It's Raining Crypto: The Need for Regulatory Clarification When it Comes to Airdrops

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ABSTRACT *Worldwide regulatory restrictions have pushed crypto entrepreneurs to take creative and novel approaches in their struggle to create viable user networks for new tokens. One of the most interesting vehicles for dispersing tokens is the 'airdrop', a process by which a developer essentially 'gives away' tokens. The developers' motives in these airdrops are typically not completely altruistic. Instead, the goal is to increase the 'buzz' about new forms of crypto, and to encourage recipients to voluntarily promote the token that they now also own. The regulatory reaction to this technique has been mixed. A few nations, most notably China, have banned airdrops. Most other countries, however, have been less drastic and more ambiguous in their responses. This article lays out some of the current reactions to crypto airdrops and explains why it generally does not make sense not to treat them as involving the distribution of a security. Only where the airdrop crosses the line and requires more than a token effort (no pun intended) is regulation warranted. Where that line should be drawn is left to individual nations.*

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I. Introduction

Crypto[1] has grabbed the attention of some of the world's great entrepreneurs and financiers.[2] Billions of dollars have been (and continue to be) raised in so-called initial coin offerings ('**ICOs**') around the world.[3] Given the amount of money involved, it is not surprising that most governments have looked at how they should approach cryptoassets in general, and ICOs in particular. As should be expected, however, different jurisdictions have taken a wide variety of regulatory approaches to public distribution of these new assets.[4] All of those approaches are continuing to evolve, and most of them are quite complex. Many nations are tentatively welcoming, but several others are also overtly hostile to crypto. Considering the potentially global nature of cryptoassets, the regulatory environment for the same is

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1 This Article assumes basic familiarity with crypto and therefore does not go into a detailed explanation of terms. If this kind of background is appropriate, see Carol Goforth, 'The Lawyer's Cryptionary: A Resource for Talking to Clients About Crypto-Transactions' (2019) 41 Campbell Law Review 47, 51.

2 For example, Vitalik Buterin is the inventor and co-founder of Ethereum. He helped create Ether when he was 19 years old and now has a personal net worth estimated to be between $100 and $200 million; Daniel Larimer founded Bitshares, Steemit, and EOS, and is probably worth between $600 to $700 million. They are both clear believers in crypto - '10 BlockchainPioneers Leading the Cryptocurrency Industry Forward' (*Medium*, 18 October 2018) <https://perma.cc/8USP-C9QQ> accessed 27 February 2019.

Nor are proponents of Bitcoin limited to tech entrepreneurs, Howard Schults, Starbucks Corp. Chairman and founder is quoted as saying that he believes '*we are heading into a new age in which blockchain technology is going to provide a significant level of a digital currency that is going to have a consumer application*.' See 'Bitcoin Bulls and Bears- Who's Hot, Who's Not on Crypto' (*Bloomberg*, 27 February 2019) <https://www.bloomberg.com/features/bitcoin-bulls-bears/> accessed 27 February 2019.

Naturally, not all of the attention has been positive. U.S. billionaire Charles Munger, vice-chairman of Berkshire Hathaway, has called Bitcoin a "*noxious poison*" - Julia Kollewe, 'Bitcoin is "noxious poison", says Warren Buffett's investment chief' (*The Guardian*, 20 February 2018) <https://perma.cc/L86E-VPL9> accessed 27 February 2019. In fact, many noted economists are highly skeptical (at best) of crypto. *See* Sead Fadilpašić, 'What Six Nobel Laurate Economists Have to Say About Crypto' (*CryptoNews*, 31 March 2018) <https://perma.cc/M9WM-LGR7> accessed 27 February 2019. Again, not all economists have been this negative. Semil Shah, 'Iterations:How Five Real Economists Think about Bitcoin's Future' (*TechCrunch*, 2013) <https://perma.cc/T993-L53B> accessed 27 February 2019.

3 The precise amount differs depending on the source. ICODATA.IO reports that there were 1257 ICOs in 2018, raising a total of $7,852,477,043 – See 'Funds raised in 2018' (*ICODATA*, 2019) <https://perma.cc/UC4Z-VYWF> accessed 27 February 2019. On the other hand, Bloomberg reported in November, 2018 that other sources suggest the total should be more than $22 billion - Justina Lee, 'How Much Have ICOs Raised in 2018? Depends on Who You Ask' (*Bloomberg*, 5 November 2018) <https://www.bloomberg.com/news/articles/2018-11-05/how-much-have-token-sales-raised-in-2018-depends-on-who-you-ask> accessed 27 February 2019.

4 For a consideration of five of the most common approaches taken by governments with regard to ICOs, see Danny Medina, 'How Governments are Reacting to ICOs' (*CoinDesk*, 3 December 2017) <https://perma.cc/89E5-U6RL> accessed 27 February 2019.

particularly challenging. What further complicates an already-bewildering array of regulatory requirements is innovation. While regulators struggle to keep up with the ICOs of yesterday, enterprising crypto-entrepreneurs are already experimenting with the next 'big thing'. Currently, it is the airdrop that has captured the imagination of the crypto-community.[5] (As will be described in more detail in Section II of this article, an airdrop is a means of disseminating cryptoassets by which the developer 'drops' the assets into qualifying crypto wallets, rather than selling them in an IPO or other alternative manners of distribution.)

Section II of this article will consider the nature of airdrops, what they do, how they work, and why entrepreneurs are increasingly using them despite regulatory uncertainty. Section III will consider the extent to which airdrops are true 'give-aways', where nothing is expected of persons acquiring the airdropped coin or token. Section IV will very briefly consider some of the concerns that have been raised with regard to airdrops. The article will then consider a limited number of the currently-existing regulatory regimes, assessing the direction in which various nations or nation-groups are progressing with their crypto regulations, as well as the current uncertainties with regard to airdrops. While only a limited number of nations have been considered, in order to make this material more accessible, national approaches have been broadly broken into three categories: nations that have some existing regulatory provisions but their treatment of airdrops is unclear (section V of this article); nations that are undecided about crypto generally and therefore have nothing on the books about airdrops (section VI of this article); and nations that are hostile towards crypto and either explicitly or presumably towards airdrops as well (section VII of this article). Finally, this article will conclude with some suggestions for how regulators in various nations might constructively approach crypto airdrops.

II. What are Airdrops?

'Airdrop' is not a regulatory term of art, but instead entered popular usage as crypto entrepreneurs turned to alternatives to public sales in order to disseminate their tokens. With regulatory authorities cracking down on unregistered coin and token distributions in the form of ICOs, and as social media sites have restricted or prohibited the advertising of ICOs, alternative distribution methods have become increasingly important. According to various

[5] *See* generally Brady Dale, 'So Long ICOs, Hello Airdrops: The Free Token Giveaway Craze Is Here' (*CoinDesk*, 17 March 2018) <https://perma.cc/H2DU-7RDN> accessed 27 February 2019.

commentators, "*[a]irdrops can be defined as the process whereby a cryptocurrency enterprise distributes cryptocurrency tokens to the wallets of some users free of charge. Airdrops are usually carried out by blockchain-based startups to bootstrap their cryptocurrency projects*."[6] The critical component of the process is that the distribution of coins or tokens is essentially free to the recipient. One source reports that Jun Hasegawa, Chief Executive Officer of Omise, claims to have pioneered the process on Ethereum in August, 2017.[7]

This article will use the term 'airdrop' to refer to a distribution of a cryptocoin or token in a manner that requires no or very little effort from the recipient and involves no exchange of tangible consideration in the form of fiat or other cryptocurrencies. Any 'contribution' from the recipient is to be evaluated based on what it costs the recipient in terms of time and effort, and not from the value to the issuer (for reasons that will be explained later). This definition is intended to be useful in both considering the question of how airdrops should be regulated, and consistent with the general understanding of airdrops in the crypto-community.

