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LEGAL MEMORANDUM

To: Zen Systems
Attn: Robert Viglione

From: Cogent Law Group, LLP
Evan Smith
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Date: January 25, 2018

Questions Presented

Is the ZenCash token (the "Token") considered a convertible virtual currency according to FinCEN or a security under the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act")?

Brief Answer

Upon review of the frameworks articulated in FinCEN guidance, and rulings and settlements regarding virtual currencies, we believe that properly informed regulators and fact-finders would determine that the token is a convertible virtual currency and not a security.

Facts

"Zen is an end-to-end encrypted system with zero-knowledge technology over which communications, data, or value can be securely transmitted and stored."[1] Zen is an ecosystem of products, services and businesses built upon a permissionless, decentralized blockchain. Zen's current and planned products and services include: 1) ZenTalk – a highly secure, encrypted messaging network; 2) ZenPub – an anonymous publishing platform; and 3) ZenHide – a tool that enables the Zen community to circumnavigate cryptocurrency blocking mechanisms.

[1] Zen Systems, *Zen White Paper* (May 2017) *available at* https://zensystem.io/assets/Zen%20White%20Paper.pdf

The Zen system operates using ZenCash, a token that operates in much the same way that ether does on the Ethereum blockchain. In essence, ZenCash (the "Token") functions as the Zen system's token of value or transaction fuel.

Zen and ZenCash were built to contribute to and expand the spirit and legacy of other anonymity-focused cryptocurrencies like Dash and ZCash.

Scope, interpretative Matters, Assumptions, and Limitations

This memorandum addresses only the following US federal laws and regulations: the Bank Security Act of 1970 ("BSA"), the Securities Act of 1933 ("Securities Act"), and the Securities Exchange Act of 1934 ("Exchange Act"). We have not undertaken a review of the law of any other jurisdiction. Insofar as the laws of the federal government are concerned, our review of laws is only of those laws, rules, and regulations that, in our experience, are normally applicable to the regulation of virtual currencies, money transmitters, and persons issuing securities. Without limiting the generality of the foregoing, we have not reviewed, and express no opinion with respect to, the federal laws, the ordinances and statutes, the administrative decisions and orders, or the rules and regulations of the United States, other than the BSA, the Securities Act, and the Exchange Act.

When statements expressed herein are stated to be "to our knowledge," such statements are to the actual knowledge of the attorneys in our firm who are actively involved in handling this matter for the Company and without any independent investigation or verification on our part.

We have assumed, with your permission, (i) legal capacity of natural persons, (ii) the authenticity of all documents submitted to us as originals, (iii) the conformity to original documents of all documents submitted to us as certified, facsimile, scanned, digitally submitted, or photostatic copies, (iv) the authenticity of the originals of such latter documents, and (v) the genuineness of all signatures on all documents examined by us.

The application of federal laws and regulations to token sales and token-based operations is in a state of ongoing development. This Legal Memorandum is effective as of the date hereof, and we do not undertake any obligation to provide you with any updates of the Memorandum. The Memorandum of Law is issued to Zen Systems as part of a review of legal compliance, and may not be relied on for any other purpose or by any entity other than Zen Systems.

Discussion

I. Federal regulators would likely find that the Token is a convertible virtual currency.

The Financial Crimes Enforcement Network ("FinCEN"), a bureau under the auspices of the Department of the Treasury, is responsible for administering the BSA. FinCEN makes rulings and publishes guidance clarifying the application of the BSA.

In 2013, FinCEN published guidance titled, "Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies".[2] In this document, FinCEN asserts the Department of the Treasury's definition of real currency: "the coin and paper money of the United States or of any other country that [i] is designated as legal tender and that [ii] circulates and [iii] is customarily used and accepted as a medium of exchange in the country of issuance."[3] Also in its 2013 guidance, FinCEN makes reference to two terms that do not appear in the BSA: 1) virtual currency and; 2) convertible virtual currency. FinCEN's guidance defined a virtual currency as "a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency" (e.g., it does not constitute legal tender in any jurisdiction). Moreover, a convertible virtual currency either "has an equivalent value in real currency, or acts as a substitute for real currency."

