears to believe that the OSC told Kik that a sale of Kin would be deemed an unregistered sale of a security under Canadian law. In the Staff’s view, apparently, this discussion with the OSC put Kik on notice that sales of Kin would also be deemed a sale of a security under U.S. law because the definition of a “security” under Canadian law mirrors the definition of a “security” under U.S. law. But the Staff has misread the record. During an August 2017 meeting, the OSC told Kik and its counsel that that the OSC believed *Howey* was an outdated test and that it would not necessarily be followed under Canadian law. (P. Heinke Tr. at 433:6–20.) Moreover, under Canadian law, the OSC has the ability to, among other things, order that the trading in or acquisition of any securities by a person or company cease permanently, order that any exemptions contained in the Ontario securities laws do not apply to a person or company, and impose monetary fines up to \$1 million Canadian dollars for each failure to comply with Ontario securities laws. *See Ontario Securities Act* § 127 (1). This broad statutory discretion is based on an expansive definition of the “public interest,” even if there has been no actual violation of express Canadian securities law. *Id.* Given the lack of clarity, Kik decided to exclude Canadian residents. (P. Heinke Tr. at 444:10–14.) Kik also excluded residents from China and New York due to compliance concerns. (*Id.* at 421:23–423:11.) The Staff appears to believe that Kik’s decision to proceed in the rest of the United States, while excluding residents of Canada, China, and New York, reflects poorly on Kik and somehow suggests that Kik believed it was violating U.S. law. But the facts suggest precisely the opposite conclusion: when Kik believed there were serious regulatory concerns in a given jurisdiction (as there were in Canada, China, and New York), Kik took steps to avoid violating the law. Kik proceeded in the rest of the United States precisely because it did not believe it was violating U.S. law.

The Staff has also suggested that Kik should have reached out to them in advance of the TDE. But Kik felt confident that the TDE would not constitute a sale of securities, precluding a need to reach out to the Staff. Further, law and regulations are supposed to provide clear notice and guidance without necessitating confirmation of compliance by regulatory agencies. In the absence of any clear guidance from the Commission, companies like Kik are under no obligation to present every new idea to the Commission for its blessing. And, there are substantial doubts whether the Staff would have given Kik clear direction, and even if it did, it would take years to receive it as many projects are experiencing.

the Commission offered no guidance for companies that engaged in non-fraudulent cryptocurrency projects. In 2017, as public cryptocurrency sales became more prevalent, the community began asking for real clarity, even petitioning the Commission to “provide guidance to the fintech industry on when digital assets will be deemed securities and when the firms that facilitate the trading of digital assets must register as a broker-dealer, an ATS, or exchange.” (Letter from Vincent Molinari, Chief Executive Officer and President, Ouisa Capital, to Hon. Brent J Fields, Securities and Exchange Commission (March 13, 2017).²⁹) In the meantime, other regulatory agencies, such as the IRS, FinCEN and CFTC, had already weighed in on virtual currencies – the IRS viewed it as intangible property, FinCEN viewed it as money, and the CFTC viewed it as a commodity.

In contrast, the first time the SEC issued guidance on token sales was the July 25, 2017, DAO Report. SEC Release No. 81207, Report of the Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, July 25, 2017. The DAO Report stated that U.S. federal securities laws “*may* apply” to virtual tokens, *Id.* (emphasis added), and confirmed that such a determination would turn on an application of the *Howey* test to the specific “facts and circumstances” of each token sale. Applying this guidance, the DAO Report concluded that the token in question (the “DAO Token”) constituted a security for at least three reasons. First, purchasers jointly contributed funds to invest in projects. Second, token holders obtained the right to vote on which projects to pursue. Finally, holders received pro rata dividend payments from each project’s profits. On their face, the token holders were analogous to public company shareholders, who invest in a business – the tokens possessed absolutely no consumptive purpose.

