MATERIALS

The SEC's Spotlight on Digital Assets

Presented by

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66 S.Ct. 1100
Supreme Court of the United States

SECURITIES AND EXCHANGE COMMISSION
v.
W. J. HOWEY CO. et al.

No. 843
|
Argued May 2, 1946.
|
Decided May 27, 1946.
|
Rehearing Denied Oct. 14, 1946.

See 67 S.Ct. 27.

Synopsis

Suit by the Securities and Exchange Commission against W. J. Howey Company and Howey-in-the-Hills Service, Inc., to restrain alleged violations of the Securities Act. To review a judgment of the Circuit Court of Appeals, 151 F.2d 714, affirming a judgment of the District Court, 60 F.Supp. 440, for defendants, plaintiff brings certiorari.

Reversed.

Mr. Justice FRANKFURTER dissenting.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

West Headnotes (4)

[1] **Securities Regulation** In general; investment contracts

An "investment contract", as used in the Securities Act, means a contract, transaction, or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from efforts of promoter or a third party, it being immaterial whether shares in enterprise are evidenced by formal certificate or by nominal interests in physical assets employed in enterprise. Securities Act of 1933, § 2(1), 15 U.S.C.A. § 77b(1).

1475 Cases that cite this headnote

[2] **Securities Regulation** In general; investment contracts

Congress by including the term "investment contract" in Securities Act as one of the things constituting a security required to be registered, without further definition of term, intended that term be given meaning which had been crystallized by prior judicial interpretation thereof as used in various state "blue sky" laws. Securities Act of 1933, § 2(1), 15 U.S.C.A. § 77b(1).

70 Cases that cite this headnote

[3] **Securities Regulation** Real estate contracts; condominium interests

Corporations, offering opportunity to contribute money and to share in profits of a large citrus fruit enterprise managed and partly owned by corporations to persons residing in distant localities who lack equipment and experience requisite to operation of a citrus grove through medium of service contracts and land sales contracts and warranty deeds, which serve as a convenient method of determining investors' allocable shares of profits, were offering "investment contracts" within meaning of Securities Act requirement for registering such contracts as nonexempt securities, notwithstanding that some purchasers chose not to accept full offer of investment contract by declining to enter into a service contract. Securities Act of 1933, §§ 2(1, 3), 3(b), 5(a), 15 U.S.C.A. §§ 77b(1, 3), 77c(b), 77e(a).

1050 Cases that cite this headnote

[4] **Securities Regulation** In general; investment contracts

The test of an investment contract within Securities Act is whether scheme involves an investment of money in a common enterprise with profits to come solely from efforts of others, and, if test is satisfied, it is immaterial whether enterprise is speculative or nonspeculative or whether there is a sale of property with or without intrinsic value. Securities Act of 1933, §§ 2(1, 3), 3(b), 5(a), 15 U.S.C.A. §§ 77b(1, 3), 77c(b), 77e(a).

1523 Cases that cite this headnote

Attorneys and Law Firms

****1100** ***294** Mr. Roger S. Foster, of Philadelphia, Pa., for petitioner.

****1101** Messrs. C. E. Duncan, of Tavares, Fla., and George C. Bedell, of Jacksonville, Fla., for respondents.

Opinion

Mr. Justice MURPHY delivered the opinion of the Court.

This case involves the application of s 2(1) of the Securities Act of 1933 [1] to an offering of units of a citrus grove development coupled with a contract for cultivating, marketing and remitting the net proceeds to the investor.

The Securities and Exchange Commission instituted this action to restrain the respondents from using the mails and instrumentalities of interstate commerce in the offer and sale of unregistered and nonexempt securities in violation of s 5(a) of the Act, 15 U.S.C.A. s 77e(a). The District Court denied the injunction, 60 F.Supp. 440, and the Fifth Circuit Court of Appeals affirmed the judgment, 151 F.2d 714. We granted certiorari, 327 U.S. 773, 66 S.Ct. 821, on a petition alleging that the ruling of the Circuit Court of Appeals conflicted with other federal and state decisions and that it introduced a novel and unwarranted test under the statute which the Commission regarded as administratively impractical.

Most of the facts are stipulated. The respondents, W. J. Howey Company and Howey-in-the-Hills Service ***295** Inc., are Florida corporations under direct common control and management. The Howey Company owns large tracts of citrus acreage in Lake County, Florida. During the past several years it has planted about 500 acres annually, keeping half of the groves itself and offering the other half to the public 'to help us finance additional development.' Howey-in-the-Hills Service, Inc., is a service company engaged in cultivating and developing many of these groves, including the harvesting and marketing of the crops.

Each prospective customer is offered both a land sales contract and a service contract, after having been told that it is not feasible to invest in a grove unless service arrangements are made. While the purchaser is free to make arrangements with other service companies, the superiority of Howey-in-the-Hills Service, Inc., is stressed. Indeed, 85% of the acreage sold during the 3-year period ending May 31, 1943, was covered by service contracts with Howey-in-the-Hills Service, Inc.

The land sales contract with the Howey Company provides for a uniform purchase price per acre or fraction thereof, varying in amount only in accordance with the number of years the particular plot has been planted with citrus trees. Upon full payment of the purchase price the land is conveyed to the purchaser by warranty deed. Purchases are usually made in narrow strips of land arranged so that an acre consists of a row of 48 trees. During the period between February 1, 1941, and May 31, 1943, 31 of the 42 persons making purchases bought less than 5 acres each. The average holding of these 31 persons was 1.33 acres and sales of as little as 0.65, 0.7 and 0.73 of an acre were made. These tracts are not separately fenced and the sole indication of several ownership is found in small land marks intelligible only through a plat book record.

***296** The service contract, generally of a 10-year duration without option of cancellation, gives Howey-in-the-Hills Service, Inc., a leasehold interest and 'full and complete' possession of the acreage. For a specified fee plus the cost of labor and materials, the company is given full discretion and authority over the cultivation of the groves and the harvest and marketing of the crops. The company is well established in the citrus business and maintains a large force of skilled personnel and a great deal of equipment, including 75 tractors, sprayer wagons, fertilizer trucks and the like. Without the consent of the company, the land owner or purchaser has no right of

entry to market the crop; [2] **1102 thus there is ordinarily no right to specific fruit. The company is accountable only for an allocation of the net profits based upon a check made at the time of picking. All the produce is pooled by the respondent companies, which do business under their own names.

