



## Legal Opinion: AVA Token

AVA token (“AVA”) is issued by Avatly L.L.C-FZ License number: 2201643.01, Business Center 1, M Floor, Nad Al Sheba, Dubai, U.A.E., and is a fully pre-mined BEP20 token. It is the native currency of the AVA platform which is a metaverse-based fashion e-commerce platform/marketplace. AVA has a total supply of 1 billion tokens and is presently in pre-sale launch phase. The AVA token will fuel the ecosystem that is intended to be a fashion e-commerce platform where users are digitized into the metaverse and are able to try on and purchase a variety of fashion related brands, advertise, attend virtual events, and participate in other potential future uses. Users may receive rewards in AVA for holding the token for specified periods. The token offering is yet to occur with the AVA platform is currently in early development phase. Future DEX and CEX launches are planned to occur some time in 2022 into 2023. All future issuer profits are planned to be used to buyback and burn AVA. The ecosystem is intended to be marketed B2B for advertising, events, and provision of branded 3D fashion display goods for real world purchase through the metaverse, as well as to retail AVA purchasers who will engage on the platform with these various brands and activities. This analysis focuses only on retail purchasers of AVA.

Section 2(a)(1) of the Securities Act of 1933 defines “securities” as: “any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement ... investment contract ... or, in general, any interest or instrument commonly known as a ‘security’, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.”

The seminal Supreme Court case for determining whether an instrument meets the definition of security is *SEC v. Howey*, 328 U.S. 293 (1946). The Supreme Court has reaffirmed the *Howey* analysis as recently as 2004. *Howey* focuses specifically on the term “investment contract” within the definition of security, noting that it has been used to classify those instruments that are of a “more variable character” that may be considered a form of “contract, transaction, or scheme whereby an investor lays out money in a way intended to secure income or profit from its employment.” Not every contract or agreement is an “investment contract” and the Supreme Court developed a four-part test to determine whether an agreement constitutes an investment contract and therefore a security.

The Court articulated the test as follows: A contract constitutes an investment contract that meets the definition of “security” if there is (i) an investment of money; (ii) in a common enterprise; (iii) with an expectation of profits; (iv) solely from the efforts of others (e.g., a promoter or third party), “regardless of whether the shares in the enterprise are evidenced by formal certificates or by nominal interest in the physical assets used by the enterprise.” In order to be considered a security, all four factors must be met.

1. Under *Howey*, and case law following it, an investment of money may include not only the provision of capital, assets and cash, but also goods, services or a promissory note. Given the

broad definition of a money investment and the fact that AVA is distributed by the issuer to buyers with the price set per token, even if payment is made in the form of cryptocurrency - ETH in this case - the first factor will likely be satisfied.

2. Various circuit courts use different tests to analyze whether a common enterprise exists. Three approaches predominate: (i) horizontal; (ii) narrow vertical and (iii) broad vertical.
  - a. Under the horizontal approach, a common enterprise is deemed to exist where buyers pool funds into an investment and the profits of each buyer correlate with those of the *other buyers*. This analysis does not analyze a given investor's relationship to the issuer. Whether funds are pooled appears to be the key question, and thus in cases where there is no sharing of profits or pooling of funds, a common enterprise may be deemed *not* to exist.
    - i. Under the horizontal approach, the AVA project is likely to be deemed a common enterprise because at this phase of development the buyers of AVA will pool their funds into development of the AVA platform so that the funds may be utilized to create, oversee and manage the platform, as well as to provide for marketing and other operational costs of centralized management. Once the metaverse platform is substantially complete and operational this analysis will likely change as it will become more decentralized and automated, and funds will no longer be pooled to develop the metaverse ecosystem. Furthermore, profits will not be correlated between AVA holders since users of the platform will have different engagement, spending, and reward levels therefore producing varying profits/rewards, if any.
  - b. The narrow vertical approach looks to whether the profits of an investor are tied to a promoter and the analysis is similar to the next approach.
  - c. The broad vertical approach considers whether the success of an investor depends on the promoter's expertise. If there is such reliance, then a common enterprise may be deemed to exist.
    - i. The less of a reliance on the issuer's expertise, then the less chance the AVA project would be viewed as a common enterprise. The metaverse AVA platform is presently in its early development phase. There is substantial reliance on the development team to complete the platform, implement network upgrades, and oversee its marketing and launch. Promoter's expertise is required to launch and manage the ecosystem and it appears AVA may also be a common enterprise under this test at this time, unless in the future, substantially all platform activity is managed algorithmically by the platform with minimal centralized managerial control, at which point it can be reasonably said that the

