CuBit™ and the Howey Test In-house Analysis

August 2024

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Foreword

The Howey analysis of C*u*Bit™ was originally performed in November of 2022. Since then, the regulatory picture has become much clearer.

The classification of Bitcoin (BTC) and Ethereum (ETH) as commodities unequivocally took them out of the realm of securities. On the securities side, the creation of exchange traded funds (ETF) for both BTC and ETH opened a well-regulated avenue for industrial investors to put their money into cryptocurrencies on an equal footing with other commodities trading.

UREWPS believes that these developments, and the structure of C*u*Bit™ moot the point-by-point discussion of how this receipt cryptocurrency fails the Howey test. Regardless, it is still helpful to many readers to understand exactly why CuBit™ is appropriately exempt from securities laws.

Introduction

Consideration of whether C*u*Bit™ qualifies as a security requires understanding the principal test used in US Law to figure out what constitutes a security. The US Supreme Court's *Howey* case and later case law are our best guides. We expect the most reliable interpretation of these frameworks is found on the official website of the Securities and Exchange Commission (SEC): www.sec.gov.

The analysis below breaks down the *Framework for "Investment Contract" Analysis of Digital Assets*, as found on the SEC site, point by point as it relates to C*u*Bit™. For a full explanation of C*u*Bit™, please read the C*u*Bit™ Whitepaper.

Application of *Howey* to Digital Assets

There are three key points in the so-called Howey Test:

1. Investment of Money
2. Common Enterprise
3. Reasonable Expectation of Profits Derived from Efforts of Others

The first two points are so universally applicable to any enterprise that they are uncontestable for C*u*Bit™. This leads us to dissect and respond only to the elements of the third prong of *Howey*. Additionally, the cited article notes some other relevant considerations which we also address.

The third test in *Howey* has two subsections:

1. Reliance on the Efforts of Others
2. Reasonable Expectation of Profits

Regarding reliance on the efforts of others, UREWPS concedes that there is no worthwhile endeavor which can succeed without the cooperation of others. Even the farmer who plants, waters, harvests, and sells his own crops is dependent upon the manufacturer of irrigation systems, planting machinery, harvesters, pesticides, cargo trucks, etc. Therefore, it is unrealistic to believe that <u>any</u> endeavor can be carried to fruition without reliance on the efforts of others.

CuBit™ Context

To consider the following points about a reasonable expectation of profits it is first necessary to understand the purpose and intent of CuBit™, and its structure. We will begin with the structure.

Structure of CuBit™

CuBit™ is a blockchain smart contract using the ERC-20 standard contract protocol on the Ethereum Mainnet blockchain. Without trying to explain all these terms further we will say that what is important to understand from this is that CuBit™ is not creating a network, or a new blockchain to support its functionality. In short, the value of CuBit™, today or tomorrow, is not dependent in any way on further development of any network.

Purpose and Intent of CuBit™

CuBit™ is intended to function as a vehicle for depositors to keep their wealth stored relatively safely from the effects of inflation and market volatility. Regardless of all precautions, CuBit™ cannot guarantee inflation or volatility will not degrade the value of deposits. No economic vehicle is immune to catastrophic economic events.

Reasonable Expectation of Profits

While it might be convenient for readers to push the following table (See Table 1) into an appendix, we have opted instead to include this here as it embodies the primary points of this paper. The left column has intact, direct excerpts from the cited article. The right column has the CuBit™ position compared to the point cited in the left column.

Key Exemption

In the third row of the table below is a key exemption which applies to CuBit™.

> *"Price appreciation driven solely by external market forces (such as inflationary trends or the economy) impacting the supply and demand for an underlying asset generally is not considered 'profit' under the Howey test."*

All value changes expected for CuBit™ are designed to derive from real estate appreciation.

These changes are expected to be sufficient to offset increases in inflation. CuBit™ is designed to prevent extreme variations in its value independent of extreme changes in inflation. It achieves this through two mechanisms:

1. a geographically diversified real estate portfolio across the USA
2. diversified real estate types (e.g., single family, multi-family, commercial, etc.)

