Will ApeCoin and Yuga Labs make the regulators go ape?

You know what, I do think it’s nice that the Bored Ape Yacht Club is trying to do something more ambitious than just selling people code that says they own jpegs! But I am very interested in whether its ApeCoin is going to get shot out of the sky by regulators before it has a chance to [rocket emoji] to the [moon emoji].

Look, I’ve been told by a bunch of people with more money than me that Web3 is the future and that I should get in now. Maybe that is true! But how we regulate the future is going to matter, and I can’t help but remember a craze in crypto token launches in 2017 that ended in tears (and fines) for the issuers. A lot of crypto’s regulatory path is still in flux. That may not be good news for Yuga Labs, which originated the BAYC and Mutant Ape Yacht Club NFTs, but it’s great news for me, a person who loves drama.

Stock vibes
Let’s start with what a security is: a category of financial instruments or interests, which include things such as stocks, bonds, options, and a whole bunch of other things. Legally, anyone issuing a security has to register it with the Securities and Exchange Commission — the idea is that this protects investors from fraud. So if Yuga Labs were trying to form a separate *company* to prop up the value of BAYC and MAYC, they’d have to go register with the SEC before they sold shares, which divvy up ownership of the company.

Now $APE is trading on Coinbase and a bunch of other exchanges. Aesthetically, ApeCoin feels like a stock, what with the trading and speculation. It’s just got, for lack of a

better word, stock *vibes.*

But unlike a company selling its shares, the ApeCoin DAO — the decentralized autonomous organization supposedly behind it all — isn't registered with the SEC. Technically, this DAO isn't really a legally-recognized entity at all. ApeCoin seems like an attempt to remain in a legal gray area.

The standard test used for determining whether something is a security or not is from a 1946 Supreme Court case called SEC v Howey : a security represents "an investment in a common enterprise with the expectation of profit solely through the efforts of others." Let's say an investor buys a bunch of shares in Tesla, figuring he'll make some profit. Maybe he's read something about how the US is moving away from fossil fuels; maybe he saw a hot tip in his weekly horoscope. Either way, he thinks he's going to make money on this group effort made by other people. For the purposes of the Howey Test, it doesn't matter whether Tesla is incorporated, or whether its shares are trading on Wall Street, or even whether Tesla has made a car yet.

The very first DAO was *distinctly* a security, the SEC has said. Of course that organization was *explicitly* meant to invest in things, and ApeCoin DAO very carefully doesn't promise a profit to its coin holders.

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The cryptocurrency world favors a different framework for evaluation, which it calls the "Hinman test," after a speech given by SEC regulator William Hinman in 2018. In it, Hinman suggests that if something is "sufficiently decentralized," it might not be a security. This isn't meant to contradict the Howey test, but to supplement it — Hinman seemed to think that in order to expect profit from the "efforts of others," the others in question have to have some kind of control over the enterprise. Bitcoin and Ethereum, Hinman noted, don't seem to

have that going for them – and by his logic, wouldn't be securities.

ApeCoin DAO is *awfully* centralized, though. And its holders also seem to be relying very heavily on "the efforts of others." Although holders haven't been promised profits from any of the enterprises it might take on in the future, it seems like a lot of people are speculating on ApeCoin's value in the many exchanges it was listed in at launch. At the end of the first trading day, March 17th, ApeCoin closed at $8.52, according to CoinMarketCap. It has since varied in value, surging as high as $17.75 per coin. Its total market cap, as of this writing, is more than $3.5 billion.

If ApeCoin is indeed an unlicensed security, the SEC will get involved. If it isn't a security, I expect the cryptocurrency community will widely copy its structure. Either way, these silly simians are going to be influential.

ApeCoin's first use is an in-game currency for Animoca Brands' Benji Bananas. The game, which was previously free to play, now has a play-to-earn tier that requires a pass that costs 25 ApeCoins (plus whatever Eth is required for the transaction fee). Then, they'll earn tokens by playing the game, which can be swapped for ApeCoins.

Yuga Labs airdropped ApeCoin to people who own BAYC and MAYC NFTS. Stuff you get for free – well, minus some transaction fees – is not a security, say Moish Peltz and Kyle Lawrence, lawyers at Falcon Rappaport & Berkman. That part's fine.

The ApeCoin page calls ApeCoin both a "utility token" – crypto jargon that means it's got a use case: the token serves as in-game currency. ApeCoin is also called a "governance token," which means it gives the ApeCoin holders voting rights over the funds in the DAO's treasury. I'm not sure how legally enforceable that right is.

A consistent problem with DAOs is that they are not as

decentralized as they initially seem, making it easy for voting blocs to form (for instance, between Yuga Labs and Andreessen Horowitz, which led Yuga Labs' latest funding round).

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Let's use the crypto industry's preferred standard, the "Hinman test," extracted from a speech we talked about earlier. If something passes the Hinman test, it theoretically means it's decentralized enough that it won't be regulated as a security. Hinman outlined six questions for determining whether something is "sufficiently decentralized." Some of those questions have to do with whether a group has "sponsored or promoted" the digital asset and retained a stake, motivating it to increase the asset's value. Are the purchasers seeking a return? Do people besides those who set the thing up have meaningful influence?

Yuga Labs has been adamant that they are *not* running the DAO, though they were obviously instrumental in setting it up and are likely to benefit from it. Yuga Labs does indeed have a stake in the DAO and does stand to profit on their ApeCoin if it increases in value. The answers to the rest of the questions are murkier.