The purchasers for the most part are non-residents of Florida. They are predominantly business and professional people who lack the knowledge, skill and equipment necessary for the care and cultivation of citrus trees. They are attracted by the expectation of substantial profits. It was represented, for example, that profits during the 1943—1944 season amounted to 20% and that even greater profits might be expected during the 1944—1945 season, although only a 10% annual return was to be expected over a 10-year period. Many of these purchasers are patrons of a resort hotel owned and operated by the Howey Company in a scenic section adjacent to the groves. The hotel's advertising mentions the fine groves in the vicinity and the attention of the patrons is drawn to the *297 groves as they are being escorted about the surrounding countryside. They are told that the groves are for sale; if they indicate an interest in the matter they are then given a sales talk.

It is admitted that the mails and instrumentalities of interstate commerce are used in the sale of the land and service contracts and that no registration statement or letter of notification has ever been filed with the Commission in accordance with the Securities Act of 1933 and the rules and regulations thereunder.

Section 2(1) of the Act defines the term 'security' to include the commonly known documents traded for speculation or investment. [3] This definition also includes 'securities' of a more variable character, designated by such descriptive terms as 'certificate of interest or participation in any profit-sharing agreement,' 'investment contract' and 'in general, any interest or instrument commonly known as a 'security.'' The legal issue in this case turns upon a determination of whether, under the circumstances, the land sales contract, the warranty deed and the service contract together constitute an 'investment contract' within the meaning of s 2(1). An affirmative answer brings into operation the registration requirements of s 5(a), unless the security is granted an exemption under s 3(b), 15 U.S.C.A. s 77c(b). The lower courts, in reaching a negative answer to this problem, treated the contracts and deeds *298 as separate transactions involving no more than an ordinary real estate sale and an agreement by the seller to manage the property for the buyer.

[1] [2] The term 'investment contract' is undefined by the Securities Act or by relevant legislative reports. But the term was common in many state 'blue sky' laws in existence prior to the adoption of the federal statute and, although the term was also undefined by the state laws, it had been broadly construed by state courts so as to afford the investing public a full measure of protection. Form was disregarded for substance and emphasis was placed upon economic reality. An investment contract thus came to mean a contract or scheme for 'the placing of capital or laying out of money in a way intended to secure income or profit from its employment.' State v. Gopher Tire & Rubber Co., 146 Minn. 52, 56, 177 N.W. 937, 938. This definition was uniformly applied by state courts to a variety of situations **1103 where individuals were led to invest money in a common enterprise with the expectation that they would earn a profit solely through the efforts of the promoter or of some one other than themselves. [4]

By including an investment contract within the scope of s 2(1) of the Securities Act, Congress was using a term the meaning of which had been crystallized by this prior judicial interpretation. It is therefore reasonable to attach that meaning to the term as used by Congress, especially since such a definition is consistent with the statutory aims. In other words, an investment contract for purposes of the Securities Act means a contract, transaction *299 or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise. Such a definition necessarily underlies this Court's decision in Securities Exch. Commission v. C. M. Joiner Leasing Corp., 320 U.S. 344, 64 S.Ct. 120, 88 L.Ed. 88, and has been enunciated and applied many times by lower federal courts. [5] It permits the fulfillment of the statutory purpose of compelling full and fair disclosure relative to the issuance of 'the many types of instruments that in our commercial world fall within the ordinary concept of a security.' H.Rep.No.85, 73rd Cong., 1st Sess., p. 11. It embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.

[3] The transactions in this case clearly involve investment contracts as so defined. The respondent companies are offering something more than fee simple interests in land, something different from a farm or orchard coupled with

management services. They are offering an opportunity to contribute money and to share in the profits of a large citrus fruit enterprise managed and partly owned by respondents. They are offering this opportunity to persons who reside in distant localities and who lack the equipment ***300** and experience requisite to the cultivation, harvesting and marketing of the citrus products. Such persons have no desire to occupy the land or to develop it themselves; they are attracted solely by the prospects of a return on their investment. Indeed, individual development of the plots of land that are offered and sold would seldom be economically feasible due to their small size. Such tracts gain utility as citrus groves only when cultivated and developed as component parts of a larger area. A common enterprise managed by respondents or third parties with adequate personnel and equipment is therefore essential if the investors are to achieve their paramount aim of a return on their investments. Their respective shares in this enterprise are evidenced by land sales contracts and warranty deeds, which serve as a convenient method of determining the investors' allocable shares of the profits. The resulting transfer of rights in land is purely incidental.

****1104** Thus all the elements of a profit-seeking business venture are present here. The investors provide the capital and share in the earnings and profits; the promoters manage, control and operate the enterprise. It follows that the arrangements whereby the investors' interests are made manifest involve investment contracts, regardless of the legal terminology in which such contracts are clothed. The investment contracts in this instance take the form of land sales contracts, warranty deeds and service contracts which respondents offer to prospective investors. And respondents' failure to abide by the statutory and administrative rules in making such offerings, even though the failure result from a bona fide mistake as to the law, cannot be sanctioned under the Act.

This conclusion is unaffected by the fact that some purchasers choose not to accept the full offer of an investment contract by declining to enter into a service contract with ***301** the respondents. The Securities Act prohibits the offer as well as the sale of unregistered, non-exempt securities.[6] Hence it is enough that the respondents merely offer the essential ingredients of an investment contract.

[4] We reject the suggestion of the Circuit Court of Appeals, 151 F.2d at page 717, that an investment contract is necessarily missing where the enterprise is not speculative or promotional in character and where the tangible interest which is sold has intrinsic value independent of the success of the enterprise as a whole. The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others. If that test be satisfied, it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value. See S.E.C. v. C. M. Joiner Leasing Corp., supra, 320 U.S. 352, 64 S.Ct. 124, 88 L.Ed. 88. The statutory policy of affording broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae.

Reversed.

Mr. Justice JACKSON took no part in the consideration or decision of this case.

Mr. Justice FRANKFURTER dissenting.

