



## Legal Opinion: RUM TOKEN

RUM TOKEN (“RUM”) is issued by ArrLabs FZ-LLC., located at Al Shohada Road, AL Hamra Industrial Zone-FZ Ras Al Khaimah, United Arab Emirates, and is a fully pre-mined deflationary Polygon chain token that is intended to be used as the medium of exchange for the in-game metaverse economy called Pirates of Arrland. Pirates of Arrland (“Pirates”) is a realistic 3D metaverse based pirate themed blockchain game that utilizes NFTs and 2 types of tokens; only RUM will be the subject of this opinion. RUM has a total supply of 150 million tokens and a portion has been sold at presale, with a current float of about 40,000, but is currently available for purchase on at least one DEX with more liquidity planned in the near future. RUM has specific in-game functions such as minting/purchasing NFTs, exchange for the in-game sister token, staking, and as a reward for engagement on the Pirates platform, and purchase of in-game items. Portions of the Pirates metaverse ecosystem are currently in beta testing, with full platform launch scheduled for last quarter of 2023.

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 RUM is distributed by the issuer to buyers with the price set per token, even if payment is made in the form of cryptocurrency - 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*. 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 Pirates project is likely not to be deemed a common enterprise because the buyers of RUM will utilize the token in different ways on the Pirates platform which may include purchase of in game items, staking, exchange for other crypto assets, purchase/minting of non-fungible tokens, and potentially holding it for profit. There does not appear to be any proportional sharing of profits or pooling of funds, since RUM's principal function is to be utilized during game play; therefore, buyers of RUM will experience a broad variety of profits or losses depending on how each platform user utilizes RUM, in his or her sole discretion, without interference or direction of the issuer.
  - 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 each buyer of RUM 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 RUM project would be viewed as a common enterprise. RUM token is presently in partial circulation, having gone through a pre-sale approximately one year ago before this opinion was drafted. At this stage there is some reliance on the promoter to complete and launch the full platform, although users of RUM will also rely on the operating portions of the platform and other users of the Pirates ecosystem to succeed or not. Because buyers of RUM possess total autonomy in how to utilize RUM on the platform, without direction or control of the issuer, the likelihood is that while there is some reliance on the issuer, it is more likely that such reliance would not be deemed essential or sufficiently material to overcome the reliance on the platform and other users, hence this factor is likely to fail. In any case, regardless of the analysis of this factor, RUM fails other factors which militate towards the same conclusion, even if a given court finds that there is sufficient reliance on the promoter to pass this approach.

- d. Given the diverging approaches, the law on the “common enterprise” element is somewhat unclear and not easily susceptible to objective analysis. In this case, given that the Pirates platform is in beta testing, and the fact that buyers maintain sole control over how RUM is utilized on the platform, this common enterprise factor is more likely than not to fail. The conclusion remains that RUM is not intended or marketed to be held for profit, hence even if this factor is deemed to be satisfied, RUM still almost certainly fails at least one other essential factor.
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 RUM, this could refer to any type of return or income earned as a result of being a RUM purchaser, 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 RUM may be purchasing it to obtain capital gains, rewards, or more likely for the purpose of using it up through one of the many uses that require the expenditure of RUM on the Pirates platform, it is unclear whether this factor would be met. The main part of the analysis requires ascertaining the expectations of the buyers created by the issuer’s statements and disclosures in its marketing materials. If the issuer markets the token to a greater extent touting the functionality of the token, then RUM is less likely to be deemed a security. Current marketing materials lean towards RUM failing this factor because this token is clearly described as essential to gain access to the Pirates platform and must be used during gameplay to make progress in the game and interact with the metaverse, including with other players.
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 RUM 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 some investment interests attached to the use of RUM with respect to staking, and capital gains with respect to the spot price of RUM. The question is whether such interests are essential or tangential, and in this case the answer appears to indicate that such investment interests are tangential to the main engagement with the Pirates platform, which requires substantial involvement by a given purchaser, who may also make an election to stake his/her

holdings of RUM. Active engagement is required from all buyers of RUM who wish to obtain access to the Pirates platform, and they must utilize their RUM in various ways such as purchasing/creating NFTs, obtaining in-game items (such as virtual land, ships, weapons, magic, and other similar game-play virtual items), and obtaining additional RUM as a reward for engaging on the platform. Ultimately, active engagement by purchasers is mandatory to utilize the Pirates ecosystem.

