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ICOs: Cloud-based but likely grounded in regulations

What is an ICO?

ICOs are a popular way to raise money for a new cryptocurrency project by distributing a percentage of the initial coin supply among the early supporters and backers. Anyone participating in an ICO should not expect to receive even a subway token. Instead, in a typical ICO, investors purchase digital tokens that provide them access to a new platform using blockchain technology. Access to this new platform would be limited to those having the right digital tokens, i.e. coins. Amid the excitement over blockchain technology and the reported valuation of Bitcoin, Ether, and newer entrants like zCash, many are speculating in the new coins in the hopes of selling them on developing secondary markets.

Subject to Regulation?

Only time will tell, but probably yes. While the next cryptocurrency indeed may unlock untold benefits of the blockchain, ICOs potentially raise myriad regulatory questions and, depending on the structure of the offering, likely do not allow software developers to escape the reach of U.S. securities regulators.

Risks and Disclosures

One risk of regulation is that those “offering” these new coins—the developers of new coins—typically issue a white paper describing the new application in technical terms but that’s a far cry from the usual exhaustive delineation of risk factors in an unregistered securities offering. Avoiding the time and expense associated with an unregistered offering (let alone a registered offering) of securities makes an ICO appealing for start-ups seeking to move fast and contain costs. However, any developer whose primary mode of distributing new coins is through the payment of fiat currency (or the selling of “pre-mined” coins in cryptocurrency terms) likely is well along the way of satisfying the first prong of the

seminal legal test for what constitutes a sale of securities according to U.S. law.

Considerations for Launching an ICO

Careful thought should be given to how ICOs are structured and, as importantly, promoted because it is only a matter of time before creative counsel launches securities fraud cases against developers whose application has flamed out. Depending on the promotional materials and terms of the ICO, such lawyers might not need to be very creative at all to successfully prosecute such claims.

For advice on ICOs, please contact [Gray Sasser](#).

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