issuer's expertise is no longer necessary for holders of AVA to earn profits/rewards.

- d. Given the diverging approaches, the law on the "common enterprise" element is somewhat unclear and not easily susceptible to analysis. In this case, at the present time, there appears to be pooling of funds and substantial reliance on the issuer. Whether there is pooling of funds and reliance on the issuer also depends on the phase of platform development. The AVA platform runs on the BEP20 blockchains and is presently operating under generally centralized managerial control. Until the platform's activities are substantially automated and decentralized it is likely this test would be met for AVA under all common enterprise analyses.
3. Under the "expectation of profits" element, profit refers to the type of return or income an investor seeks on their investment (rather than the profits that the system or issuer might earn). Thus, for purposes of AVA, this could refer to any type of return or income earned as a result of being an AVA investor, which would be narrowed to the extent it is derived passively, i.e., from the efforts of others. Since courts consider this factor through the lens of the "efforts of others" factor, this prong is analyzed along with the fourth factor below. In other words, just because there is a return or profit, does not mean that the investment contract is a security. It is the essentially *passive nature of the return*, as determined by the "efforts of others" analysis that results in an "investment contract" and a "security" as opposed to a simple contract instrument. Because buyers of AVA are not likely purchasing AVA predominantly for the purpose of profit generation, but for the purpose of utilization on the AVA metaverse ecosystem, it is not unlikely this element would be met. While the token's value would likely fluctuate according the growth and popularity of the ecosystem, that would not be dispositive in the analysis of the expectations of platform users. AVA is the native currency of the metaverse ecosystem and it is necessary to engage upon it in any manner, therefore, present value of AVA may just as likely be irrelevant to users as long as it can be utilized in on-platform transactions.
  4. "Solely from the efforts of others": typically, courts have been flexible with the word "solely," such that, in addition to the literal meaning, it also will include significant or essential managerial or other efforts by the issuer necessary to the success of the investment.
    - a. The expectation of profits resulting from the purchase of AVA would primarily relate to whether a buyer receives rights and/or investment interests. While non-security token holders may receive money, capital gains, or other forms of financial incentives by virtue of merely owning the token, any such incentives should be derived through their own efforts, rather than through a passive investment. There are such interests or incentives granted to buyers in the case of AVA, however the engagement on the platform required of users to generate profits is likely to negate the passivity element.