The reliance of *Cu*Bit™ value changes on external market forces is sufficient, by itself, to decide that *Cu*Bit™ is not a security. Regardless, we address all the remaining points individually in the table below. In most cases, failing a test point below means *Cu*Bit™ is not a security. However, some test points need to be 'passed' to indicate *Cu*Bit™ is not a security.

Since we do not believe *Cu*Bit™ is a security we are pleased when a point demonstrates *Cu*Bit™ is not a security. To clarify our views, we have added icons to the table which show when an answer pleases us.

Table 1 SEC Analysis of Digital Assets v CuBit™

Framework for "Investment Contract" Analysis of Digital Assets As found on 11/1/2022 at: https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets	*Cu*Bit™ Position	
	Icon	Meaning
	🙂	NOT A SECURITY
	😐	MIGHT BE A SECURITY
	☹️	PROBABLY A SECURITY

This framework represents the views of the Strategic Hub for Innovation and Financial Technology ("FinHub," the "Staff," or "we") of the Securities and Exchange Commission (the "Commission"). It is not a rule, regulation, or statement of the Commission, and the Commission has neither approved nor disapproved its content. Further, this framework does not replace or supersede existing case law, legal requirements, or statements or guidance from the Commission or Staff. Rather, the framework provides additional guidance in the areas that the Commission or Staff has previously addressed. *See, e.g., Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO* (Exchange Act Rel. No. 81207) (July 25, 2017) ("*The DAO Report*"); William Hinman, *Digital Asset Transactions: When Howey Met Gary (Plastic)*, Remarks at the Yahoo Finance All Markets Summit: Crypto (June 14, 2018), available at https://www.sec.gov/news/speech/speech-hinman-061418.	

1. Reasonable Expectation of Profits An evaluation of the digital asset should also consider whether there is a reasonable expectation of profits. Profits can be, among other things, capital appreciation resulting from the development of the initial investment or business enterprise or a participation in earnings resulting from the use of purchasers' funds.[18] Price appreciation resulting solely from external market forces (such as general inflationary trends or the economy) impacting the supply and demand for an underlying asset generally is not considered "profit" under the *Howey* test. [our emphasis]	🙂 NOT A SECURITY :Value appreciation for *Cu*Bit™ results from price appreciation of real estate as driven by external market forces. The highlighted phrase embodies the value driver for *Cu*Bit™. It should, by itself, be sufficient to safely decide that *Cu*Bit™ is not a security.

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Reasonable Expectation of Profit – 12 Tests	
The more the following characteristics are present, the more likely it is that there is a reasonable expectation of profit:	
The digital asset gives the holder rights to share in the enterprise's income or profits or to realize gain from capital appreciation of the digital asset.	🙂 NOT A SECURITY – CuBit™ depositors have no claims on income or profits.
The opportunity may result from appreciation in the value of the digital asset that comes, at least in part, from the operation, promotion, improvement, or other positive developments in the network, particularly if there is a secondary trading market that enables digital asset holders to resell their digital assets and realize gains.	🙂 NOT A SECURITY - Network development does not drive the value of CuBit™. Real estate appreciation is the sole driver of value for CuBit™.
This also can be the case where the digital asset gives the holder rights to dividends or distributions.	🙂 NOT A SECURITY - CuBit™ depositors do not receive dividends or distributions.
The digital asset is transferable or traded on or through a secondary market or platform, or is expected to be in the future.[19]	🙂 NOT A SECURITY - Secondary markets may reasonably be expected to arise, as with any commodity or currency. Such secondary markets are not sponsored by or supported by CuBit™.
Purchasers reasonably would expect that an AP's efforts will result in capital appreciation of the digital asset and therefore be able to earn a return on their purchase.	🙂 NOT A SECURITY – AP efforts do not drive real estate appreciation, which is the sole value driver for CuBit™.
The digital asset is offered broadly to potential purchasers as compared to being targeted to expected users of the goods or services or those who have a need for the functionality of the network.	🙂 NOT A SECURITY - CuBit™ is targeted only at people who have the need to protect their money against inflation.