'Investment contract' is not a term of art; it is conception dependent upon the circumstances of a particular situation. If this case came before us on a finding authorized by Congress that the facts disclosed an 'investment contract' within the general scope of s 2(1) of the Securities Act, 48 Stat. 74, 15 U.S.C. s 77b(1), 15 U.S.C.A. s 77b(1), the Securities and Exchange Commission's finding would govern, unless, on the record, it was wholly unsupported. But ***302** that is not the case before us. Here the ascertainment of the existence of an 'investment contract' had to be made independently by the District Court and it found against its existence. 60 F.Supp. 440. The Circuit Court of Appeals for the Fifth Circuit sustained that finding. 151 F.2d 714. If respect is to be paid to the wise rule of judicial administration under which this Court does not upset concurrent findings of two lower courts in the ascertainment of facts and the relevant inferences to be drawn from them, this case clearly calls for its application. See Allen v. Trust Co. of Georgia, 326 U.S. 630, 66 S.Ct. 389. For the crucial issue in this case turns on whether the contracts for the land and the contracts for the management of the property were in reality separate agreements or merely parts of a single transaction. It is clear from its opinion that the District Court was warranted in its conclusion that the record does not establish the existence of an investment contract:

'* * * the record in this case shows that not a single sale of citrus grove property **1105 was made by the Howey Company during the period involved in this suit, except to purchasers who actually inspected the property before purchasing the same. The record further discloses that no purchaser is required to engage the Service Company to care for his property and that of the fifty-one purchasers acquiring property during this period, only forty-two entered into contract with the Service Company for the care of the property.' 60 F.Supp. at page 442.

Simply because other arrangements may have the appearances of this transaction but are employed as an evasion of the Securities Act does not mean that the present contracts were evasive. I find nothing in the Securities Act to indicate that Congress meant to bring every innocent transaction within the scope of the Act simply because a perversion of them is covered by the Act.

All Citations

328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244, 163 A.L.R. 1043

Footnotes

1 48 Stat. 74, 15 U.S.C. s 77b(1), 15 U.S.C.A. s 77b(1).

2 Some investors visited their particular plots annually, making suggestions as to care and cultivation, but without any legal rights in the matters.

3 'The term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, 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.'

4 State v. Evans, 154 Minn. 95, 191 N.W. 425, 27 A.L.R. 1165; Klatt v. Guaranteed Bond Co., 213 Wis. 12, 250 N.W. 825; State v. Health, 199 N.C. 135, 153 S.E. 855, 87 A.L.R. 37; Prohaska v. Hemmer-Miller Development Co., 256 Ill.App. 331; People v. White, 124 Cal.App. 548, 12 P.2d 1078; Stevens v. Liberty Packing Corp., 111 N.J.Eq. 61, 161 A. 193. See also Moore v. Stella, 52 Cal.App.2d 766, 127 P.2d 300.

5 Atherton v. United States, 9 Cir.,. 128 F.2d 463; Penfield Co. of California v. S.E. C., 9 Cir., 143 F.2d 746; S.E.C. v. Universal Service Association, 7 Cir., 106 F.2d 232; S.E.C. v. Crude Oil Corp., 7 Cir., 93 F.2d 844; S.E.C. v. Bailey, D.C., 41 F.Supp. 647; S.E.C. v. Payne, D.C., 35 F.Supp. 873; S.E.C. v. Bourbon Sales Corp., D.C., 47 F.Supp. 70; S.E.C. v. Wickham, D.C., 12 F.Supp. 245; S.E.C. v. Timetrust, Inc., D.C., 28 F.Supp. 34; S.E.C. v. Pyne, D.C., 33 F.Supp. 988. The Commission has followed the same definition in its own administrative proceedings. In re Natural Resources Corporation, 8 S.E.C. 635.

6 The registration requirements of s 5 refer to sales of securities. Section 2(3) defines 'sale' to include every 'attempt or offer to dispose of, or solicitation of an offer to buy,' a security for value.

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110 S.Ct. 945
Supreme Court of the United States

Bob REVES, et al., Petitioners
v.
ERNST & YOUNG.

No. 88–1480
|
Argued Nov. 27, 1989.
|
Decided Feb. 21, 1990.
|
Rehearing Denied April 16, 1990.
|
See 494 U.S. 1092, 110 S.Ct. 1840.

Synopsis

After farmer's cooperative filed for bankruptcy, holders of demand promissory notes sold by the coop to raise money to support its general business operations brought suit against the coop's auditor. Holders alleged that the auditor had violated the antifraud provisions of the Securities Exchange Act and Arkansas securities law by intentionally failing to follow generally accepted accounting principles that would have made the coop's insolvency apparent to potential note purchasers. The United States District Court for the Western District of Arkansas rendered judgment on jury verdict against auditor, and auditor appealed. The Court of Appeals, 856 F.2d 52, affirmed in part, reversed in part and remanded. After granting certiorari, the Supreme Court, Justice Marshall, held that: (1) in determining whether an instrument denominated a "note" is a "security," within the meaning of the securities laws, court should apply "family resemblance" test; (2) demand notes issued by coop fell under "note" category of instruments that are "securities" under the Securities Act and the Securities Exchange Act; and (3) demand notes did not fall within statutory exception for notes having maturity at time of issuance of less than nine months.

Reversed and remanded.

Justice Stevens filed a concurring opinion.

Chief Justice Rehnquist filed an opinion concurring in part and dissenting in part, in which Justices White, O'Connor and Scalia joined.

Opinion on remand, 937 F.2d 1310.

Procedural Posture(s): On Appeal.

West Headnotes (6)

[1] Securities Regulation Validity

Congress' purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called.

88 Cases that cite this headnote

[2] Securities Regulation Bills and notes; commercial paper, mortgages and bonds

Phrase "any note" in section of the Securities Exchange Act defining term "security" should not be interpreted to mean literally "any note," but must be understood against backdrop of what Congress was attempting to accomplish in enacting the statute. Securities Exchange Act of 1934, § 3(a)(10), as amended, 15 U.S.C.A. § 78c(a)(10).

75 Cases that cite this headnote

[3] Securities Regulation Bills and notes; commercial paper, mortgages and bonds

In determining whether an instrument denominated a "note" is a "security," within the meaning of the Securities Exchange Act, courts should apply "family resemblance" test; under that test, note is presumed to be a "security," and presumption may be rebutted only by showing that the note bears a strong resemblance, determined by examining four specified factors, to one of a judicially crafted list of categories of instruments that are not securities; if an instrument is not sufficiently similar to a listed item, court must decide whether another category should be added by examining same factors.

Securities Exchange Act of 1934, § 3(a)(10), as amended, 15 U.S.C.A. § 78c(a)(10).

287 Cases that cite this headnote

[4] **Securities Regulation** Bills and notes; commercial paper, mortgages and bonds

Demand promissory notes sold by farmer's cooperative to members and nonmembers fell under "note" category of instruments that are "securities" under the Securities Act and the Securities Exchange Act, considering that cooperative sold notes to raise capital, and they were bought to earn a profit in the form of interest; that there was "common trading" of the notes, which were offered and sold to a broad segment of the public; that the public reasonably perceived from advertisements that the notes were investments; and that there was no risk-reducing factor that would make application of the securities laws unnecessary, since the notes were uncollateralized and uninsured and would escape federal regulation entirely if such laws were held not to apply Securities Exchange Act of 1934, § 3(a)(10), as amended, 15 U.S.C.A. § 78c(a)(10).