- b. Assets held by AVA purchasers are managed by automated smart contracts which control the distribution of holding rewards to AVA holders, as well as the burning protocol. During the asset holding period any oversight by the management team may be deemed non-essential and non-managerial. Furthermore, purchasing and holding AVA does not equate to passive investment as holders are just as likely to hold some AVA to generate rewards, and use other AVA to engage on the platform.
  - c. The capital gains aspect of AVA, wherein the buyers would expect an increase in value of AVA from its purchase price, would not be dispositive towards either security or non-security status of AVA because the capital gains would occur through the buyers' own efforts and because of the AVA platform, as it continues to become more decentralized, in addition to the efforts of the issuer. Therefore, the efforts of the issuer would not predominate this reliance factor, and are unlikely to be deemed "essential" once the ecosystem is operational.
  - d. The manner in which the sale of AVA occurs, particularly the promotion and marketing, may also affect the "expectation of profits" analysis. For example, if the language used to promote AVA includes words like "investment," "returns" or "profits," the purchasers of AVA may be more likely to expect passive profits from the efforts of others than if AVA is promoted on the basis of the usefulness of the functionality attaching to it. Presently there does not appear to be any investment-type language as noted above being used in the marketing of AVA, making it less likely that purchasers would acquire AVA for purposes of investment rather than for purposes of using it up as a ticket or license on the AVA ecosystem.
  - e. With respect to voting rights, courts have also analyzed the existence of voting rights through this Howey factor. Whether voting rights are determinative of a security will be based on the facts at hand. For example, where (i) the holder is provided with rights that provide it with significant managerial control— i.e., the ability to participate in decisions that will affect the success of the enterprise; (ii) the holder has the resources and expertise to make a meaningful contribution; and (iii) the holder does, in fact, participate in management decisions, the instrument is *less* likely to be considered a security, due to the active nature of engaging in an informed and significant voting process. At present, there are no voting rights granted to each holder of AVA with respect to control and management of the AVA platform.
5. Based on the above analysis of the unique nature of AVA, the security/non-security scale leans substantially towards AVA **not** being a security due to its possible failure of the 3<sup>rd</sup> and likely failure of the 4<sup>th</sup> factor. The predominant factor behind the purchase of AVA by a given buyer is more likely to be for the purpose of active engagement on the AVA ecosystem, rather than for the purpose of investment, since AVA is required to participate in the fashion marketplace. This active engagement will likely also negate the passivity element that is required of a security. Users will

actively create their avatar and enter the metaverse so as to engage and activities and purchase goods. The following will provide a summary of the above factors used in the analysis.

- a. AVA will be sold for value to investors thereby satisfying the first factor of the test.
- b. AVA has unique functionality akin to a license (platform use, burning mechanism, payment for platform assets) which may not be accessed by anyone other than specific AVA holders; this factor shifts the scale toward the AVA not being a security.
- c. AVA provides no voting, management, and control rights over the AVA platform; therefore, this factor is not dispositive as the ecosystem, by its nature, requires active engagement, analogous to in-game currency. There would likely be greater reliance on the AVA platform itself, other holders of AVA as a user base, and the underlying assets being held by the platform, than on the management team.
- d. AVA marketing does not appear to use investment correlated terms such as “ROI” “profit” or “returns,” “investment” etc., therefore this tends to push the scale toward AVA not being deemed a security sold for investment purposes. This factor is not dispositive of security or non-security status; however, it is one of numerous considerations in the assessment of the expectations of AVA purchasers.
- e. The passivity element required of a security likely fails since only buyers of AVA receive a license by the purchase and use of AVA to enter the metaverse and utilize all its functions. The fact that the management/development team would oversee platform operations, fix bugs, provide operational support, marketing, upgrade platform functionality, monitor operations, and interact with holders of AVA would not likely overcome the lack of the reliance element as such activity by the management team would more likely be deemed as incidental and not essential.

**CONCLUSION:**

1. AVA token is unlikely to be deemed a “security” under applicable U.S. federal securities laws.
2. Trades of AVA tokens may be subject to regulation under laws applicable to trading of commodities.

  
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**Disclaimer:**

The above analysis is based on information obtained from a representative of the AVA project token issuer, the company's public documentation, and the law as it exists as of the date hereof. No US state or non-US law was considered herein; only federal securities laws. No opinion is expressed with regard to any other body of law or legal construct, including without limitation the franchise laws of any US state. No court or any administrative body has directly addressed the question of whether any blockchain tokens/coins are "securities" under federal law; as such, the SEC or a court of competent jurisdiction may reach an alternative conclusion to that stated in this opinion letter. This analysis does not constitute an approval or endorsement that any kind of fundraising or investment offering that may be conducted by the issuer hereto without compliance with all securities regulations promulgated by the SEC or any other regulatory body. No warranties or guarantees of any kind as to the future treatment of AVA tokens or similar tokens are being made herein.