The DAO Report cannot be read to suggest that virtual currencies designed and marketed as a medium of exchange are subject to the federal securities laws as it omitted any discussion of the issue. As a result, the industry understood the DAO Report to stand for the proposition that token sales with “specific utility [] to software or a platform” likely do not require registration. (See, e.g., Jon Buck, *Forewarned Is Forearmed: Key Takeaways from SEC DAO Report*, CoinTelegraph, July 30, 2017.³⁰)

On that point, at the time of the TDE hundreds of different tokens had been distributed to the public and to Kik’s knowledge, ***not one issuer filed a registration statement with the SEC***, demonstrating that the industry generally believed that tokens were not “securities” under existing law. Moreover, the reasonable conclusion Kik drew from the non-regulation of Bitcoin and Ether, was that Kin, like those tokens, would fall outside the SEC’s jurisdiction. Specifically, like Bitcoin, Kin was repeatedly marketed as a decentralized digital currency that could be earned and spent. Similarly, when Ethereum launched in 2014, it had no immediate utility as the network did not go live until almost a year later. Accordingly, given Kik’s interpretation of existing law, it

²⁹ Available at <https://www.sec.gov/rules/petitions/2017/petn4-710.pdf>.

³⁰ Available at <https://cointelegraph.com/news/forewarned-is-forearmed-key-takeaways-from-sec-dao-report>.

attempted to be compliant with all applicable regulatory authorities, and undertook substantial and novel efforts in that respect to best serve and protect Kin token recipients.

Notably, Kik excluded residents from China, Canada, and certain individual states within the United States based on existing guidance suggesting that the sale of Kin may violate their laws. However, based on existing law and guidance within the United States, Kik felt confident that the TDE was not an unregistered sale of securities. Had Kik felt otherwise, it would have excluded United States participants, like it did in other jurisdictions.

B. Given the Guidance Existing at the Time of the TDE, Any Enforcement Action Is Tantamount to Regulating by Enforcement, and Will Only Harm Kin Holders

Kin was developed to function in a decentralized ecosystem that would allow smaller developers to innovate and succeed, without being pushed out of the market by the dominant players in the current digital advertising market. Participants purchased Kin with the understanding that it would be used in a “digital services ecosystem that is fair and open,” and could be used in “everyday digital services such as chat, social media, and payments.” (SEC Ex. 2 at KIK000005, KIK000008.) The sale of Kin has resulted in no harm to Kin holders to date. If, however, the Commission were to bring an enforcement action, it may inhibit the Kin ecosystem reaching its full potential, ultimately harming each and every Kin holder. For example, upon the SEC’s release of the Airfox settlement last month, cryptocurrency exchanges de-listed AirTokens. Such a result would prevent developers from treating Kin as compensation because they would not be able to convert the currency to U.S. dollars. Further, it would limit new users from obtaining Kin and using it within the ecosystem.

Token offerings and blockchain technology present novel and complex fact patterns, creating immense regulatory uncertainty for both users of the technology and the Commission. However, filing an enforcement action against Kik and/or the Kin Foundation, and in turn seeking to create regulatory policy through enforcement actions, will have broad ramifications in an industry desperately needing affirmative guidance. As a result, it will drive innovators offshore because the “[c]urrent uncertainty surrounding the treatment of offers and sales of digital tokens is hindering innovation in the United States and will ultimately drive business elsewhere.” (Letter from fifteen members of Congress to Chairman Clayton (Sept. 28, 2018).)