351 Cases that cite this headnote

[5] **Securities Regulation** Bills and notes; commercial paper, mortgages and bonds

With respect to section of the Securities Exchange Act excluding from definition of "security" any note "which has a maturity at the time of issuance of not less than nine months," the "maturity" of notes is a question of federal law. Securities Exchange Act of 1934, § 3(a)(10), as amended, 15 U.S.C.A. § 78c(a)(10).

58 Cases that cite this headnote

[6] **Securities Regulation** Bills and notes; commercial paper, mortgages and bonds

Assuming that Congress intended to create a bright-line rule exempting from coverage of the securities laws all notes of less than nine months' duration on ground that short-term notes are sufficiently safe that the securities laws need not apply, exemption did not cover demand notes, which did not necessarily have short terms, since demand could be made years or decades into the future. Securities Exchange Act of 1934, § 3(a)(10), as amended, 15 U.S.C.A. § 78c(a)(10).

95 Cases that cite this headnote

****946** *Syllabus* *

***56** In order to raise money to support its general business operations, the Farmers Cooperative of Arkansas and Oklahoma (Co–Op) sold uncollateralized and uninsured promissory notes payable on demand by the holder. Offered to both Co–Op members and nonmembers and marketed as an "Investment Program," the notes paid a variable interest rate higher than that of local financial institutions. After the Co–Op filed for bankruptcy, petitioners, holders of the notes, filed suit in the District Court against the Co–Op's auditor, respondent's predecessor, alleging, *inter alia,* that it had violated the antifraud provisions of the Securities Exchange Act of 1934—which regulates certain specified instruments, including "any note[s]"—and Arkansas' securities laws by intentionally failing to follow generally accepted accounting principles that would have made the Co–Op's insolvency apparent to potential note purchasers. Petitioners prevailed at trial, but the Court of Appeals reversed. Applying the test created in *SEC v. W.J. Howey Co.,* 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244, to determine whether an instrument is an "investment contract" to the determination whether the Co–Op's instruments were "notes," the court held that the notes were not securities under the 1934 Act or Arkansas law, and that the statutes' antifraud provisions therefore did not apply.

Held: The demand notes issued by the Co–Op fall under the "note" category of instruments that are "securities." Pp. 948–955.

(a) Congress' purpose in enacting the securities laws was to regulate *investments,* in whatever form they are made and by whatever name they are called. However, notes are used in a variety of settings, not all of which involve investments. Thus, they are not securities *per se,* but must be defined using the "family resemblance" test. Under that test, a note is presumed to be a security unless it bears a strong

resemblance, determined by examining four specified factors, to one of a judicially crafted list of categories of instrument that are not securities. If the instrument is not sufficiently similar to a listed item, a court must decide whether another category should be added by examining the same factors. The application of the *Howey* test to notes is rejected, since to hold that a "note" is not a "security" unless it meets a test designed for ***57** an entirely different variety of instrument would make the 1933 Securities Act's and 1934 Act's enumeration of many types of instruments superfluous ****947** and would be inconsistent with Congress' intent in enacting the laws. Pp. 948–952.

(b) Applying the family resemblance approach, the notes at issue are "securities." They do not resemble any of the enumerated categories of nonsecurities. Nor does an examination of the four relevant factors suggest that they should be treated as nonsecurities: (1) the Co–Op sold them to raise capital, and purchasers bought them to earn a profit in the form of interest, so that they are most naturally conceived as investments in a business enterprise; (2) there was "common trading" of the notes, which were offered and sold to a broad segment of the public; (3) the public reasonably perceived from advertisements for the notes that they were investments, and there were no countervailing factors that would have led a reasonable person to question this characterization; and (4) there was no risk-reducing factor that would make the application of the Securities Acts unnecessary, since the notes were uncollateralized and uninsured and would escape federal regulation entirely if the Acts were held not to apply. The lower court's argument that the demand nature of the notes is very uncharacteristic of a security is unpersuasive, since an instrument's liquidity does not eliminate the risk associated with securities. Pp. 952–953.

(c) Respondent's contention that the notes fall within the statutory exception for "any note ... which has a maturity at the time of issuance of not exceeding nine months" is rejected, since it rests entirely on the premise that Arkansas' statute of limitations for suits to collect demand notes—which are due immediately—is determinative of the notes' "maturity," as that term is used in the *federal* Securities Acts. The "maturity" of notes is a question of federal law, and Congress could not have intended that the Acts be applied differently to the same transactions depending on the accident of which State's law happens to apply. Pp. 953–955.

(d) Since, as a matter of federal law, the words of the statutory exception are far from plain with regard to demand notes, the exclusion must be interpreted in accordance with the exception's purpose. Even assuming that Congress intended to create a bright-line rule exempting from coverage *all* notes of less than nine months' duration on the ground that short-term notes are sufficiently safe that the Securities Acts need not apply, that exemption would not cover the notes at issue here, which do not necessarily have short terms, since demand could just as easily be made years or decades into the future. P. 955.

856 F.2d 52 (CA8 1988), reversed and remanded.

***58** MARSHALL, J., delivered the opinion for a unanimous Court with respect to Part II, and the opinion of the Court with respect to Parts I, III, and IV, in which BRENNAN, BLACKMUN, STEVENS, and KENNEDY, JJ., joined. STEVENS, J., filed a concurring opinion, *post,* p. 955. REHNQUIST, C.J., filed an opinion concurring in part and dissenting in part, in which WHITE, O'CONNOR, and SCALIA, JJ., joined, *post,* p. 957.

Attorneys and Law Firms

John R. McCambridge argued the cause for petitioners. With him on the briefs were Gary M. Elden, Jay R. Hoffman, and Robert R. Cloar.

Michael R. Lazerwitz argued the cause for the Securities and Exchange Commission as amicus curiae urging reversal. With him on the brief were Solicitor General Starr, deputy Solicitor General Merrill, Daniel L. Goelzer, Paul Gonson, Jacob H. Stillman, Martha H. McNeely, Randall W. Quinn, and Eva Marie Carney.

John Matson argued the cause for respondent. With him on the brief were Carl D. Liggio, Kathryn A. Oberly, and Fred Lovitch.*

* Briefs of amicus curiae urging reversal were filed for the Arkansas Securities Department by John Steven Clark, Attorney General of Arkansas; and for the North American Securities Administrators Association, Inc., by Joseph C. Long.

Opinion

Justice MARSHALL delivered the opinion of the Court.