Note that not all airdrops are conducted at the beginning of a coin or token's existence. There exist precursors to the current form of airdrops on which this article focuses, in the form of distributions following hard forks where a change to the underlying programming was a adopted by some but not all participants on a given blockchain.[8] (Where a change is not adopted unanimously, the result may be a chain with two 'forks', both of which exist moving forward.) Bitcoin, for example, has forked multiple times, resulting in the creation and 'airdropping' of a number of new coins derived from the original asset.

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[6] Katalyse.io, Mission.Org, 'What are "Airdrops" in Crypto World?' (*Medium*, 15 February 2018) <https://perma.cc/DCN8-TB8E> accessed 27 February 2019 (this same source also notes that established blockchain-based enterprises such as trading platforms or wallet services can conduct airdrops as well).

[7] Dale (n 5).

[8] A hard fork (or split among nodes on a blockchain) usually occurs after discussion and disagreement among the development team behind a virtual currency and the mining and (sometimes) investing communities. If unanimity is not possible, a hard fork will be necessary. This means there will be two non-identical but related copies of the blockchain going forward. Typically, the original asset goes on as it has before, while the new iteration adopts some different protocols and adjustments to the code. It is also possible to have a hard fork that occurs not because of a dispute between developers and miners but is instead an attempt to create a different version of a preexisting coin. For additional discussion of hard and soft forks, see Antonio Madeira, 'The DAO, The Hack, The Soft Fork and The Hard Fork' (*CryptoCompare*, 26 July 2016) <https://perma.cc/9JNT-HX9L> accessed 27 February 2019.

The first significant Bitcoin fork was likely Bitcoin XT in 2014. This development was designed to increase the number of transactions per second.[9] While it initially appeared to be successful, with more than a thousand nodes running the new software by the summer of 2015, it has now fallen out of favour. The tokens created by that fork are, however, still available.[10] In early 2016, Bitcoin Classic was launched in another effort to increase block size.[11] Early interest was strong, with about 2,000 nodes participating. Bitcoin Classic has now ceased operations.[12]

In 2015, a soft fork was implemented on the Bitcoin blockchain to allow more transactions to occur at once. In response, some users initiated a hard fork to avoid certain protocol updates that would have been required. Bitcoin Cash ('**BCH**') was issued as a result of this change and split from the main blockchain in 2017.[13] Anyone who held Bitcoin at the time of the fork became an owner of BCH as well.[14]

These kinds of transactions paved the way for the modern airdrop, as a fork is not required in order for a cryptoasset to be dropped into the wallets of crypto-users. Recognising this, one might ask why a developer or company with a new coin or token would be willing to give it away? There are, in fact, a number of valid strategies that could support such a decision.

A likely motive for token start-ups is to generate awareness of the new asset. There is more value when a token is held on as many wallets as possible, and more tokenholders create more interest, wider exposure, and an increased trading volume, particularly if there is enough interest and demand to have the interest listed on an exchange. In essence, an airdrop can be a virtually free way to conduct marketing and generate interest among members of the crypto community.

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[9] For a further discussion of the history of Bitcoin XT, see Mike Hearn, 'An XT FAQ' (*Medium*, 27 August 2015) <https://perma.cc/6NJE-BNDX> accessed 27 February 2019. *See* also (*BXT*, 2019) <https://perma.cc/RQ4G-W6G6> accessed 27 February 2019.

[10] 'BitTokens (BXT)' (*CoinMarketCap*, 25 February 2019) <https://perma.cc/L7BW-JPYP> accessed 25 February 2019 (showing a market capitalization of $316,597 as of February 25, 2019).

[11] For a discussion of Bitcoin Classic (and the other Bitcoin hard forks), see Nathan Reiff, 'A History of Bitcoin Hard Forks' (*Investopedia*, 25 April 2018) <https://perma.cc/D6ZA-NGJW> accessed 27 February 2019.

[12] Tom Zander, 'Bitcoin Classic Closing its doors' (*Bitcoin Classic News*, 2019) <https://perma.cc/N9SL-QR5P> accessed 27 February 2019.

[13] Reiff (n 11).

[14] For a description of this airdrop, see 'Bitcoin cash (BCC)' (*Airdropalert*, 2019) <https://perma.cc/95NC-5D9R> accessed 25 February 2019. BCH is the most successful hard fork of Bitcoin, and as of the end of February, 2019, is the sixth-largest cryptocurrency by market capitalisation showing Bitcoin Cash with a market cap in excess of $2.4 billion. (*CoinMarketCap*, 2019) <https://perma.cc/9QS9-H6BZ> accessed 25 February 2019.

In addition, an airdrop can be used to more evenly distribute token supply, which is a particular benefit in a blockchain system. It can also help generate a lead database or network before a more public distribution goes live. Alternatively, depending on how it is conducted, it can also be used to reward early or loyal investors or participants in a venture. It certainly is one way to gain entrance into, and interact with the existing crypto community.

The benefits are real, because once someone holds a token they have the same motive as everyone else who owns the token or intends to invest in it — the incentive is to see that the value of the token increases. Whether by word of mouth or by virtue of the fact that people tend to value something that they own more highly than if they have no connection with it, this is a powerful way to improve token value.

However, modern economic commerce is sometimes summarised by the slogan that 'There ain't no such thing as a free lunch.' Given this reality, it is fair to look more closely at these 'free tokens.' While developers do often drop their tokens into wallets for no explicit transfer of consideration and no payment of fiat or other crypto currency, are airdrops really 'free'?

III. Are Developers and Companies really "Giving" away their Tokens?

Even sources geared at defining what constitutes an airdrop acknowledge that some distribution schemes that characterise themselves as airdrops are not completely free, at least of effort, for the recipient. For example, while noting that crypto airdrops generally refer to a distribution of 'free tokens', one source also explains that "*[t]o qualify for this free gift, one may need to perform certain tasks that include posting on social media forums, connecting with a particular member of the blockchain project, or writing a blog post.*"[15]

All airdrops require that a recipient already have a wallet that can accommodate different types of cryptocurrency. Most wallets will handle tokens that are likely to be dropped.[16] The requirements for wallet type and storage vary by project, and in some cases can be satisfied with an online soft wallet, and in some instances will need to be a wallet residing on a particular

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[15] CoinBundle Team, 'What Are Airdrops' (*Medium*, 14 September 2018) <https://perma.cc/U5SE-TUPJ> accessed 27 February 2019.

[16] Crypto Coin Junky, 'Beginners Guide to Crypto Airdrops: Free Coins & Tokens' (*Medium*, 5 October 2018) <https://perma.cc/SB9S-CG3K> accessed 27 February 2019 (suggesting a wallet that will accommodate several different types of Ethereum Request for Comment number 20 tokens). Note that airdrops may also occur on other blockchains, such as EOS.

exchange. In addition, the wallet must be active (i.e., it must both hold a minimum level of some form of cryptocurrency before the date set by the project, and demonstrate some level of activity), to avoid the creation of multiple wallets solely to claim airdropped coins or tokens.