- b. The capital gains aspect of RUM, wherein buyers would expect an increase in value of the RUM from the purchase price of the token, and/or obtain staking rewards, would not be dispositive towards either security or non-security status of RUM because the capital gains would occur through the buyers' own efforts, the efforts of other users, and the platform's natural economic activity, in addition to the efforts of the issuer. In this case, the efforts of the issuer would not likely predominate this reliance factor as further explained below, and are unlikely to be deemed "essential". Furthermore, RUM's use case is quite broad, and it is necessary to use it up and then acquire more in order to continue to be permitted to have access to the Pirate ecosystem.
  - c. The manner in which the sale of RUM occurs, particularly the promotion and marketing, may also affect the "expectation of profits" analysis. For example, if the language used to promote RUM includes words like "investment," "returns" or "profits," the purchasers of RUM may be more likely to expect passive profits from the efforts of others than if RUM is promoted on the basis of the usefulness of the functionality attaching to it. Presently there is no language suggestive of an investment being used in the marketing of RUM, hence it is unlikely, and possibly unreasonable, that an expectation of profits in the minds of buyers should be created.
  - d. 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 insignificant minor voting rights attached to holders of a certain minimum amount of RUM, and such rights do not provide significant managerial control.
5. Based on the above analysis of the unique nature of RUM, the security/non-security scale leans strongly towards RUM **not** being a security due to its likely failure of at least one and perhaps three Howey factors. Though hypothetically, there may be a possibility of an expectation of profit, no matter how unreasonable, it appears that RUM is intended to be sold as a license to gain access

to the Pirates ecosystem, without which, no utilization of the platform may occur. The following will provide a summary of the above factors used in the analysis.

- a. RUM will be sold for value to investors thereby satisfying the first factor of the test.
- b. RUM has unique functionality which may not be accessed by anyone other than specific RUM holders utilizing it as a license to gain access to the metaverse; this factor shifts the scale toward RUM not being deemed a security.
- c. There is probably no common enterprise under most or all the versions of the analysis due to the fact that profits are not correlated among buyers or RUM, there is no pooling of funds because the platform is substantially operational, and there is little reliance on the promoter's expertise for the same reason, since it is more likely there is greater reliance on the platform itself and other users of the platform.
- d. RUM does not provide significant voting and control rights over the Pirates ecosystem; therefore, this does not contribute to RUM being deemed a non-security.
- e. There is unlikely to be significant reliance on the development/management team at this stage, whose oversight efforts will not likely be deemed essential to the continued successful operations of the Pirate ecosystem since there would likely be equal or greater reliance on the commercial activities occurring on the platform, and on other users of RUM, than the issuer.
- f. RUM marketing materials do not appear to use investment correlated terms therefore this tends to push the scale toward RUM not being deemed a security.
- g. The important passivity element probably fails since buyers of RUM must actively participate in the economy of the Pirates platform to obtain any benefits. The fact that the issuer would oversee platform operations, fix bugs, provide support, upgrade platform functionality, monitor operations, and interact with holders of RUM 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. RUM token is unlikely to be deemed a "security" under applicable U.S. federal securities laws.
2. Trades of RUM tokens may be subject to regulation under laws applicable to trading of commodities or currencies, and/or state securities laws and regulations.

  
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**BRUCE BELENKY, ESQ** **04.22.23**  
**DATE**

**Disclaimer:**

The above analysis is based on information obtained from a representative of the RUM 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. 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 RUM tokens or similar tokens are being made herein.