This case presents the question whether certain demand notes issued by the Farmers Cooperative of Arkansas and

Oklahoma (Co–Op) are "securities" within the meaning of § 3(a)(10) of the Securities Exchange Act of 1934. We conclude that they are.

I

The Co–Op is an agricultural cooperative that, at the time relevant here, had approximately 23,000 members. In order to raise **948 money to support its general business operations, the Co–Op sold promissory notes payable on demand by the holder. Although the notes were uncollateralized and uninsured, they paid a variable rate of interest that was adjusted *59 monthly to keep it higher than the rate paid by local financial institutions. The Co–Op offered the notes to both members and nonmembers, marketing the scheme as an "Investment Program." Advertisements for the notes, which appeared in each Co–Op newsletter, read in part: "YOUR CO–OP has more than $11,000,000 in assets to stand behind your investments. The Investment is not Federal [*sic*] insured but it is ... Safe ... Secure ... and available when you need it." App. 5 (ellipses in original). Despite these assurances, the Co–Op filed for bankruptcy in 1984. At the time of the filing, over 1,600 people held notes worth a total of $10 million.

After the Co–Op filed for bankruptcy, petitioners, a class of holders of the notes, filed suit against Arthur Young & Co., the firm that had audited the Co–Op's financial statements (and the predecessor to respondent Ernst & Young). Petitioners alleged, *inter alia,* that Arthur Young had intentionally failed to follow generally accepted accounting principles in its audit, specifically with respect to the valuation of one of the Co–Op's major assets, a gasohol plant. Petitioners claimed that Arthur Young violated these principles in an effort to inflate the assets and net worth of the Co–Op. Petitioners maintained that, had Arthur Young properly treated the plant in its audits, they would not have purchased demand notes because the Co–Op's insolvency would have been apparent. On the basis of these allegations, petitioners claimed that Arthur Young had violated the antifraud provisions of the 1934 Act as well as Arkansas' securities laws.

Petitioners prevailed at trial on both their federal and state claims, receiving a $6.1 million judgment. Arthur Young appealed, claiming that the demand notes were not "securities" under either the 1934 Act or Arkansas law, and that the statutes' antifraud provisions therefore did not apply. A panel of the Eighth Circuit, agreeing with Arthur Young on both the state and federal issues, reversed. *Arthur Young & Co. v. Reves,* 856 F.2d 52 (1988). We granted certiorari to address *60 the federal issue, 490 U.S. 1105, 109 S.Ct. 3154, 104 L.Ed.2d 1018 (1989), and now reverse the judgment of the Court of Appeals.

II

A

This case requires us to decide whether the note issued by the Co–Op is a "security" within the meaning of the 1934 Act. Section 3(a)(10) of that Act is our starting point:

> "The term 'security' means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a 'security'; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited." 48 Stat. 884, as amended, 15 U.S.C. § 78c(a)(10).

**949 The fundamental purpose undergirding the Securities Acts is "to eliminate serious abuses in a largely unregulated securities market." *United Housing Foundation, Inc. v. Forman,* 421 U.S. 837, 849, 95 S.Ct. 2051, 2059, 44 L.Ed.2d 621 (1975). In defining the scope of the market that it wished to regulate, Congress painted with a broad brush. It recognized the virtually limitless scope of *61 human ingenuity, especially in the creation of "countless and variable schemes devised by those who seek the use of the money

of others on the promise of profits," *SEC v. W.J. Howey Co.,* 328 U.S. 293, 299, 66 S.Ct. 1100, 1103, 90 L.Ed. 1244 (1946), and determined that the best way to achieve its goal of protecting investors was "to define 'the term "security" in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security.' " *Forman, supra,* 421 U.S., at 847–848, 95 S.Ct., at 2058–2059 (quoting H.R.Rep. No. 85, 73d Cong., 1st Sess., 11 (1933)). Congress therefore did not attempt precisely to cabin the scope of the Securities Acts. [1] Rather, it enacted a definition of "security" sufficiently broad to encompass virtually any instrument that might be sold as an investment.

[1] Congress did not, however, "intend to provide a broad federal remedy for all fraud." *Marine Bank v. Weaver,* 455 U.S. 551, 556, 102 S.Ct. 1220, 1223, 71 L.Ed.2d 409 (1982). Accordingly, "[t]he task has fallen to the Securities and Exchange Commission (SEC), the body charged with administering the Securities Acts, and ultimately to the federal courts to decide which of the myriad financial transactions in our society come within the coverage of these statutes." *Forman, supra,* 421 U.S., at 848, 95 S.Ct., at 2059. In discharging our duty, we are not bound by legal formalisms, but instead take account of the economics of the transaction under investigation. See, *e.g., Tcherepnin v. Knight,* 389 U.S. 332, 336, 88 S.Ct. 548, 553, 19 L.Ed.2d 564 (1967) (in interpreting the term "security," "form should be disregarded for substance and the emphasis should be on economic reality"). Congress' purpose in enacting the securities laws was to regulate *investments,* in whatever form they are made and by whatever name they are called.

***62** A commitment to an examination of the economic realities of a transaction does not necessarily entail a case-by-case analysis of every instrument, however. Some instruments are obviously within the class Congress intended to regulate because they are by their nature investments. In *Landreth Timber Co. v. Landreth,* 471 U.S. 681, 105 S.Ct. 2297, 85 L.Ed.2d 692 (1985), we held that an instrument bearing the name "stock" that, among other things, is negotiable, offers the possibility of capital appreciation, and carries the right to dividends contingent on the profits of a business enterprise is plainly within the class of instruments Congress intended the securities laws to cover. *Landreth Timber* does not signify a lack of concern with economic reality; rather, it signals a recognition that stock is, as a practical matter, always an investment if it has the economic characteristics traditionally associated with stock. Even if sparse exceptions to this generalization can be found, the public perception of common stock as the paradigm of a security suggests that stock, in whatever context it is sold, should be treated as within the ambit of the Acts. *Id.,* at 687, 693, 105 S.Ct., at 2302, 2305.