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• The digital asset is offered and purchased in quantities indicative of investment intent instead of quantities indicative of a user of the network. For example, it is offered and purchased in quantities significantly greater than any likely user would reasonably need, or so small as to make actual use of the asset in the network impractical.	🙂	NOT A SECURITY – CuBit™ depositors can make their deposits in a wide variety of increments without any minimum requirement.
There is little apparent correlation between the purchase/offering price of the digital asset and the market price of the particular goods or services that can be acquired in exchange for the digital asset.	🙂	NOT A SECURITY - The good or service is protecting savings against inflation and volatility. The denominations of CuBit™ allow deposits in small or large quantities.
There is little apparent correlation between quantities the digital asset typically trades in (or the amounts that purchasers typically purchase) and the amount of the underlying goods or services a typical consumer would purchase for use or consumption.	🙂	NOT A SECURITY – there is a direct correlation between the amount people deposit in CuBit™ and the amount of money they want to protect from inflation and volatility, which they might typically deposit in a bank savings account or certificate of deposit (CD).
The AP has raised an amount of funds in excess of what may be needed to establish a functional network or digital asset.	🙂	NOT A SECURITY – A portion of deposits are used to buy real estate to protect the value of CuBit™ against inflation and volatility. The "excess" is held in liquid asset reserves to meet the liquidity needs of CuBit™ depositors. After the initial establishment of the management entity, no part of the deposits is used for further development of any network or the digital asset.
The AP is able to benefit from its efforts as a result of holding the same class of digital assets as those being distributed to the public.	😐	MIGHT BE A SECURITY – the AP, and anyone else, can use CuBit™ as a savings vehicle. The AP has no special privileges or restrictions regarding making deposits in CuBit™.

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		PROBABLY A SECURITY

The AP continues to expend funds from proceeds or operations to enhance the functionality or value of the network or digital asset.	NOT A SECURITY - Beyond ongoing purchases of real estate, no enhanced functionality is necessary to sustain the value of CuBit™.

Marketing Considerations – 8 Tests	
The digital asset is marketed, directly or indirectly, using any of the following:	
• The expertise of an AP or its ability to build or grow the value of the network or digital asset.	MIGHT BE A SECURITY – The ability of the AP to buy real estate to back the value of CuBit™ does support the value of CuBit™ and is mentioned in marketing materials. In like manner, the ability of the Governors of the Federal Reserve affects the value of the US Dollar.
• The digital asset is marketed in terms that indicate it is an investment or that the solicited holders are investors.	NOT A SECURITY – CuBit™ 'buyers' are depositors. CuBit™ is not marketed as an investment or to "investors." It is marketed as a currency depositors can use to protect their wealth against inflation and volatility.
• The intended use of the proceeds from the sale of the digital asset is to develop the network or digital asset.	NOT A SECURITY – The development of CuBit™ is complete. The network is the Ethereum Mainnet, which is has been fully functional for many years.
• The future (and not present) functionality of the network or digital asset, and the prospect that an AP will deliver that functionality.	NOT A SECURITY – The development of CuBit™ is complete. The network is the Ethereum Mainnet, which is has been fully functional for many years.
• The promise (implied or explicit) to build a business or operation as opposed to delivering currently available goods or services for use on an existing network.	NOT A SECURITY – Real estate is currently available all over the USA. The CuBit™ management entity can buy real estate today.
• The ready transferability of the digital asset is a key selling feature,	PROBABLY A SECURITY – any currency that is not easily transferred is useless as a currency.