As stated above, Kik made substantial efforts to comply with the federal securities laws, including conducting the pre-sale as an exempt offering under Regulation D of an investment contract relating to future delivery of Kin. And, currently, more than a year after the TDE, token issuers and industry participants alike are still unclear as to what types of tokens fall within the definition of a “security.” Neither public statements from the Commission nor recent enforcement settlements have provided prescriptive guidance to that effect because regulation through enforcement relies only on specific fact patterns based on individual cases rather than providing a

true framework akin to a safe harbor or prescriptive rules. For example, Chairman Clayton said earlier this year that “[j]ust because it’s a security today doesn’t mean it’ll be a security tomorrow, and vice-versa” without providing detail about the exact point in time the characterization could or would change with respect to specific token offerings. (Jay Clayton, Address at Princeton University, “Cryptocurrency and Initial Coin Offerings” (April 5, 2018)) The Commission has yet to approve exchanges or alternative trading systems (“ATS”) to allow for cryptocurrency transactions. Nor has it provided any details about how cryptocurrencies would be traded (if at all) and what disclosures should attend to them, let alone what will happen to the over 2,000 tokens currently trading in the United States.

Similarly, the Commission has not yet articulated whether it considers virtual currency in and of itself to be a security, or only that *sales* of such currency constitute “investment contracts.” *Paragon Coin, Inc.*, Securities Act Release No. 10574, at 2 (Nov. 16, 2018) (referring to PRG tokens themselves as “securities”). Division of Corporation Finance Director Bill Hinman’s June 14, 2018, speech, while insightful, suggested that Bitcoin and Ether were not securities, without explaining whether the initial sales would be characterized as “investment contracts,” and if so, when exactly the tokens fell outside the scope of the federal securities laws. Even more troubling, however, is the Commission’s perceived reluctance to provide definitive guidance as demonstrated by a Staff member’s statement earlier this year that “if you were to start down the road of being very prescriptive and putting out specific releases about hypothetical situations, not only would you probably waste a lot of time, *you would probably create a road map to get around it.*” (Valerie Szczepanik, Address at the ACT-IAC 2018 Blockchain Forum (April 3, 2018)) To the contrary, such guidance is exactly what the industry needs to fully understand how to comply with the law. Prescriptive guidance also allows the SEC to address specific concerns that support its mission of investor protection and full and fair disclosure, rather than simply addressing the industry and its regulatory challenges on a case by case basis.

Numerous Congressmen recently wrote to Chairman Clayton that, while recognizing the challenges the Commission faces in regulating the industry, “[we] believe that formal guidance may be an appropriate approach to clearing up legal uncertainties which are causing the environment for the development of innovative technologies in the United States to be unnecessarily fraught.” (Letter from fifteen members of Congress to Hon. Jay Clayton, Chairman, Securities and Exchange Commission (Sept. 28, 2018).) The letter also requests clarity on “the criteria used to determine when offers and sales of digital tokens should properly be considered . . . offerings of securities” because “[i]n the current environment it is unclear which other unique characteristics of digital tokens are also considered by the SEC when making this determination.” *Id.*

The Congressmen’s sentiments are consistent with the demand from companies like Kik and further demonstrate the flawed logic of the Staff’s statement above: industry participants are seeking guidance so that they can clearly operate within the SEC’s interpretation of the laws and in the U.S., rather than using guidance to evade compliance. The current best choice for evading

compliance is to simply exclude U.S. participants and move the entirety of a project offshore. Kik and the Foundation understand that there are significant nuances and novelties involved but given the industry's interpretation of guidance at the time of the TDE, and the continuing uncertainty surrounding the legality of token sales, it is fundamentally unfair to retroactively punish Kik, the Kin Foundation, and holders of Kin by filing an enforcement action. This is especially so given that the Staff has characterized this matter as a "non-fraud ICO case," where Kik acted in good faith.


Moreover, filing an enforcement action against Kik and the Kin Foundation will not resolve this regulatory uncertainty, but instead will result in discrete and inconsistent rulings, an unfortunate byproduct of regulating through enforcement. On this point, the above-referenced Congressmen further noted that "we are concerned about the use of enforcement actions *alone* to clarify policy." *Id.* With such an approach, prospective token issuers will be confined to comparing themselves to existing fact patterns. For example, *Munchee*, *Paragon Coin*, and *Airfox* provide no insight as to whether the Commission believes that token functionality removes it from the purview of the federal securities laws, and if so, what degree of functionality is required. Thus, an issuer whose token provides more functionality than the AirToken (while having to interpret what "more functionality" means) for instance, may reasonably believe that its sale would not be considered a sale of unregistered securities. This is the precisely how token issuers interpreted the DAO Report at the time it was published, given the voting and dividend rights that DAO tokens conferred. In contrast, tokens meant to be used in digital applications, such as Kin, contained distinct and substantial factual differences from DAO tokens, encouraging such issuers that their sales would not be considered "investment contracts."