However, some airdrops require more than an active wallet. The project may require a recipient to do one or more of the following to participate: sign-up; retweet; refer a friend; join the project's Telegram account; join the project's discord chat; post a comment or private message about the project; or complete other social media tasks geared at spreading the word about the project.[17]

There is even terminology to distinguish between a truly 'free' airdrop and one that requires specific protocols to be followed. An 'automatic airdrop' does not require the recipient to do anything other than hold a suitable, active wallet. A 'manual' airdrop is one where specific requirements are imposed in the protocol devised by the project developers.[18] Alternative nomenclature sometimes refers to programs that require more substantial efforts from recipients as 'bounty programs', rather than airdrops. Usually these require completion of specific tasks or jobs, such as creation of new graphics, translations, marketing and promotion for the project, or writing content.[19] The line between airdrops and bounties is, however, unclear.

In a pure airdrop, however, the recipient 'pays' nothing and invests little in the way of time or effort. If it is automatic, the recipient does not even have to know that they are receiving the crypto. This would, at first glance, seem to be a situation where little is needed in terms of regulation. The recipient is not 'investing' anything, and therefore does not stand to lose any money or much, if any, time. The developer is not gaining any new currency with which to conduct illicit operations. These facts, however, do not mean that there is no reason for caution. Airdrops can still be abused.

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[17] These potential tasks are discussed in sources such as Sudhir Khatwani, 'Airdrops In Cryptocurrencies: Everything A Beginner Needs To Know' (*CoinSutra*, 13 October 2018) <https://perma.cc/MAE9-PANZ> accessed 27 February 2019.

[18] *See* Marko Vidrih, 'Airdrops—What exactly is an Airdrop?' (*Medium*, 12 June 2018) <https://perma.cc/8WM9-7YA6> accessed 27 February 2019.

[19] *See* generally Winco, 'What is the difference between Faucets, Airdrops, and Bounties?' (*Good Audience Blog,* 10 October 2018) <https://perma.cc/V6WP-SZ68> accessed 27 February 2019. Although not directly relevant to this article, a 'faucet' is a website that offers very small increments of crypto in exchange for periodic visits or tasks over an extended period of time, usually as an incentive to help that site generate advertising income.

IV. Reasons to be Careful

There are a number of reasons for investors to be cautious and regulators to be concerned about airdrops. As is the case with any innovation, unscrupulous players have been quick to enter the field.[20] One risk is that a scammer may create a fake Twitter account that mimics an official cryptocurrency company's account. The fake account then poses as a developer for the team and requests private wallet keys,[21] ostensibly in order to airdrop coins. Alternatively, a Twitter account that resembles a legitimate company may generate a request that a target send cryptocurrency to a wallet owned by the fraudster, again in order to receive the 'free' tokens.[22] This can be done along with a promise that the transferred tokens will be returned and assurance that this is only a test to ensure that the wallet is active. There are a range of phishing, hacking, and identity theft scams that could be carried out with airdrops,[23] typically with regards to requests for information, account access, or payments that are not required in genuine airdrops.

From the perspective of the project, the lack of clarity from regulators is another reason for caution. When regulations do not clearly address the requirements applicable to airdrops, even legitimate companies acting in good faith run the risk of finding themselves in trouble with regulatory authorities down the road.

It must be noted that there are some risks often mentioned in connection with crypto that are not mentioned here. For example, one of the mostly commonly cited concerns has to do with the risk that crypto is being used for illicit purposes (either for money laundering or to finance illegal operations such as those involving terrorist activities).[24] If an airdrop does not involve the transmission of any property of value to the developer in exchange for

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[20] For a more detailed consideration of the kinds of airdrop scams, see Alex Lielacher, 'A Guide to Airdrops Part 3: Airdrop Scams' (*BTCManager*, 26 March 2018) <https://perma.cc/U9Y9-VFFX> accessed 27 February 2019.

[21] A private key is the cryptographically protected access code that allows an owner to access his or her wallet; it is not designed to be shared with third parties. For a substantially more sophisticated explanation of public and private keys, *see* Leon Di, 'Why Do I Need a Public and Private Key on the Blockchain?' (*WeTrust*, 29 January 2017) <https://perma.cc/SE4B-MYEP> accessed 27 February 2019.

[22] Note that these kinds of things raise red flags. Private keys are never required by legitimate companies, and no airdrop requires that tokens be sent to another address first. Ideally, before taking any affirmative steps in response to an offer of airdropped coins or tokens, official sources should be checked.

[23] Crystal Stranger, 'Airdrops: the Good, the Bad, and the Scammy' (*Medium*, 7 September 2018) <https://perma.cc/T7D9-UWGX> accessed 27 February 2019.

[24] 'Regulation of Cryptocurrency Around the World' (Law Library of Congress, June 2018) 1 <https://perma.cc/T7NJ-GN3Y> accessed 27 February 2019.

crypto, neither of these would seem to be an issue with airdrops per se. This does not, of course, mean that secondary trading transactions could not cause problems, but the airdrop itself should not contribute to this particular problem.

These facts lead to the question of how nations are reacting to the new development. Not surprisingly, the development has engendered all kinds of reaction (and non-reaction). Some countries are generally welcoming to crypto, and therefore are more likely to be responding in a potentially positive or informative way to airdrops. Some nations are hostile to crypto generally, and these jurisdictions generally are not in favor of airdrops either. However, because initial regulations did not anticipate or explicitly address the airdrop phenomenon, the majority of countries have yet to indicate how they intend to reaction. For this reason, among others, it is useful to look at how countries are, in general terms, responding.

V. State of Regulation — Unclear or Ambiguous

While it is exceedingly difficult to make blanket statements about crypto because of the myriad regulatory schemes and approaches, it is generally safe to say that current regulation of airdrops is both complicated and confusing. A number of nations have some regulatory pronouncements in place, but their application is either in the process of evolving or, at best, unclear as to airdrops.

The United States ('**U.S.**') is one of the nations that have a regulatory system that it is attempting to apply to crypto, but has not decided on precise or definitive guidelines. In general terms, crypto entrepreneurs operating in the U.S. seem to be most concerned with whether airdrops will be treated as a distribution of securities and therefore within the purview of the U.S. Securities and Exchange Commission ('**SEC**'). Under the current approach taken by the SEC, crypto is generally a security if it: (1) involves the investment of money or something of value; (2) is in a common enterprise; (3) is carried out with the expectation of profits; (4) is based on the essential entrepreneurial efforts of others.[25] Airdrops could easily be found to lack the first element, meaning that they should not be treated as involving the distribution of a security.[26]

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[25] That test is known as the Howey investment contract test ('**Howey**'), and it was first established by the U.S. Supreme Court in *Securities & Exchange Commission v W.J. Howey Co.*, 1946 SCC OnLine US SC 95 : 90 L Ed 1244 : 328 US 293 (1946).

[26] The consequences of being treated as a security are outside the scope of this Article. For a more detailed assessment of securities treatment of crypto, see Carol R. Goforth, 'Securities

However, the fear is that the SEC will treat crypto airdrops as securities in much the same way that it warned against giveaways of stock in 1999.[27] In addition, on August 14, 2018, the SEC issued a cease and desist order (the '**Tomahawk Order**') against a company and its founder for actions in connection with an ICO of 'Tomahawkcoins' or 'TOM' tokens.[28] In the Tomahawk Order,[29] the SEC found that the issuer's 'Bounty Program' constituted an offer and sale of securities because the company "*provided TOM to investors in exchange for services designed to advance Tomahawk's economic interests and foster a trading market for its securities.*"[30] The lack of cash payment did not prevent the distribution from involving securities, because the company "*received value in exchange for the bounty distributions, in the form of online marketing…*".[31] Some sources were quick to treat this as a potential condemnation of airdrops,[32] although the company called it a bounty program, and a degree of effort was required to participate.