In our opinion, the Token would most likely be viewed by regulators as a convertible virtual currency. Under the definition provided by FinCEN, a convertible virtual currency need only act as a substitute for real currency. ZenCash was developed as a mechanism to enable transactions across the Zen system, and in that respect we believe regulators are likely to argue that ZenCash serves as a currency substitute.

II. Federal regulators would likely find that the Token is not a security.

In assessing the likelihood that the ZenCash token would be considered a security, we look to the following regulatory and legal authorities: 1) Section 2(a)(1) Securities Act; 2) Section 3(a)(10) of the Exchange Act; and 3) relevant case law, including, but not limited to SEC v. Howey, 328 U.S. 293 (1946).

Initially, we note the definition of a "security" as presented in Section 2(a)(1) of the Securities Act: "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." Based on our understanding of the purpose and function of your Token, we do not believe that it operates as any of these

[2] Department of the Treasury Financial Crimes Enforcement Network. FIN-2013-G001, Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies (March 18, 2013).

[3] 31 CFR § 1010.100(m)

categories of securities articulated in Section 2(a)(1) of the Securities Act. That is, the Token is not a note, stock, treasury stock, security feature, security-based swap, bond, debenture, certificate of interest, investment contract, etc. nor does it represent or provide a right in any of these types of securities.

In evaluating treatment of the Token under the Securities Act, courts and regulators would also consider whether your Token constitutes an investment contract and is subject to regulation as such. The court in *Howey* established a four-prong test ("*Howey* test") to determine whether or not a contract or agreement constitutes an investment contract. Specifically, a contract is an investment contract if: (1) there is an investment of money; (2) in a common enterprise; (3) with an expectation of profits; (4) solely from the efforts of others. Subsequent case law has determined that in order to be deemed an investment contract, a contract must meet all four of the criteria illuminated in *Howey*. In essence, if at least one of the prongs of the *Howey* test is not satisfied, then the contract is not an investment contract.

Regulatory or legal authorities might argue that sale of your Token satisfies the first two prongs of the *Howey* test (i.e., that the purchase of tokens is an investment of money in a common enterprise). However, we believe that, when analyzed in tandem, the third and fourth prongs (i.e., that there is an expectation of profits solely from the efforts of others) do not apply to ZenCash.

While the Zen system enables Token holders to receive rewards and to vote on the direction of Zen, the rights granted do not provide an expectation of profits analogous to dividends, shareholder rights, and the like, derived from the efforts of others. Because of the Zen system's unique and decentralized structure, Token holders, and not Zen or other parties, are in control of the system. The Token holders are active participants (e.g., Token holders may utilize tokens to secure voting rights in DAO and are awarded tokens through mining mechanisms). Thus, Token holders put forth the central group effort that generates individual incentives and rewards, rather than profiting solely from the efforts of others.

In evaluating the proper application of the *Howey* test under these facts, we also considered court decisions that provide additional context for the fourth prong of the *Howey* test (i.e., *solely* from the efforts of others). Some courts have concluded that the word "solely" should not be taken literally and should be expanded to include contracts that enable significant or essential managerial efforts (or other efforts) that are necessary to the investment [*See* SEC v. Glenn W. Turner Enters., 474 F.2d 476, 482-83 (9th Cir.1973)]. We considered the potential argument that the Zen team exerted managerial control by creating and setting up the Zen system, thereby satisfying the fourth prong of the *Howey* test. However, we believe that a properly informed regulator or fact finder would reject this argument because, as noted above, token holders have significant participation in the operation of the Zen system. Holders can and do exert significant managerial control (e.g., Token holders can make proposals and vote on the direction of any changes to the protocol) and have the expertise and resources to make significant contributions. We believe that regulators or courts, if properly informed of these distinguishing features of the Zen system, will be less likely to find that the instrument constitutes a security [(See, e.g., Williamson v. Tucker, 645 F.2d 404 (5th Cir.), cert.

denied, 454 U.S. 897 (1981); Odom v. Slavik, 703 F.2d 212, 215 (6th Cir. 1983), Stewart v. Ragland, 934 F.2d 1033 (9th Cir. 1991)].

For the foregoing reasons, we conclude that properly informed federal regulators would determine that the ZenCash token is not subject to regulation as a security.