V. CONCLUSION

As discussed above, prospective claims against Kik and the Foundation involve no fraud, but instead unjustifiably target a Company that made substantial efforts in good faith to comply with all existing laws and regulations when selling Kin in September 2017. Most importantly, however, the Commission will not and cannot demonstrate that Kin in and of itself or any specific sale or distribution of Kin fall within the purview of the federal securities laws. Not only do claims that the TDE constitute an "investment contract" lack merit, but any contention that the Commission has jurisdiction over subsequent Kin distributions to developers and users is similarly baseless. Indeed, Kin is becoming more adopted, transacted, and used every day; and come trial, Kin may be the most widely used cryptocurrency in the world, creating an insurmountable obstacle to the Commission in proving its case. But even if the Commission disagrees with Kik and the Kin Foundation regarding the central legal issues, it should nonetheless exercise prosecutorial discretion because any enforcement action is tantamount to improperly regulating by enforcement in an industry desperately needing affirmative guidance regarding the applicability of the federal securities laws. Any enforcement action will similarly harm the very people the Commission seeks to protect: Kin purchasers. However, should the Commission choose to file an enforcement action, Kik and the Kin Foundation are prepared to litigate and are confident that they will prevail in court.

Accordingly, and for the foregoing reasons, Kik and the Kin Foundation respectfully request that the Staff reconsider its position and not recommend an enforcement action be instituted.

**KIK INTERACTIVE, INC. AND
THE KIN ECOSYSTEM FOUNDATION**

By:  _____
Patrick E. Gibbs
COOLEY LLP
Counsel for Kik Interactive, Inc. and the
Kin Ecosystem Foundation

APPENDIX A¹



Addme describes itself as a “social business card” that allows users to aggregate their social media profiles into a single location. Users can earn Kin within the app, for example by aggregating their profiles into the platform. Users can spend Kin to unlock premium in-app features.



Beseech is a location-based forum for suggestions, referrals, information, micro-tasks, and classified ads. It allows users to exchange Kin as they post and reply to items posted on the forum – for example, users can post a set amount of Kin as a reward for the user who provides the best answer to their post.



Blastchat is a multi-purpose messaging app that lets users blast direct messages to your most important friends, customers, and fans. Users can earn Kin by signing up for Blastchat products (for example, a safety alert product), sharing content, or earning tips from other users. Users can spend Kin to tip other users, to unlock the ability to add or edit Blastchat moments, or to unlock the ability to show blasts for more than the default 24-hour period.



ChatSwapDitch is a communications app that allow users to meet new people based on common interests and permits simple, fast communications. Users can earn Kin by completing registration, using the app for multiple days in a row, or if another user spends Kin to extend time chatting with them. On the other hand, users can spend Kin to extend one-to-one chat time with other users or change profile details.



Coin Fantasy allows users to learn about cryptocurrency and trade tokens. Coin Fantasy plans to integrate Kin as a replacement for their native currency, CF Points, which is used to enter contests and get rewards. Users will be able to earn Kin by inviting friends or completing games, and can spend Kin on contest entry fees and raffles.



Find is a platform where travelers can discover new friends. Users can earn Kin by forming connections with other travelers through the app, and can spend Kin on booking tours and travel-services, as well as tips to other users for providing useful travel advice.