Further complicating matters, in the spring of 2019, the SEC issued a substantially expanded framework for determining how the conventional investment contract analysis should apply to digital assets.[33] As SEC Commission Hester Peirce has noted in her commentary on the new framework "*[w]hile Howey has four factors to consider, the framework lists 38 separate considerations, many of which include several sub-points.*"[34] Included in that extensive, multi-factor framework is a very brief, and not very helpful, footnote on bounties and airdrops. With regard to airdrops in particular, the framework contends that "*the lack of monetary consideration for digital assets, such as those distributed via a so-called 'air drop,' does not mean*

Treatment of Tokenized Offerings Under US Law' (2019) 46 Pepperdine Law Review 405.

27 *See* 'SEC Brings First Actions To Halt Unregistered Online Offerings of So-Called "Free Stock"' (*US SEC*, 22 July 1999) <https://perma.cc/8TAT-7PEE> accessed 27 February 2019.

28 US SEC, Press Release, 'SEC Bars Perpetrator of Initial Coin Offering Fraud' 2018-152 (*US SEC*, 14 August 2018) <https://perma.cc/G2G2-3N2P> accessed 27 February 2019.

29 A copy of the Tomahawk Cease and Desist Order is archived at <https://perma.cc/3ZGB-BD79> accessed 27 February 2019.

30 The specific things for which 'bounties' were offered included things such as '*as making requests to list TOM on token trading platforms, promoting TOM on blogs and other online forums like Twitter or Facebook, and creating professional picture file designs, YouTube videos or other promotional materials*.' Tomahawk Order (n 29) 21.

31 Tomahawk Order (n 29) 34.

32 Robert Wernli, Jr., Robert Weber, and Osama Khan, 'Airdrop of Crypto Tokens Hits Regulatory Flak' *Sheppard Mullin* (2018).

33 SEC, 'Framework for "Investment Contract Analysis of Digital Assets"' (SEC, 3 April 2019) <https://perma.cc/J4KQ-HW52> accessed 8 April 2019.

34 Hester Peirce, 'How we Howey' (*US SEC*, 9 May 2019) <https://perma.cc/729A-CG6C> accessed 10 May 2019.

that the investment of money prong is not satisfied; therefore, an airdrop may constitute a sale or distribution of securities."[35]

This statement does not negate the first element of *Howey*, and if the matter is ever litigated, American courts may well find that an automatic airdrop lacks the requirement that an investment contract be predicated on the contribution of money or value, meaning that it will not be the sale of a security. Because this has not yet occurred, U.S. law on airdrops is unclear, especially since stock is different from crypto,[36] and the effort required of token recipients in the Tomahawk situation was substantially greater than generally expected in a true airdrop.[37]

As is the case in the U.S., the European Union ('**E.U.**') securities market regulator, the European Securities and Markets Authority, ('**ESMA**') has yet to definitely suggest to member nations whether or how airdrops should be regulated.[38] Based upon how ESMA would treat ICOs, an airdrop would have to involve the offer of a transferable security. If a true utility token is involved, there is a good argument that there is no transferable security. A truly automatic airdrop is likely to not involve an 'offer', and there may be broad exemptions if the value of any consideration is less than 100,000 Euros. To reach these conclusions, various definitions and rulings have to be made outside the context of airdrops.

'Transferable security' is defined broadly by a parliamentary directive to included "*classes of securities negotiable on the capital market*", not including instruments of payment, but including company shares, units of securitized debt, and securities "*giving the right to acquire or sell any such*

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[35] SEC (n 33) 9.

[36] *See* Dale (n 5), citing Todd Kornfeld, counsel at the Pepper Hamilton LLP law firm, as expressing concern based on SEC actions from 1999 that targeted giveaways of free equity interests. This source reports that Stream, a blockchain-based video streaming platform, '*delayed its airdrop indefinitely because of concern that airdrops could also be in violation of securities law.*' However, stock is always treated as a security under US law while crypto must satisfy the Howey investment contract analysis, which among other things looks at whether there is an investment of money or something else of value.

[37] This is the first element of the investment contract test as set forth by the US Supreme Court in *Howey*. This is the current test utilised by the SEC to determine whether or not crypto transactions involve the sale of securities. Note that this is not the test for determining whether equity is a security. In fact, under current Supreme Court jurisprudence, equity interests in the form of stock are always a security. *Landreth Timber Co. v k. Landreth* 1985 SCC Online US SC 135 : 85 L Ed 2d 692 : 471 US 681(1985). The elements relevant to determining whether there is an investment contract do not apply in the case of stock, making the 1999 reaction by the SEC to stock giveaways largely inapplicable to crypto airdrops. See US SEC (n 27).

[38] 'Airdrops: Are free tokens free from regulation?' (*A&L Goodbody*, 4 June 2018) <https://perma.cc/Z89X-KBTA> accessed 28 February 2019.

transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures."[39] Presumably, a true utility token that has no possibility of appreciation or value other than the offered utility is not likely to meet this definition, but tokens marketed as investments would be. This should apply to airdrops as much as to ICOs.

If a token is a 'transferable security', anyone 'offering' it may be subject to various regulatory requirements, which raises the question of what constitutes an offering.[40] ESMA has previously considered the treatment of 'free' stock give-aways in a question and answer ('**Q&A**') publication intended to explain E.U. prospectus requirements that may be triggered when there is such an offer.[41] In the Q&A, ESMA indicates that "*where securities are generally allotted free of charge, no prospectus should be required.*"[42] While this appears to support the conclusion that airdrops (which are also free) do involve an offering, the ESMA position is not actually that clear-cut. The clarification from the not Commission Services was that there should be no 'offer' of securities where there is 'no element of choice', but that if the recipient 'decides' on whether to accept the security, it should be treated as an offer for no consideration.[43] However, the Q&A then suggests that there is also an exemption for offers of less than EUR 100,000.[44] Based on this reading, only truly automatic airdrops would seem to be excluded from the definition of an offering, but exemptions should apply because airdrops do not actually raise funds.

Adding complexity to this issue, however, is a recent pronouncement from ESMA. On January 9, 2019, ESMA published advice to E.U. institutions (the Commission, Council, and Parliament) that suggests that even crypto that is not a financial instrument should always be subject to anti- money laundering requirements, and similarly that all crypto should be accompanied by appropriate risk disclosures.[45] This leaves crypto entrepreneurs in the E.U.

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[39] Directive 2014/65/Eu of the European Parliament and of the Council 2014, Tit. I, art 4 § 44.

[40] The parameters of such requirements are outside the scope of this Article, but they may include regulations under Markets in Financial Instruments Directive II, the Alternative Investment Fund Managers Directive, and the Fourth Anti-Money Laundering Directive. If there is an 'offer to the public', it would be subject to the prospectus requirements set out in the EU Prospectus Directive. See 'Airdrops: Are free tokens free from regulation?' (n 38).

[41] 'Questions and Answer- Prospectuses' (*ESMA*, January 2019) <https://perma.cc/NDJ9-RQTN> accessed 28 February 2019.

[42] ibid 13.

[43] ibid 13.

[44] ibid 13.