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	Icon	**Meaning**
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	😐	MIGHT BE A SECURITY
	☹️	PROBABLY A SECURITY

• The potential profitability of the operations of the network, or the potential appreciation in the value of the digital asset, is emphasized in marketing or other promotional materials.	🙂 NOT A SECURITY – Value gains for CuBit™ are not driven by the operations of the network. The value gains driven by real estate appreciation are emphasized.
• The availability of a market for the trading of the digital asset, particularly where the AP implicitly or explicitly promises to create or otherwise support a trading market for the digital asset.	🙂 NOT A SECURITY – CuBit™ is not creating any trading market

Reasonable Expectation Reevaluation – 6 Tests	
In evaluating whether a digital asset previously sold as a security should be reevaluated at the time of later offers or sales, there would be additional considerations as they relate to the "reasonable expectation of profits," including but not limited to:	
Purchasers of the digital asset no longer reasonably expect that continued development efforts of an AP will be a key factor for determining the value of the digital asset.	🙂 NOT A SECURITY – CuBit™ is delivered complete. Further development efforts of the AP do not affect the value.
The value of the digital asset has shown a direct and stable correlation to the value of the good or service for which it may be exchanged or redeemed.	🙂 NOT A SECURITY – CuBit™ value is tied to real estate values. The correlation is direct.
The trading volume for the digital asset corresponds to the level of demand for the good or service for which it may be exchanged or redeemed.	🙂 NOT A SECURITY - Trading volume is expected to be low because it is primarily a savings vehicle. As depositors need to tap into their savings for other needs, they may draw down their CuBit™ balances. As they accumulate wealth, they may increase their CuBit™ balances.

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	Icon	Meaning
	🙂	NOT A SECURITY
	🙁	MIGHT BE A SECURITY
	☹️	PROBABLY A SECURITY
Whether holders are then able to use the digital asset for its intended functionality, such as to acquire goods and services on or through the network or platform.	🙂	NOT A SECURITY - Intended use is wealth protection from inflation and volatility. Acquisition of other goods and services in pending and incidental. The network (Ethereum Mainnet) is simply a delivery vehicle and information security structure, not a value driver.
Whether any economic benefit that may be derived from appreciation in the value of the digital asset is incidental to obtaining the right to use it for its intended functionality.	🙂	NOT A SECURITY – The primary reason for the existence of *Cu*Bit™ is to increase in value proportionate to real estate values as a protection against decreasing value from inflation and volatility.
No AP has access to material, non-public information or could otherwise be deemed to hold material inside information about the digital asset.	🙂	NOT A SECURITY – There is no "inside information" about real estate values across the USA.

2. Other Relevant Considerations

When assessing whether there is a reasonable expectation of profit derived from the efforts of others, federal courts look to the economic reality of the transaction.[20] In doing so, the courts also have considered whether the instrument is offered and sold for use or consumption by purchasers.[21]

Although no one of the following characteristics of use or consumption is necessarily determinative, the stronger their presence, the less likely the Howey test is met:

Digital assets with these types of use or consumption characteristics are less likely to be investment contracts.

Consumption Characteristics – 16 Tests		
The distributed ledger network and digital asset are fully developed and operational.	🙂	NOT A SECURITY - The development of *Cu*Bit™ is complete. The network is the Ethereum Mainnet, which is has been fully functional for many years.

| *Framework for "Investment Contract" Analysis of Digital Assets*	C*u*Bit™ Position	
As found on 11/1/2022 at: https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets	Icon	Meaning
	🙂	NOT A SECURITY
	🙂	MIGHT BE A SECURITY
	🙁	PROBABLY A SECURITY
Holders of the digital asset are immediately able to use it for its intended functionality on the network, particularly where there are built-in incentives to encourage such use.	🙂 NOT A SECURITY - The intended use is savings and wealth protection. That functionality is immediately available. The built-in incentives are protection against inflation and volatility.	
The digital assets' creation and structure is designed and implemented to meet the needs of its users, rather than to feed speculation as to its value or development of its network. For example, the digital asset can only be used on the network and generally can be held or transferred only in amounts that correspond to a purchaser's expected use.	🙂 NOT A SECURITY – The use of the publicly displayed Asset Ledger, showing the value of assets backing C*u*Bit™, and the relative value of each C*u*Bit™ in circulation is expressly designed to thwart value speculation.	
Prospects for appreciation in the value of the digital asset are limited. For example, the design of the digital asset provides that its value will remain constant or even degrade over time, and, therefore, a reasonable purchaser would not be expected to hold the digital asset for extended periods as an investment.	🙂 NOT A SECURITY - Appreciation of Value Limited: Value growth is limited by real estate value growth. 🙁 PROBABLY A SECURITY - Degraded Value Over Time: Building in mechanisms to degrade the value of a currency directly conflicts with the interests of currency holders. It amounts to stealing their wealth. 🙂 NOT A SECURITY -A reasonable purchaser of savings vehicles is expected to continually build their savings over their lifetime to enable them to weather economic misfortunes and make large purchases. Reasonable purchasers don't expect their savings to degrade in purchasing power over time. They expect their savings to keep their purchasing power over time.	