[2] We made clear in *Landreth Timber* that stock was a special case, explicitly limiting our holding to that sort of instrument. *Id.,* at 694, 105 S.Ct., at 2304. Although we ****950** refused finally to rule out a similar *per se* rule for notes, we intimated that such a rule would be unjustified. Unlike "stock," we said, " 'note' may now be viewed as a relatively broad term that encompasses instruments with widely varying characteristics, depending on whether issued in a consumer context, as commercial paper, or in some other investment context." *Ibid.* (citing *Securities Industry Assn. v. Board of Governors of Federal Reserve System,* 468 U.S. 137, 149–153, 104 S.Ct. 2979, 2985–88, 82 L.Ed.2d 107 (1984)). While common stock is the quintessence of a security, *Landreth Timber, supra,* 471 U.S., at 693, 105 S.Ct., at 2305, and investors therefore justifiably assume that a sale of stock is covered by the Securities Acts, the same simply cannot be said of notes, which are used in a variety of settings, not all of which involve investments. Thus, ***63** the phrase "any note" should not be interpreted to mean literally "any note," but must be understood against the backdrop of what Congress was attempting to accomplish in enacting the Securities Acts. [2]

Because the *Landreth Timber* formula cannot sensibly be applied to notes, some other principle must be developed to define the term "note." A majority of the Courts of Appeals that have considered the issue have adopted, in varying forms, "investment versus commercial" approaches that distinguish, on the basis of all of the circumstances surrounding the transactions, notes issued in an investment context (which are "securities") from notes issued in a commercial or consumer context (which are not). See, *e.g., Futura Development Corp. v. Centex Corp.,* 761 F.2d 33, 40–41 (CA1 1985); *McClure v. First Nat. Bank of Lubbock, Texas,* 497 F.2d 490, 492–494 (CA5 1974); *Hunssinger v. Rockford Business Credits, Inc.,* 745 F.2d 484, 488 (CA7 1984);

Holloway v. Peat, Marwick, Mitchell & Co., 879 F.2d 772, 778–779 (CA10 1989), cert. pending No. 89–532.

[3] The Second Circuit's "family resemblance" approach begins with a presumption that *any* note with a term of more than nine months is a "security." See, *e.g.,* *Exchange Nat. Bank of Chicago v. Touche Ross & Co.,* 544 F.2d 1126, 1137 (CA2 1976). Recognizing that not all notes are securities, however, the Second Circuit has also devised a list of notes that it has decided are obviously not securities. Accordingly, ***64** the "family resemblance" test permits an issuer to rebut the presumption that a note is a security if it can show that the note in question "bear[s] a strong family resemblance" to an item on the judicially crafted list of exceptions, *id.,* at 1137–1138, or convinces the court to add a new instrument to the list, see, *e.g.,* *Chemical Bank v. Arthur Andersen & Co.,* 726 F.2d 930, 939 (CA2 1984).

In contrast, the Eighth and District of Columbia Circuits apply the test we created in *SEC v. W.J. Howey Co.,* 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946), to determine whether an instrument is an "investment contract" to the determination whether an instrument is a "note." Under this test, a note is a security only if it evidences "(1) an investment; (2) in a common enterprise; (3) with a reasonable expectation of profits; (4) to be derived from the entrepreneurial or managerial efforts of others." 856 F.2d, at 54 (case below). Accord, *Baurer v. Planning Group, Inc.,* 215 U.S.App.D.C. 384, 391–393, 669 F.2d 770, 777–779 (1981). See also ****951** *Underhill v. Royal,* 769 F.2d 1426, 1431 (CA9 1985) (setting forth what it terms a "risk capital" approach that is virtually identical to the *Howey* test).

We reject the approaches of those courts that have applied the *Howey* test to notes; *Howey* provides a mechanism for determining whether an instrument is an "investment contract." The demand notes here may well not be "investment contracts," but that does not mean they are not "notes." To hold that a "note" is not a "security" unless it meets a test designed for an entirely different variety of instrument "would make the Acts' enumeration of many types of instruments superfluous," *Landreth Timber,* 471 U.S., at 692, 105 S.Ct., at 2305, and would be inconsistent with Congress' intent to regulate the entire body of instruments sold as investments, see *supra,* at 949–950.

The other two contenders—the "family resemblance" and "investment versus commercial" tests—are really two ways of formulating the same general approach. Because we ***65** think the "family resemblance" test provides a more promising framework for analysis, however, we adopt it. The test begins with the language of the statute; because the Securities Acts define "security" to include "any note," we begin with a presumption that every note is a security. [3] We nonetheless recognize that this presumption cannot be irrebuttable. As we have said, *supra,* at 949, Congress was concerned with regulating the investment market, not with creating a general federal cause of action for fraud. In an attempt to give more content to that dividing line, the Second Circuit has identified a list of instruments commonly denominated "notes" that nonetheless fall without the "security" category. See *Exchange Nat. Bank, supra,* at 1138 (types of notes that are not "securities" include "the note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a 'character' loan to a bank customer, short-term notes secured by an assignment of accounts receivable, or a note which simply formalizes an open-account debt incurred in the ordinary course of business (particularly if, as in the case of the customer of a broker, it is collateralized)"); *Chemical Bank, supra,* at 939 (adding to list "notes evidencing loans by commercial banks for current operations").

We agree that the items identified by the Second Circuit are not properly viewed as "securities." More guidance, though, is needed. It is impossible to make any meaningful inquiry into whether an instrument bears a "resemblance" to ***66** one of the instruments identified by the Second Circuit without specifying what it is about *those* instruments that makes *them* non-"securities." Moreover, as the Second Circuit itself has noted, its list is "not graven in stone," 726 F.2d, at 939, and is therefore capable of expansion. Thus, some standards must be developed for determining when an item should be added to the list.

An examination of the list itself makes clear what those standards should be. In creating its list, the Second Circuit was applying the same factors that this Court has held apply in deciding whether a transaction involves a "security." First, we examine the transaction to assess the motivations that would prompt a reasonable seller and buyer to enter into it. If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments

and the buyer is interested primarily **952 in the profit the note is expected to generate, the instrument is likely to be a "security." If the note is exchanged to facilitate the purchase and sale of a minor asset or consumer good, to correct for the seller's cash-flow difficulties, or to advance some other commercial or consumer purpose, on the other hand, the note is less sensibly described as a "security." See, *e.g.*, *Forman,* 421 U.S., at 851, 95 S.Ct., at 2060 (share of "stock" carrying a right to subsidized housing not a security because "the inducement to purchase was solely to acquire subsidized low-cost living space; it was not to invest for profit"). Second, we examine the "plan of distribution" of the instrument, *SEC v. C.M. Joiner Leasing Corp.,* 320 U.S. 344, 353, 64 S.Ct. 120, 124, 88 L.Ed. 88 (1943), to determine whether it is an instrument in which there is "common trading for speculation or investment," *id.,* at 351, 64 S.Ct., at 123. Third, we examine the reasonable expectations of the investing public: The Court will consider instruments to be "securities" on the basis of such public expectations, even where an economic analysis of the circumstances of the particular transaction might suggest that the instruments are not "securities" as used in that transaction. Compare *Landreth Timber,* 471 *67 U.S., at 687, 693, 105 S.Ct., at 2302, 2305 (relying on public expectations in holding that common stock is always a security), with *id.,* at 697–700, 105 S.Ct., at 2307–2308 (STEVENS, J., dissenting) (arguing that sale of business to single informed purchaser through stock is not within the purview of the Acts under the economic reality test). See also *Forman, supra,* at 851, 95 S.Ct., at 2060. Finally, we examine whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary. See, *e.g.*, *Marine Bank,* 455 U.S., at 557–559, and n. 7, 102 S.Ct., at 1224–1225, and n. 7.