GoChallengeMe.club is a social media platform that will incentivize people to achieve their goals through competition and accountability. Users can enter competitions with other community members working toward the same goal, and will earn Kin for being the first member to reach that goal, as well as for completion of surveys, polls, and quizzes. Users can spend Kin to set up and/or participate in competitions.

¹ Information contained herein can be found on <https://medium.com/kinblog>.



Kik is a popular mobile messaging app that allows users to send messages, videos, and images both one-on-one and in group messages. Within the app, users can earn Kin by completing surveys, tutorials, polls, and other tasks. Users can use Kin to purchase premium content within the app, including stickers and chat themes. Kik also hosts a Kin Marketplace, in which users can earn and spend Kin on various goods and services. In addition, users can tip administrators in group chats to reward them for curating a positive user experience.



Kimeo is a new generation video platform that will use the IFPS protocol and Kin to create a content distribution platform where everyone gets rewarded. Creators will be able to earn Kin for uploading content, generating views, offering premium content subscriptions, and generating referrals. Consumers can earn Kin by watching promoted content, commenting and voting on content, and generating referrals. Users can spend Kin on premium content subscriptions and on creating promoted content and campaigns.



Kinetik is an incentive-based mechanism to help users achieve their goals, for example by creating and joining other users in challenges to achieve those goals. Kin can be used to create and join others' challenges, give other users "high fives," and complete quizzes and polls. Additionally, in challenges, users can put up Kin as an incentive mechanism which the winner of the challenge will earn.



King VPN is a cross-platform VPN system in which Kin is used to obtain access to its services. Users can spend Kin earned by completing quizzes, polls, and advertisements in the Kin Marketplace on VPN services.



Kinit is an intuitive and streamlined app designed for an active user experience, which shows how Kin can power everyday value exchanges in consumer apps. The app takes users through the process of setting up their wallet, and then offers opportunities to earn Kin through surveys. Then, this grants users access to the Kin Marketplace Beta, which allows them to spend Kin on gift cards from brands and retailers like Amazon, AMC Theaters, and Google Play. The app also allows users to transfer Kin from one user to another.



Kinguist is a language-learning app that lets users create modules in their native language to help others learn new languages. Anyone can create a language-learning pack, complete with challenges and quizzes. Users can earn Kin by creating modules to help others learn their native language, selling modules you created, answering quiz questions correctly, or beating challenges; and can spend Kin on unlocking new modules or asking questions to module creators.



Kinny the KinTipBot enables users to earn Kin in-app and send and receive Kin through social media. Users can earn Kin by completing surveys and polls through a third-party polling service, as well as by earning tips from other users.



KinQuest is a social platform that allows travelers to meet and socialize with other travelers in their local area. Users can earn Kin by performing quests and meeting up with others, as well as by completing their in-app profile and writing reviews of other users and businesses. Eventually, businesses will have the option to sponsor quests and offer discounts, and users will be able to pay with Kin to join these sponsored quests.



Klicktion is a gamified platform where anyone can earn and spend Kin by reading and writing interactive fiction stories. Kin is earned in the app by winning games in interactive stories and completing quizzes or polls in the Kin Marketplace, and can be spent on reading and playing interactive stories as well as new avatars.



Matchmaker is a matchmaking app that provides relationship recommendations by crowdsourcing ideas and opinions. Users vote on whether two people should be matched together, and those who fall in the majority earn Kin, and those who fall in the minority lose Kin.



Nearby is a social network that helps users meet new people nearby. Kin will replace the existing Nearby Points system, and users can earn Kin by messaging new users (without knowing in advance which users are new), so it incentivizes participation in the Nearby network. Users can redeem Kin for Nearby Points for the time being, but ultimately users will be able to spend Kin on other things, including tips to other users, sending virtual gifts, and featuring posts to increase visibility.



Photo Mail Joy helps users to order photo prints, paid for in Kin, from their phones. The app uses Kin to encourage user participation, for example by filling out in-app surveys about photo preferences, sharing the app on social media with friends, or signing up for email updates. Kin can be spent to obtain coupons for discounted photo orders made through the app.