[45] Crypto-Assets Need Common EU-Wide Approach to Ensure Investor Protection (*ESMA*, 9 January 2019) <https://perma.cc/SQ6F-U3ZD> accessed 28 February 2019.

in much the same position as they are in the U.S. — uncertain as to law applicable to airdrops.

Of course, individual countries in the E.U. can also adopt positions on crypto. For example, in 2017, Switzerland issued guidance on the treatment of ICOs.[46] After noting that ICOs would need to be evaluated on a case-by-case basis, the Swiss Financial Market Supervisory Authority ('**FINMA**') suggested the following concerns that would impact whether particular regulations applied to ICOs:

i. The need to apply anti-money laundering requirements to token sales involving payment instruments or to regulate third parties such as crypto brokers and trading platforms carrying out secondary transactions.

ii. The need to apply banking requirements to ICO operators who accept public deposits.

iii. The need for persons acting as a securities dealer to comply with licensing requirements.

iv. The need to comply with collective investment schemes legislation if assets collected as part of the ICO are managed externally.

These concerns make it look like airdrops would not be subject to intensive regulation, given that no currency (fiat or digital) is paid to the issuer, there are no public deposits, no one is acting as a dealer, and there is no investment of assets at all. On the other hand, FINMA has also claimed that asset tokens and utility tokens that have any investment function are to be treated as securities,[47] potentially complicating matters. Only true cryptocurrencies that act purely as payment tokens, or utility tokens that provide access and have no investment potential, would be outside the definition of 'security' if this approach is taken. This leaves Swiss law in a state of uncertainty similar to that which exists in the U.S. and the rest of the E.U.

Singapore is another nation with regulations for crypto (referred to there as digital tokens) that do not specifically mention airdrops. The Monetary Authority of Singapore ('**MAS**') updated guidelines applicable to digital token offerings in 2018.[48] The current guide suggests that an offer "or issue"

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[46] 'Regulatory Treatment of Initial Coin Offerings' (FINMA Guidance 04/2017, 29 September 2017) <https://perma.cc/BW46-C7UL> accessed 28 February 2019.

[47] 'FINMA publishes ICO guidelines' (*FINMA News*, 16 February 2018) <https://perma.cc/FW9B-EHH9> accessed 28 February 2019.

[48] 'A Guide to Digital Token Offerings' (*MAS*, November 2018) <https://perma.cc/9N-HK-QM8A> accessed 28 February 2019.

of digital tokens that are regulated as securities must comply with securities laws.[49] The Singapore Securities and Futures Act ('**SFA**') 'interprets' security to include shares representing legal or beneficial ownerships in certain businesses, or debentures, but does not include units of a collective investment scheme ('**CIS**'),[50] which is what a token-based ecosystem is likely to involve.[51] On the other hand, tokens that are true cryptocurrencies are generally not securities, at least according to Case Study 6 in the MAS Guide, which references an understanding that digital payment systems like Bitcoin are not securities or units in a CIS.[52] On the other hand, the MAS guidelines then say that if the digital token is either a security or units in a CIS, then all offers must be made in accordance with the registration requirements of the SFA. Unfortunately, neither the SFA nor the new guidance interprets or explains what constitutes an 'offer'.

The strongest authority for suggesting that airdrops should not be problematic in Singapore comes from Case Study 8 in the MAS Guide. In that example, a company intends to sell tokens to fund development of a platform. The token is designed to give holders voting rights, but nothing else. In addition, the company will distribute the token as a reward based on use and activity on the platform. In assessing whether the securities laws would apply, MAS concludes that the token in question is not a share or debenture, and not a CIS because there is no manager. The explanation also says that "*[a]s the rewards are distributed in proportionate to investor's usage and activity on the platform, it does not represent a right to claim dividends or return on capital*."[53] In this case, there is at least the potential that the tokens could appreciate in value, and nothing in the example restricted resale of tokens. This did not, however, factor into the MAS' assessment of how to treat the token distribution, leaving the appropriate treatment of airdrops unsettled since the basis for the conclusion was that there was no manager, not that there was no consideration exchanged.

Finally, consider the case of Indonesia. Indonesia is in the very early stages of developing a regulatory paradigm for crypto. Indonesia's Futures

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[49] ibid 2.1.

[50] Singapore Securities and Futures Act 2001, ch 289, s 2.

[51] A collective investment scheme involves arrangement in respect of any property where participants do not have day-to-day management control, and (among other options) the effect of the arrangement enables participants to receive returns from the property. Singapore Securities and Futures Act 2001, ch 289, s 2. If the benefit to a token holder is appreciation of the token by virtue of the efforts of the issuer or its managers, then this definition might be met.

[52] 'A Guide to Digital Token Offerings' (n 48) 13-14.

[53] ibid 16.

Exchange Supervisory Board ('**Bappebti**') announced in June of 2018 that digital currencies were tradable commodities,[54] and at that time indicated an intent to create a system of comprehensive regulation of crypto as a commodity. More recently, Bappebti announced new regulations on the implementation of physical markets for crypto assets in futures trading.[55] Those regulations apparently focus on mechanisms for crypto asset trading, starting from the opening of accounts and including crypto asset transactions.[56] The actual regulations, however, appear to focus on traders and exchanges, which require that brokers have at least 1 trillion rupiahs (USD 70 million) in their accounts, clearing houses need paid up capital worth at least USD 107 million, and traders need to make a deposit worth USD 6,000.[57] In addition, exchanges must employ at least one security expert and retain trading information for at least five years on a server located in Indonesia.[58] As might be expected with such a nascent regulatory framework, there is nothing indicating how airdrops will be treated or how issuers of crypto will be regulated.

This group of countries is broadly representative of nations that have crypto regulations in place. Regardless of how detailed the paradigm or structure is (and in some cases, such as for the U.S., it is very detailed), airdrops tend to be outside the settled rules. This leaves the brave or fearless (some might say foolhardy) entrepreneur with room to proceed with airdrops, while more compliant or risk-averse developers may be discouraged from proceeding with this process in these nations.

VI. State of Regulation — Uncertainty in the face of Silence

A second group of countries are still deciding on how to treat crypto. Until that initial decision is made, obviously there will be little in the way of specific guidance about how airdrops should fit into the regulatory regime.

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[54] Mandy Williams, 'Indonesian Regulatory Body sets Cryptos as a Futures Trading Commodity' (*CryptoPotato*, 4 June 2018) <https://perma.cc/4T5W-KLDV> accessed 27 February 2019.

[55] See Jeffrey GoGo, 'Indonesia's Futures Regulator Issues New Rules for Crypto Assets' (*Bitcoin.com News*, 13 February 2019) <https://perma.cc/V8XC-ARFW> accessed 27 February 2019.

[56] 'Futures Exchange Authority Issues Regulation on Cryptocurrency' (*The Jakarta Post*, 13 February 2019) <https://perma.cc/YFY5-B47P> accessed 27 February 2019.

[57] Rahul Nambiampurath, 'Indonesian Regulator Accepts Bitcoin as Tradeable Commodity' (*BeinCrypto*, 16 February 2019) <https://perma.cc/N5P5-PUPL> accessed 27 February 2019.

[58] ibid.