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	Icon	**Meaning**
	🙂	NOT A SECURITY
	😐	MIGHT BE A SECURITY
	🙁	PROBABLY A SECURITY
With respect to a digital asset referred to as a virtual currency, it can immediately be used to make payments in a wide variety of contexts, or acts as a substitute for real (or fiat) currency.	🙂 NOT A SECURITY - CuBit™ is a substitute for keeping savings in fiat currency. The ability to fund purchases directly out of savings accounts is curtailed by US banking regulations.	
• This means that it is possible to pay for goods or services with the digital asset without first having to convert it to another digital asset or real currency.	🙂 NOT A SECURITY (contingent) - As deposits in CuBit™ grow we will partner with debit card providers to enable direct purchasing from CuBit™ balances.	
• If it is characterized as a virtual currency, the digital asset actually operates as a store of value that can be saved, retrieved, and exchanged for something of value at a later time.	🙂 NOT A SECURITY – CuBit™ operates as a store of value. It is saved in user-controlled wallets compatible with the ERC20 protocol. It can be retrieved and exchanged by depositors at-will.	
With respect to a digital asset that represents rights to a good or service, it currently can be redeemed within a developed network or platform to acquire or otherwise use those goods or services. Relevant factors may include:	🙂 NOT A SECURITY - The essential service of CuBit™ is protecting wealth through real estate ownership. It is a savings vehicle.	
• There is a correlation between the purchase price of the digital asset and a market price of the particular good or service for which it may be redeemed or exchanged.	🙂 NOT A SECURITY – The ability of depositors to exchange their CuBit™ for goods and services at market values is helped by the CuBit™ value information available in the Asset Ledger.	
• The digital asset is available in increments that correlate with a consumptive intent versus an investment or speculative purpose.	🙂 NOT A SECURITY - The CuBit™ Denominations in the CuBit™ Whitepaper directly support large and small purchases of items.	
• An intent to consume the digital asset may also be more evident if the good or service underlying the digital asset can only be acquired, or more efficiently acquired, through the use of the digital asset on the network.	😐 MIGHT BE A SECURITY - Real estate is not a consumable. Using real estate to protect wealth from inflation and volatility is realized more efficiently through CuBit™ than through direct real estate purchases and through targeted real estate purchases.	

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	Icon	Meaning
	🙂 (green)	NOT A SECURITY
	😐 (yellow)	MIGHT BE A SECURITY
	☹️ (orange)	PROBABLY A SECURITY
Any economic benefit that may be derived from appreciation in the value of the digital asset is incidental to obtaining the right to use it for its intended functionality.	🙂	NOT A SECURITY – The intended functionality of CuBit™ is to protect stored wealth from inflation and volatility.
The digital asset is marketed in a manner that emphasizes the functionality of the digital asset, and not the potential for the increase in market value of the digital asset.	🙂	NOT A SECURITY – Marketing of CuBit™ focuses on its use to protect wealth from inflation and volatility. Value increases in CuBit™ are positioned against value losses due to inflation and volatility.
Potential purchasers have the ability to use the network and use (or have used) the digital asset for its intended functionality.	🙂	NOT A SECURITY – Depositors can use CuBit™ to protect their wealth from inflation and volatility today.
Restrictions on the transferability of the digital asset are consistent with the asset's use and not facilitating a speculative market.	🙂	NOT A SECURITY – True currency is always highly transferrable. Transfers of CuBit™ will be in exchange for goods or services. The Asset Ledger destroys any speculative market for CuBit™.
If the AP facilitates the creation of a secondary market, transfers of the digital asset may only be made by and among users of the platform.	🙂	NOT A SECURITY – Most currencies are available on lawful currency exchanges. The AP has no plans or intentions of facilitating creation of any secondary market for CuBit™. CuBit™ is interchangeable with ETH, several USD-linked stablecoins, USD, and possibly BTC. This is in keeping the nature of CuBit™ as a currency.