Let's consider the token distribution and see if that clears anything up. There are 1 billion tokens in total. Here's who gets what:

- 150 million to BAYC / MAYC members
- 150 million to Yuga Labs
- 80 million to Yuga Labs' founders
- 140 million to "launch contributors," such as Andreessen Horowitz and Animoca
- 10 million to charity

So Animoca's contribution here is obvious. What did Andreessen Horowitz do? "They helped in designing the ApeCoin DAO," says

John O’Brien, an outside spokesman for Yuga Labs. Okay, but how? Andreessen’s Mike Manning didn’t respond to a request for comment.

So Yuga Labs, Yuga Labs’ founders, and its “launch contributors” together own 370 million tokens, or almost 70 percent, of the 530 million I’ve accounted for here. There are another 470 million tokens reserved for the DAO treasury to be unlocked in stages over the next 48 months.

In practical terms, how much control does Yuga Labs have over this entity? It kind of seems like a lot. Yuga Labs also owns seven Bored Apes and 10 Mutant Apes, O’Brien confirmed. If this effort is about community, the question is: which one?

The legal entity that exists to implement the ApeCoin DAO’s decisions is something called the Ape Foundation, which is based in the Cayman Islands. “Wrapping” a DAO in a legal entity so it can interact with off-chain assets isn’t that unusual, says Erich Dylus, a lawyer who helped create a similar foundation for API3 DAO. The DAO itself isn’t really a legal entity, but the foundation is.

“The Foundation does not control ApeCoin or the ApeCoin DAO,” the website explaining ApeCoin says. It exists to “oversee” decisions, as well as to be a “management team in charge of ensuring ApeCoin DAO decisions are implemented.” The foundation also engages in “day-to-day administration,” “bookkeeping,” and “project management.” So it’s both overseeing decisions at a high level and executing details on a day-to-day, but not controlling ApeCoin? Got it.

The Ape Foundation is both overseeing decisions at a high level and executing details on a day-to-day, but not controlling ApeCoin?
Ape Foundation board member Maaria Bajwa, a principal at Sound Ventures, said in an emailed statement that “governance happens at the DAO level. The Ape Foundation acts solely on behalf of ApeCoin DAO community proposals.”

The Ape Foundation is overseen by its board, which, according to a DAO proposal, are each compensated with $125,000 in ApeCoin per 6-month term. That proposal wasn't written by the community but by the Cartan Group, which is a Caymans-based consulting firm. They were posted by user btang, who CoinDesk identifies as Brian Tang, the Cartan Group's co-founder.

When I emailed to ask, Tang declined to say whether the posts were his. He also didn't say if the Cartan Group was a launch partner or whether the group has been compensated yet. Instead, he referred back to the DAO proposals (specifically the ones named Ape Improvement Projects 1, 2, and 3), saying "our engagement is fully transparent." He then said the group would provide operational and project management support.

According to the AIPs, the Cartan Group will be paid $150,000 a month over a 6-month term to, among other things, moderate AIP proposals.

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Implementation of proposals will be managed by the project managers employed by the Foundation and may be "immaterially or materially altered" for a variety of reasons, including security or usability.

The ApeCoin DAO's common enterprise doesn't seem to be executed by the actual DAO – voting on ApeCoin proposals isn't done on-chain, and both the Foundation and the Cartan Group seem to be handling a lot of infrastructure. While this saves members on gas fees, this is not quite the decentralized future I was promised.

In conclusion, it kind of looks like the people who *actually* run the Ape Foundation, on a day-to-day basis, are the board members and the Cartan Group – which, I mean, is not exactly *decentralized* or *autonomous.* Maybe ApeCoin is just an O, not a DAO.

Some think the setup will hold up under scrutiny. "I don't

think this wanders into securities territory the way the law is presently applied," says Lawrence. Still, he says he wouldn't be surprised if the project "got some attention" — at the very least, regulators may just want to know how it works.

"Even with the microscope level scrutiny that everyone puts on tokens, it's a coin flip what gets enforced," says Dylus, the DAO lawyer.

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But as ApeCoin gets bigger, so does the target on its back. As of this writing, more than 85 percent of all airdropped ApeCoin has been claimed by NFT owners, according to a dashboard put together by a Dune analytics power user. ApeCoin is the most traded token by the biggest 100 wallets in the Ethereum ecosystem, according to WhaleStats.

Maybe there are lots of people holding onto their governance tokens for the voting power or spending their tokens as in-game currency. Who knows! What we do know for sure is that there is lots of buying and selling ApeCoin as a speculative asset.

Some very recent history: in 2017, there were a lot of initial coin offerings, or ICOs. These were attempts to raise money for a venture, kind of like cryptocurrency's version of an IPO. Now, when the Securities and Exchange Commission is unhappy about an ICO, it uses words like "fraudulent," "defrauding investors," and "scam" and files charges. Calling a token a "utility token" is not enough to deflect the wrath of the SEC.

Depending on how the Biden Administration chooses to treat cryptocurrency, Yuga Labs and its collaborators might be on the hook for millions in fines. If they aren't, though, this is a nice tidy profit for Yuga Labs and Andreessen Horowitz, among others.

That’s part of why I’m watching ApeCoin so closely. Usually, you have to actually create a business to turn a profit. Just starting a DAO seems much, much faster.

https://www.theverge.com/2022/3/25/22994795/apecoin-yuga-labs-sec-regulation-utility-token