For example, Russia created the Russian Association of Blockchain and Cryptocurrency, now known as the Russian Association of Cryptocurrency and Blockchain, in August 2017. Its purpose was to promote the development of blockchain technology and to offer regulatory options, but it has had little success in clarifying the state of law relating to crypto in Russia. In May 2018, three crypto bills passed the first reading in the State Duma (the lower house of the Federal Assembly of Russia), including Bill No. 419059-7, 'On digital financial assets'. That bill would have made cyptocurrencies and tokens property. It would also have banned circulation of crypto as a "*legal means of payment on the territory of the Russian Federation*." In addition, it did not contemplate the exchange of crypto for fiat; only tokens issued as part of domestic ICOs could be exchanged for 'real' money. A new Draft Bill circulated in October 2018 would allow owners of private companies to create 'digital financial assets'. However, the Russian newspaper Kommersant reported on November 30 that the Bill had been sent back to first reading because of 'significant changes'.[59] Hearings on the Bill were postponed until an unspecified date in 2019, which some sources suggest will take place within the first quarter of the year.[60] The new Bill is expected to tie together regulatory initiatives on crypto, crowdfunding, and investment platforms, but its final content has yet to be decided. As of the date this article was finished, Russia was suggesting that the new regulations would be adopted (at least in part) by the end of 2019.[61] Until this project comes together, it is virtually impossible to predict how Russia will decide to treat crypto or airdrops.

India is another nation in the undecided group, although until recently it might have been more aptly characterized as being unwelcoming to crypto. For some times, reports were widely circulated that cryptocurrency was 'illegal' in India.[62] The Reserve Bank of India ('**RBI**') formally stopped Indian

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[59] Molly Jane Zuckerman, 'Russian Crypto Bill Draft Pushed Back to First Reading for Significant Edits' (*CoinTelegraph*, 1 December 2018) <https://perma.cc/G8RB-J6L6> accessed 27 February 2019.

[60] Ana Berman, 'Russian Parliament to Discuss Crypto Bill Within Two Months, Official States' (*CoinTelegraph*, 14 January 2019) <https://perma.cc/8XEL-KDY4> accessed 27 February 2019.

[61] Daniel Palmer, 'Russia May Allow Crypto Trading in Upcoming Legislation: Official' (*CoinDesk*, 24 June 2019) <https://perma.cc/ZU4F-7HLZ> accessed 12 August 2019. This deadline (by the end of 2019) may be more likely to be met, given that the head of the Duma Financial Market Committee, Anatoly Aksakov, has acknowledged that Russia must adopt some requirements by the end of the year '*in order to comply with recommendations from international watchdog, the Financial Action Task Force (FATF).*'

[62] William Suberg, 'Cryptocurrency "Illegal" In India Says Trade Organization Head' (*CoinTelegraph*, 26 October 2018) <https://perma.cc/YLS9-E6UQ> accessed 27 February 2019.

banks from dealing in crypto in April of 2018, and the Indian Supreme Court repeatedly postponed hearing challenges to that decision.[63] By the end of 2018, however, there were suggestions that the Indian government was considering the legalization of crypto, albeit with "*tough terms and conditions attached*".[64] On January 4, 2019, the RBI issued a report concluding that "*cryptocurrencies currently pose no threat to financial stability*".[65] Nonetheless, the RBI continued to emphasize its belief that "*cryptocurrencies need 'constant monitoring,' given their rapid expansion in recent years*."[66] On the other hand, an interdisciplinary committee set up to investigate crypto is not in favor of a ban, with an anonymous senior official reporting that "*[t]here is a general consensus that cryptocurrency cannot be dismissed as completely illegal. It needs to be legalized with strong riders*."[67] The most recent pronouncement from the country, till July 2019, comes from Anurag Thakur, India's Minister of State for Finance & Corporate Affairs, who recently explained that Bitcoin will be legal while government works on crypto regulations.[68] Until this actually happens, of course, the eventual status of things like airdrops is in the air.

Another nation yet to adopt crypto regulation is Brazil. In May 2019, the Brazilian President of the Chamber of Deputies (i.e., the federal legislative body, and lower house of the country's National Congress) ordered the creation of "*a commission to consider cryptocurrency regulation in the country*".[69] Two months later, however, a federal deputy in the National Congress (and a descendant of the former royal family of Brazil) publicly opposed any crypto regulation, suggesting that it was "*merely an example of the state intervening in something which is not its business*."[70] Until this is resolved, and regulations are adopted, the fate of crypto in general, and airdrops in particular, is uncertain in Brazil.

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[63] Ana Berman, 'India: Central Bank Report States Crypto Does Not Threaten Financial Stability' (*CoinTelegraph*, 4 January 2019) <https://perma.cc/BAW9-P2GN> accessed 27 February 2019.

[64] Yogita Khatri, 'IndiaMay Legalize Cryptos But Under 'Strong' Rules: Report' (*CoinDesk*, 26 December 2018) <https://perma.cc/EMC7-M53Q> accessed 27 February 2019.

[65] Berman (n 63), citing RBI, 'Report On Trend And Progress of Banking In India 2017-18' (*RBI*, 28 December 2018) <https://perma.cc/3QL2-S8YB> accessed 27 February 2019. The references to risk posed by cryptoassets appear at pp 29-30 of that report.

[66] Berman (n 63).

[67] Khatri (n 64).

[68] Anja Van Oosterhout, 'Bitcoin Still Legal in India; Crypto Regulation in Works' (*Bitcoinist*, 19 July 2019) <https://perma.cc/2K45-WGCS> accessed 12 August 2019.

[69] Ana Alexandre, 'Brazil Establishes Committee for Cryptocurrency Regulation' (*CoinTelegraph*, 31 May 2019) <https://perma.cc/2VUT-ZKA2> accessed 12 August 2019.

[70] Ana Alexandre, 'Brazil: Member of Former Royal Family Speaks Out Against Crypto Regulation' (*CoinTelegraph*, 15 July 2019) accessed 12 August 2019.

It should be noted that not all of the nations that have yet to enact crypto regulations appear to be hostile to crypto. The Netherlands, which apparently has "*no regulation on digital currencies*",[71] is so welcoming to crypto that the unofficial nickname for the city of Arnham has become 'Bitcoin City'.[72] In early 2019, however, the Netherlands Minister of Finance received advice that a licensing system should be introduced.[73] The emphasis on the proposed regulation was apparently on prevention of money laundering and terrorist financing, which are unlikely to be a significant issue with a 'free' token distribution such as that contemplated with airdrops. However, until regulations are actually put into place, any potential impact on crypto in general and airdrops in particular is uncertain.[74]

VII. State of Regulation — Unwelcoming

Finally, there are nations that are quite hostile to crypto, and therefore likely to be hostile to airdrops as well. China, in fact, has explicitly warned against this particularly strategy for disseminating cryptoassets.

On November 3, 2018, the People's Bank of China (the country's central bank) issued a stability report warning against the use of airdrops.[75] The report concluded that "*companies running token giveaways are evading China's blanket ban on ICOs by issuing free tokens to the investor, while keeping a large chunk of the total supply for speculation on a crypto exchange, where speculation would drive the prices up so they can profit*." This hard line approach is consistent with earlier statements from the vice governor of the People's Bank that "*[a]ny new financial product or phenomenon that is not authorized under the existing legal framework, we will crush them as soon as they dare to surface*."[76] On the other hand, it is also worth noting that reports suggest that trading in crypto continues in

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71 *See* Nick Hubble, 'Top Crypto Friendly (and Hostile) Countries' (*Capital and Conflict*, 20 March 2018) <https://perma.cc/7ZH8-GMZF> accessed 27 February 2019.

72 ibid.

73 Adrian Zmudzinski, 'Proposed License Requirements End Anonymous Crypto Selling and Buying in the Netherlands' (*CoinTelegraph*, 20 January 2019) <https://perma.cc/D5D5-8XJT> accessed 27 February 2019.