Keeping Score

🙂	😐	☹️
37	3	2
NOT A SECURITY	MIGHT BE A SECURITY	PROBABLY A SECURITY
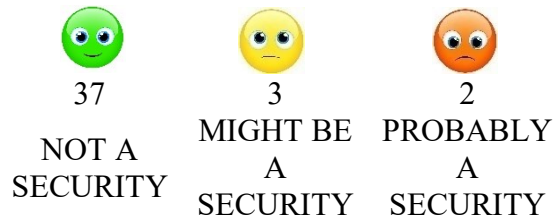
With thirty-seven of forty-two points indicating that *Cu*Bit™ is probably not a security, *Cu*Bit™ fails *Howey*. Failing the *Howey* test means the issue is not a security. The answers in the "consumption characteristics", included in the additional considerations, show that *Cu*Bit™ has consumption characteristics of a currency rather than those of a security.

Of the five points inclining toward a security, one is planned for remediation as *Cu*Bit™ matures its market presence. The second is debatable, depending upon the reader's interpretation.

- Of twelve tests listed under reasonable expectation of profits *Cu*Bit™ clearly fails eleven tests of a security and possibly fails all twelve.
- Of eight marketing tests, *Cu*Bit™ clearly does not qualify as a security for six of the tests. *Cu*Bit™ qualifies as a security by one test and may qualify as a security on a second test.
- Of six tests within reevaluation of expected profits, *Cu*Bit™ does not qualify as a security for all six.
- Of sixteen listed consumption characteristics tests, *Cu*Bit™ is clearly disqualified as a security by fifteen tests of the sixteen. Disqualification for the remaining test is possible, but unlikely, because it would require real estate to be considered a consumable product. The application of depreciation indicates consumption. Improvements (e.g., buildings, water and sewer connections, etc.) depreciate. The land itself does not depreciate.

Of the total of forty-two distinct tests in this part of *Howey*, *Cu*Bit™ clearly does not qualify as a security on thirty-seven tests. It might qualify as a security on three tests and appears to qualify on two tests.

More important than all these lesser tests is the foundational proposition that,

> *"Price appreciation resulting solely from external market forces (such as general inflationary trends or the economy) impacting the supply and demand for an underlying asset generally is not considered 'profit' under the Howey test."*

Because price appreciation for *Cu*Bit™ results primarily from the external forces affecting real estate values across the market, *Cu*Bit™ unequivocally does not qualify as a security under the *Howey* test. However, it does qualify as a currency.

Conclusions

Using *Cu*Bit™ as a replacement for fiat currencies for savings is the primary function of *Cu*Bit™. That functionality is available today. It does not depend on any future development of *Cu*Bit™.

Using *Cu*Bit™ for routine consumer purchases is a predicted development. Many features are already present. If a debit card based on *Cu*Bit™ is implemented, that utility may have an incidental effect on *Cu*Bit™ value. Because *Cu*Bit™ is a savings vehicle, based on the value of real estate, use for consumer purchases will never be a primary value driver.

Based on the overwhelming failure of C*u*Bit™ to qualify as a security under *Howey*, we believe that any reasonable person will conclude that C*u*Bit™ is not a security.

We also believe that the consumption tests demonstrate that C*u*Bit™ is a currency.

As a commodity, such as corn, wheat, BTC, and ETH, C*u*Bit™ is exempt from securities registration and regulation. Under the Commodities Futures Trading Commission (CFTC) rules, commodities are not inherently regulated or registered unless and until a party attempts to sell contracts, derivatives, or futures products based on that commodity. Then, it is the contract, not the commodity itself, which is regulated by the CFTC.