We conclude, then, that in determining whether an instrument denominated a "note" is a "security," courts are to apply the version of the "family resemblance" test that we have articulated here: A note is presumed to be a "security," and that presumption may be rebutted only by a showing that the note bears a strong resemblance (in terms of the four factors we have identified) to one of the enumerated categories of instrument. If an instrument is not sufficiently similar to an item on the list, the decision whether another category should be added is to be made by examining the same factors.

B

[4] Applying the family resemblance approach to this case, we have little difficulty in concluding that the notes at issue here are "securities." Ernst & Young admits that "a demand note does not closely resemble any of the Second Circuit's family resemblance examples." Brief for Respondent 43. Nor does an examination of the four factors we have identified as being relevant to our inquiry suggest that the demand notes here are not "securities" despite their lack of similarity to any of the enumerated categories. The Co–Op sold the notes in an effort to raise capital for its general business operations, and purchasers bought them in order to earn a profit *68 in the form of interest. [4] Indeed, one of the primary inducements offered purchasers was an interest rate constantly revised **953 to keep it slightly above the rate paid by local banks and savings and loans. From both sides, then, the transaction is most naturally conceived as an investment in a business enterprise rather than as a purely commercial or consumer transaction.

As to the plan of distribution, the Co–Op offered the notes over an extended period to its 23,000 members, as well as to nonmembers, and more than 1,600 people held notes when the Co–Op filed for bankruptcy. To be sure, the notes were not traded on an exchange. They were, however, offered and sold to a broad segment of the public, and that is all we have held to be necessary to establish the requisite "common trading" in an instrument. See, *e.g., Landreth Timber, supra* (stock of closely held corporation not traded on any exchange held to be a "security"); *Tcherepnin,* 389 U.S., at 337, 88 S.Ct., at 553 (nonnegotiable but transferable "withdrawable capital shares" in savings and loan association held to be a "security"); *Howey,* 328 U.S., at 295, 66 S.Ct., at 1101 (units of citrus grove and maintenance contract "securities" although not traded on exchange).

The third factor—the public's reasonable perceptions—also supports a finding that the notes in this case are "securities." We have consistently identified the fundamental essence of a *69 "security" to be its character as an "investment." See *supra,* at 949, 951. The advertisements for the notes here characterized them as "investments," see *supra,* at 948, and there were no countervailing factors that would have led a reasonable person to question this characterization. In these circumstances, it would be reasonable for a prospective purchaser to take the Co–Op at its word.

Finally, we find no risk-reducing factor to suggest that these instruments are not in fact securities. The notes are uncollateralized and uninsured. Moreover, unlike the certificates of deposit in *Marine Bank, supra,* at 557–558, which were insured by the Federal Deposit Insurance Corporation and subject to substantial regulation under the federal banking laws, and unlike the pension plan in *Teamsters v. Daniel,* 439 U.S. 551, 569–570, 99 S.Ct. 790, 801–802, 58 L.Ed.2d 808 (1979), which was comprehensively regulated under the Employee Retirement Income Security Act of 1974, 88 Stat. 829, 29 U.S.C. § 1001 *et seq.* (1982 ed.), the notes here would escape federal regulation entirely if the Acts were held not to apply.

The court below found that "[t]he demand nature of the notes is very uncharacteristic of a security," 856 F.2d, at 54, on the theory that the virtually instant liquidity associated with demand notes is inconsistent with the risk ordinarily associated with "securities." This argument is unpersuasive. Common stock traded on a national exchange is the paradigm of a security, and it is as readily convertible into cash as is a demand note. The same is true of publicly traded corporate bonds, debentures, and any number of other instruments that are plainly within the purview of the Acts. The demand feature of a note does permit a holder to eliminate risk quickly by making a demand, but just as with publicly traded stock, the liquidity of the instrument does not eliminate risk altogether. Indeed, publicly traded stock is even more readily liquid than are demand notes, in that a demand only eliminates risk when, and if, payment is made, whereas the ***70** sale of a share of stock through a national exchange and the receipt of the proceeds usually occur simultaneously.

We therefore hold that the notes at issue here are within the term "note" in § 3(a)(10).

III

Relying on the exception in the statute for "any note ... which has a maturity at the time of issuance of not exceeding nine months," 15 U.S.C. § 78c(a)(10), respondent contends that the notes here are not "securities," even if they would otherwise qualify. Respondent cites Arkansas cases standing ****954** for the proposition that, in the context of the state statute of limitations, "[a] note payable on demand is due immediately." See, *e.g., McMahon v. O'Keefe,* 213 Ark. 105, 106, 209 S.W.2d 449, 450 (1948) (statute of limitations is triggered by the date of issuance rather than by date of first demand). Respondent concludes from this rule that the "maturity" of a demand note within the meaning of § 3(a)(10) is immediate, which is, of course, less than nine months. Respondent therefore contends that the notes fall within the plain words of the exclusion and are thus not "securities."

Petitioners counter that the "plain words" of the exclusion should not govern. Petitioners cite the legislative history of a similar provision of the 1933 Act, 48 Stat. 76, 15 U.S.C. § 77c(a)(3), for the proposition that the purpose of the exclusion is to except from the coverage of the Acts only commercial paper—short-term, high quality instruments issued to fund current operations and sold only to highly sophisticated investors. See S.Rep. No. 47, 73d Cong., 1st Sess., 3–4 (1933); H.R.Rep. No. 85, 73d Cong., 1st Sess., 15 (1933). Petitioners also emphasize that this Court has repeatedly held (see *supra,* at 948–950) that the plain words of the definition of a "security" are not dispositive, and that we consider the economic reality of the transaction to determine whether Congress intended the Securities Acts to apply. Petitioners therefore argue, with some force, that reading the exception ***71** for short-term notes to exclude from the Acts' coverage investment notes of less than nine months' duration would be inconsistent with Congress' evident desire to permit the SEC and the courts flexibility to ensure that the Acts are not manipulated to investors' detriment. If petitioners are correct that the exclusion is intended to cover only commercial paper, these notes, which were sold in a large scale offering to unsophisticated members of the public, plainly should not fall within the exclusion.