74 In fact, reports surfaced in July, 2019, that the Netherlands was considering a more restrictive approach to crypto. 'Dutch Crypto Regulation: Ministers Becoming Anxious, Regulatory Framework to be Discussed' (*Cryptowisser*, 2 July 2019) <https://perma.cc/C4TH-XLT4> accessed 12 August 2019.

75 Jimmy Aki, 'China's Central Bank Wants to Put the Damper on Airdrops: Report,' (*Bitcoin Magazine*, 5 November 2018) <https://perma.cc/8MER-95S6> accessed 27 February 2019.

76 ibid.

China, through virtual private networks, confusing what might otherwise be a straightforward prohibition on all things crypto.[77]

Some nations that have yet to adopt any formal regulations to govern crypto have nonetheless managed to make their position fairly clear. Bulgaria is in this category, even though there are apparently no specific regulations applicable to crypto based enterprises.[78] Regardless of the lack of official regulation, in May 2017, the Bulgarian government confiscated more than 2,00,000 Bitcoins in an operation "*against organized crime*."[79] In December of the same year, Bulgarian bankers closed all accounts used by crypto exchanges, leaving thousands of investors without access to their funds.[80] Given this history, even without official regulation, it appears reasonably certain that Bulgaria is hostile to crypto and likely to airdrops as well.

Another country clearly hostile to all things crypto is Bolivia. The Bolivian government has been arresting Bitcoin miners and traders since May 2017.[81] One source describes the situation in this country as follows:

> Cryptocurrencies have never been legal in Bolivia and the government has been known to enforce its anti-Bitcoin stance rather firmly. People caught using Bitcoin and other cryptocurrencies can be fined and a number of users have even been arrested on more than one occasion for trading and mining Bitcoin.[82]

Given that all crypto appears to be illegal in the country, it is to be expected that airdrops would be similarly frowned upon although there is no regulatory structure in place that would appear to require this outcome.

VIII. Conclusion and Recommendations

While the preceding discussion picks and chooses among regulatory schemes,[83] even this abbreviated listing of regulatory approaches illustrates

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[77] *See* William Suberg, 'Despite Ban, China Keeps Trading Cryptocurrency Thanks to Tether and VPNs, Says Report' (*CoinTelegraph*, 9 September 2018) <https://perma.cc/75YX-66K7> accessed 27 February 2019.

[78] *See* Blockpit.io, 'How are Cryptocurrencies Regulated in Bulgaria' (*Medium*, 13 December 2018) <https://perma.cc/874F-G2DB> accessed 27 February 2019.

[79] Hubble (n 71).

[80] Hubble (n 71); see also 'Bulgaria News' (*CoinTelegraph*, 2019) <https://perma.cc/M2DT-D7TH> accessed 27 February 2019.

[81] Hubble (n 71).

[82] Brad Stephenson, '5 Countries Where Bitcoin Is Illegal' (*Lifewire*, 24 June 2018) <https://perma.cc/6HB9-LTSD> accessed 27 February 2019.

[83] For a more complete consideration of the international regulation of cryptocurrencies generally, see Law Library of Congress, 'Regulation of Cryptocurrency Around the World'

some of the differing reactions to crypto. It also provides fairly strong evidence that most nations have yet to address airdrops, as they continue to struggle with how to deal with the new technology.

Countries with more open and developed economies have tended to approach crypto from a relatively pragmatic position, recognising that bans are not only likely to be ineffective as against persons who insist on participating in the crypto world,[84] but also that there are potential advantages that might stem from innovation in this arena.[85] An outright ban essentially limits a nation's ability to take advantage of the potential economic benefits associated with such innovation, and therefore there would have to be a particular national perspective or interest at play in order to justify (or even really explain) this approach. It also prevents the country from having a more nuanced approach to regulation, meaning that countries with a ban might have larger problems with issues such as money laundering and the financing of terrorist and other criminal enterprises.[86]

Given the intangible nature of crypto, a more realistic approach might be to regulate the business based on national interests. For example, most countries are likely to want to avoid problems associated with money laundering and the financing of illegal activities such as terrorism. Similarly, most

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(June 2018) <https://perma.cc/T7NJ-GN3Y> accessed 27 February 2019. This source specifically notes the wide range of approaches that various nations have taken towards cryptoassets, as well as the fact that these approaches are changing dramatically over time. The most commonly noticed actions involve warnings about the risks of investing in crypto markets, and the concern over illegal activities such as money laundering and terrorism. ibid at p 1. Regulatory reactions included in the report range from outright bans on cryptoassets and ICOs to state sponsored cryptocurrencies. ibid at p 2. A list of countries with explicit and implicit bans on crypto appears at p 4.

[84] Consider this statement, issued while India was apparently still contemplating a ban on virtual currencies:

'*Plans are afoot in India to ban cryptocurrencies. While it is as yet unclear what exactly the government's move against cryptocurrencies will be, what is clear is the fact that implementing it is going to be incredibly difficult. ….[C]ryptocurrencies are not bound by national jurisdictions but are powered by blockchain technology—a decentralized, distributed, public online ledger that is used to record transactions. A global network of computers manages the database that records all deals.*'

Nupur Anand, 'Why it Won't be Easy to Ban Cryptocurrencies in India' (*Quartz India*, 14 November 2018) <https://perma.cc/9EJ5-BVZ4> accessed 28 February 2019. See also Nick Spanos, 'Stifling Innovation With Regulation: Why Countries Shouldn't Ban Cryptocurrency Trading' (*Blockchain-Expo blog*, 2 February 2018) <https://perma.cc/UC54-VGGK> accessed 28 February 2019 (suggesting that a ban is like trying to stop a flood).

[85] A discussion of the potential value of crypto is outside the scope of this limited Article. For a brief introduction to this topic, focusing on crypto following the major declines in value during 2018, see Lawrence Wintermeyer, 'The Role of Cryptocurrencies In Future Society' (*Forbes*, 26 October 2018) <https://perma.cc/84EY-7W2Z> accessed 28 February 2019.

[86] *See* Anand (n 84), making this point.

nations are reasonably concerned about the potential for fraudulent initiatives designed to bilk citizens of hard-earned wealth. Countries may also set a priority of minimising tax avoidance, either out of concern that an underground barter economy could develop, or because traders might take advantage of comparative anonymity offered in various crypto markets and fail to report economic gains that would ordinarily be taxed. Once regulatory goals are set, airdrops can be evaluated to determine how much of a risk they pose.

Consider first the problem of money laundering and the risk that either proceeds from the sale of cryptoassets could be used to fund illegal activities or the crypto itself might fund criminal enterprises. The reality is that an airdrop does not involve the exchange of any property of value for the coin or token being dropped. Since the recipient is not contributing anything that can substitute for 'money',[87] there appears to be no risk that a criminal's money will be somehow laundered as a result of the airdrop itself. If the concern is somehow with secondary trading in the asset, then it is the secondary trading market that should be regulated rather than the airdrop itself.

Similarly, the absence of any contributions in fiat or other property readily convertible into fiat similarly limits the usefulness of airdrops as a vehicle for financing criminal activities. Since no money (or property with monetary value) is being contributed, there is nothing with which to finance the illicit behavior. Further, as has previously been stated, if there is a risk associated with subsequent appreciation of the coins or tokens and later trading of those assets, regulation should focus on that behavior which is where the risk occurs.