Panion is an app that encourages users to make real-life connections with users who share similar interests. The app previously only allowed users to send messages to others with shared interests, but with Kin users will now be able to use Kin tokens to send messages to anyone on the platform. Kin will also be used to increase engagement in the app and incentivize good behavior within Panion networks, and can be earned by completing users' personal profile, suggesting new keyword tags within the app, or inviting friends. Users will also be able to spend Kin to create new communities or join existing communities.



Pause For rewards students for staying off their phones while they focus on studying. Users earn Kin by completing their focus missions, or staying off their phone for a certain amount of time, and can tip their friends as a Kin bonus for staying focused. Kin will also be spent on charitable giving to allow users to donate items to their cause of choice.



Perfect365 is an augmented reality beauty platform which allows users to virtually try on different makeup and hair styles. The app accepts Kin, which can be used to purchase premium features within the app, and also allows users to earn Kin by participating in the Kin marketplace within the app.



Pop.in is a video app that lets users compete with others on live video in front of an audience that plays along. Users can earn Kin by winning games, keeping streaks for audience members, and completing various tasks, and can also receive tips in Kin from other users. Kin can be spent on in-game purchases such as extra lives or advantages in the games, or to tip other game hosts and players.



Rave allows users to watch videos on various platforms, including YouTube, Netflix, Google Drive, and others, along with other users. Users can spend Kin to “make it rain,” a feature within the app which rewards all users currently watching the video with Kin.



Reveald is a mobile dating app that seeks to end the rapid judgment that most modern dating apps promote. The app requires users to flip through other personality traits before it reveals the photos of the individual. Users can spend Kin to unlock the ability for others to review their profile, and can earn Kin by completing their profile, reviewing the profiles of others, and completing quizzes and polls.



Rock Paper Scissors for Messenger is a rock-paper-scissors add-on game within Facebook Messenger. Players each put up Kin to challenge each other to a game of rock-paper-scissors, and the winner takes all.



Swelly allows brands to generate awareness and loyalty by putting them directly in touch with consumers in a forum where consumers can express their opinions and provide useful feedback. Brands can distribute Kin as a reward for users who provide helpful feedback, creating an experience where consumers are directly rewarded for their opinions.



Syngli is an AI-based platform that allows teachers to create course modules on various subjects and earn Kin when others purchase access to courses they create. Learners can spend Kin to sign up for courses, and then can earn Kin according to the reward logic established by the course author. For example, a course may reward users with Kin for correctly answering quiz questions.



ThisThat is building a crowdsourced knowledge discovery tool where users can ask and answer questions to learn about new things or to explore diverse opinions. Users will be able to earn Kin for completing polls, helping to improve the health of the community through up-voting and down-voting content, and reporting abusive content. Users will be able to spend Kin to create their own questions or polls and to boost them to more users.



Trivia Clan is a daily single-elimination trivia competition where users compete for a grand prize of Kin. Users earn Kin for trivia questions answered correctly, and the winners of a given round split a grand prize of Kin tokens. Users can also spend Kin on extra lives and hints to increase their chances.



Vent is a community-driven social platform that lets its 120,000 users express their feelings and support for one another. The app will integrate the Kin Marketplace to allow users to earn Kin, and will re-distribute Kin to those who complete core actions in the app, such as completing profile details and posting regularly. Users will be able to spend their Kin by tipping users who support them, and can also unlock themed emotion sets for their profiles.



Visit is a platform where physicians and healthcare providers are connected with users in order to establish health goals and incentivize lifestyle and behavioral changes. Visit utilizes Kin to reward users who meet their health goals, for example by eating healthier meals or participating in fitness activities.



Wicrypt is a peer-to-peer WiFi sharing app that rewards users for sharing their mobile data with others. Users pay WiFi hosts in Kin to use their WiFi connection, and can earn additional Kin by referring others to use the app.