The same analysis applies when considering the extent to which airdrops provide problems for taxing authorities. Since nothing of value is exchanged for an airdropped token, there is unlikely to be a taxable event at that point. If a recipient realises gain later, through secondary trading of the airdropped asset, that should be the point at which tax may be due. Regulation of trading platforms would seem to be a more appropriate response than limiting airdrops. Even so-called privacy coins (which make actual ownership hard to trace) become problematic only when the coins are traded for value or used as payment.

Another frequently identified problem associated with crypto involves thefts, scams, and outright fraud. Regulators have identified a number of

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[87] At most, a few services may be requested in order to have the coin or token dropped into a recipient's wallet. Part 3 of this Article includes a discussion of the kind of effort or actions that may be required.

common schemes associated with crypto that fit in this category, including the risk of being hacked,[88] Ponzi schemes,[89] pump-and dump operations,[90] and bait-and-switch.[91]

Hacks belong in a category of their own because the wrongdoer is not the issuer of the crypto, who also stands to lose. The market already provides incentives for reasonable cybersecurity initiatives, and the party who really needs to be monitored is the hacker rather than the creator of a new interest. For regulators convinced that legal protections are needed to minimise the risk of hacking, it is probably worth asking whether the victims of hacking are protected by other legal rights. Perhaps they have the right to utilise the country's bankruptcy laws to obtain redressal, as was the case in Japan following the Mt. Gox hack.[92] Alternatively, the victims of a hack might be able to bring a claim, individually or collectively, against the issuer of the tokens if it failed to use appropriate care in protecting the rights of the tokenholders from security risks. Tightening regulation of crypto entrepreneurs who are interested in airdrops in order to limit the impact of hackers seems like an overreaction. It might prevent hacking, but it also has the potential to stifle legitimate business and innovation as legitimate coins and tokens will also be affected.

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[88] The biggest theft of Bitcoin via a hack so far was Mt. Gox, which involved a loss of around 800,000 Bitcoins. The largest Ethereum hack was the DAO incident which involved the loss of 3.6 million Ether. See 'Scams Include Deceptive Investment Opportunities, Bait-And-Switch Schemes and Deceptive Mining Tools' (*Finder*) <https://perma.cc/WXW9-8UMQ> accessed 28 February 2019. Not that it is not the blockchain itself that is being hacked, but rather an exchange (as in the case of Mt. Gox), a wallet service, or a smart contract with an exploitable vulnerability (as in the case of The DAO).

[89] For an explanation of this kind of pyramid scam, see US SEC, *Investor Alert, Ponzi Schemes Using Virtual Currencies*, US SEC Pub. No. 153 <https://perma.cc/7QXE-3ZNU> accessed 28 February 2019.

[90] As explained by the SEC:

> 'Pump-and-dump schemes often occur on the Internet where it is common to see messages posted that urge readers to buy a stock quickly or to sell before the price goes down, or a telemarketer will call using the same sort of pitch. Often the promoters will claim to have "inside" information about an impending development or to use an "infallible" combination of economic and stock market data to pick stocks. In reality, they may be company insiders or paid promoters who stand to gain by selling their shares after the stock price is "pumped" up by the buying frenzy they create. Once these fraudsters "dump" their shares and stop hyping the stock, the price typically falls, and investors lose their money.'
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> US SEC, 'Fast Answers, "Pump-and-Dumps" and Market Manipulations' <https://perma.cc/X8U2-JH3Y> accessed 29 January 2019.

[91] *See* generally Dan Cummings, 'Cryptocurrency Fraud And The Anatomy of The Scam' (*ETHNews*, 10 June 2017) <https://perma.cc/6UDD-CCKZ> accessed 28 February 2019. This source also considers Ponzi schemes, pump and dump, and phishing.

[92] This is not to suggest that bankruptcy provides complete protection for those who lose investments to hackers. For a description of the Mt. Gox hack and bankruptcy proceedings, see Adrienne Jeffries, 'Inside The Bizarre Upside-Down Bankruptcy of Mt. Gox' (*The Verge*, 22 March 2018) <https://perma.cc/C9RB-5HAZ> accessed 28 February 2019.

With regard to other common scams associated with crypto generally, Ponzi schemes, pump-and-dump, and bait-and-switch all have the same general objective — the issuer or promoter essentially aims to steal victim's investments and leave them with nothing of value. While it is absolutely true that an airdropped coin or token may have little of value, it is equally true that the recipients have invested nothing (with the exception of time, in some cases). Thus, they don't stand to 'lose' anything. The risks of these kinds of fraudulent schemes therefore do not seem to provide a substantial reason to regulate airdrops.

This is not to say that there are no scams associated with airdrops. Phishing expeditions,[93] for example, may be particularly common. Here, however, the question is whether legitimate enterprises need to pay the price for protecting those who fall for dubious offers. A prohibition on offers that ask for private keys or a ban on requiring trust trades in order to establish that a wallet is active is not likely to be effective against individuals willing to engage in these kinds of transactions. They generally know that what they are doing is fraudulent. Broader regulation on or restriction of airdrops might limit the number of opportunities for scam artists, but again, it also limits potentially legitimate distributions. In addition, there may be less restrictive ways to combat the problem. For example, many regulators provide the public with information in the form of press releases, informational documents, investor alerts, and public warnings.

Of course, the call of where to draw the line is up to the regulatory authorities, based on whether a particular nation is more in favor of a highly regulated and therefore more protective regime, or an economy where market forces are allowed to influence outcomes. The real question for regulators, and the hardest one, is where to draw the line as to what is a true airdrop. Automatic drops that require nothing more than the possession of an active wallet do not, to this author at least, seem to require much in the way of regulation. Where more is required from the recipient in terms of effort and time, the greater the risk of abuse. An airdrop that requires significant amounts of time does implicate the risk of loss where effort may not be rewarded by a promised asset or the cryptoasset fails to do whatever it was supposed to do.

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[93] As explained by one source:

'*Phishing is one of the biggest and most common cryptocurrency scams worldwide. It is an attempt to obtain sensitive information from a user such as usernames, passwords, card details, etc. In the cryptocurrency world, phishing scams attack cryptocurrency exchange passwords, digital wallets, private keys, etc. This process is usually done through a fake website which looks like an authorized one.*'

Habib Azam, 'How to avoid the most common crypto scams' (*CryptoDigest*, 12 August 2018) <https://perma.cc/K8UB-C4TT> accessed 28 February 2019.

And because most goals focus on avoiding loss to the recipient, it is the cost of the effort to the recipient that should be used to determine whether there has been a significant or 'material' contribution.

In addition, if the recipients are expected to post positive comments and lack a sufficient basis for those observations, particularly if the terms of the airdrop are not mentioned, the greater the possibility of misrepresentations being disseminated to defraud others. Positive comments can easily contribute to an unrealistic picture of a particular coin or token, especially where a reader might be unaware that the positive review was made only in fulfillment of an airdrop requirement. This may be relevant in secondary market trading and when the issuer makes subsequent distributions. In either case, however, it is not the airdrop itself that is problematic but later activities, which themselves could be regulated.

Deciding where to draw the line as to what constitutes a genuine airdrop and what is a bounty program or offering of securities that should be regulated requires a consideration of the facts and circumstances, which may not offer the certainty that the crypto community desires outside the scope of automatic airdrops. The difficulty in drawing lines is not, however, a reason to simply ban legitimate crypto-based companies from continuing to innovate in this emerging and evolving area. A more nuanced approach is required.