We need not decide, however, whether petitioners' interpretation of the exception is correct, for we conclude that even if we give literal effect to the exception, the notes do not fall within its terms.

[5] Respondent's contention that the demand notes fall within the "plain words" of the statute rests entirely upon the premise that Arkansas' statute of limitations for suits to collect demand notes is determinative of the "maturity" of the notes, as that term is used in the *federal* Securities Acts. The "maturity" of the notes, however, is a question of federal law. To regard States' statutes of limitations law as controlling the scope of the Securities Acts would be to hold that a particular instrument is a "security" under the 1934 Act in some States, but that the same instrument is not a "security" in others.

Compare *McMahon, supra,* at 106, 209 S.W.2d 449 (statute runs from date of note), with 42 Pa.Cons.Stat. § 5525(7) (1988) (statute runs "from the later of either demand or any payment of principal of or interest on the instrument"). We are unpersuaded that Congress intended the Securities Acts to apply differently to the same transactions depending on the accident of which State's law happens to apply.

THE CHIEF JUSTICE's argument in partial dissent is but a more artful statement of respondent's contention, and it suffers from the same defect. THE CHIEF JUSTICE begins by defining "maturity" to mean the time when a note becomes due. *Post,* at 957 (quoting Black's Law Dictionary 1170 (3d ed. 1933)). Because a demand note is "immediately 'due' such ***72** that an action could be brought at any time without any other demand than the suit," *post,* at 957, THE CHIEF JUSTICE concludes that a demand note is due immediately for purposes of the federal securities laws. Even if THE CHIEF JUSTICE is correct that the "maturity" of a note corresponds to the time at which it "becomes due," the authority he cites for the proposition that, as a matter of federal law, a demand note "becomes due" immediately (as opposed to when demand is ****955** made or expected to be made) is no more dispositive than is Arkansas case law. THE CHIEF JUSTICE's primary source of authority is a treatise regarding the *state* law of negotiable instruments, particularly the Uniform Negotiable Instruments Law. See M. Bigelow, Law of Bills, Notes, and Checks v–vii (3d ed. W. Lile rev. 1928). The quotation upon which THE CHIEF JUSTICE relies is concerned with articulating the general *state*-law rule regarding when suit may be filed. The only other authority THE CHIEF JUSTICE cites makes plain that state-law rules governing when a demand note becomes due are significant only in that they control the date on which statutes of limitation begins to run and whether demand must precede suit. See 8 C.J. Bills and Notes § 602, p. 406 (1916). Indeed, the treatise suggests that States were no more unanimous on those questions in 1933 than they are now. *Ibid.* In short, the dissent adds nothing to respondent's argument other than additional authority for what "maturity" means in certain state-law contexts. The dissent provides no argument for its implicit, but essential, premise that state rules concerning the proper method of collecting a debt control the resolution of the federal question before us.

[6] Neither the law of Arkansas nor that of any other State provides an answer to the federal question, and as a matter of federal law, the words of the statute are far from "plain" with regard to whether demand notes fall within the exclusion. If it is plausible to regard a demand note as having an immediate maturity because demand *could* be made immediately, it is also plausible to regard the maturity of a demand note as ***73** being in excess of nine months because demand *could* be made many years or decades into the future. Given this ambiguity, the exclusion must be interpreted in accordance with its purpose. As we have said, we will assume for argument's sake that petitioners are incorrect in their view that the exclusion is intended to exempt only commercial paper. Respondent presents no competing view to explain why Congress would have enacted respondent's version of the exclusion, however, and the only theory that we can imagine that would support respondent's interpretation is that Congress intended to create a bright-line rule exempting from the 1934 Act's coverage *all* notes of less than nine months' duration, because short-term notes are, as a general rule, sufficiently safe that the Securities Acts need not apply. As we have said, however, demand notes do not necessarily have short terms. In light of Congress' broader purpose in the Acts of ensuring that investments of all descriptions be regulated to prevent fraud and abuse, we interpret the exception not to cover the demand notes at issue here. Although the result might be different if the design of the transaction suggested that both parties contemplated that demand would be made within the statutory period, that is not the case before us.

IV

For the foregoing reasons, we conclude that the demand notes at issue here fall under the "note" category of instruments that are "securities" under the 1933 and 1934 Acts. We also conclude that, even under respondent's preferred approach to § 3(a)(10)'s exclusion for short-term notes, these demand notes do not fall within the exclusion. Accordingly, we reverse the judgment of the Court of Appeals and remand the case for further proceedings consistent with this opinion.

So ordered.

Justice STEVENS, concurring.

While I join the Court's opinion, an important additional consideration supports my conclusion that these notes are securities ***74** notwithstanding the statute's exclusion for currency and commercial paper that has a maturity of no more than nine months. See 15 U.S.C. § 78c(a)(10) (§ 3(a)(10) of the Securities Exchange Act of 1934). The Courts of Appeals have been unanimous in rejecting a literal reading

of that exclusion. They **956 have instead concluded that "when Congress spoke of notes with a maturity not exceeding nine months, it meant commercial paper, not investment securities." *Sanders v. John Nuveen & Co.,* 463 F.2d 1075, 1080 (CA7), cert. denied, 409 U.S. 1009, 93 S.Ct. 443, 34 L.Ed.2d 302 (1972). This view was first set out in an opinion by Judge Sprecher, and soon thereafter endorsed by Chief Judge Friendly. *Zeller v. Bogue Electric Mfg. Corp.,* 476 F.2d 795, 800 (CA2), cert. denied, 414 U.S. 908, 94 S.Ct. 217, 38 L.Ed.2d 146 (1973). Others have adopted the same position since. See, *e.g., McClure v. First Nat. Bank of Lubbock, Texas,* 497 F.2d 490, 494–495 (CA5 1974), cert. denied, 420 U.S. 930, 95 S.Ct. 1132, 43 L.Ed.2d 402 (1975); *Holloway v. Peat, Marwick, Mitchell & Co.,* 879 F.2d 772, 778 (CA10 1989); *Baurer v. Planning Group, Inc.,* 215 U.S. App.D.C. 384, 389–391, 669 F.2d 770, 775–777 (1981).

In my view such a settled construction of an important federal statute should not be disturbed unless and until Congress so decides. "[A]fter a statute has been construed, either by this Court or by a consistent course of decision by other federal judges and agencies, it acquires a meaning that should be as clear as if the judicial gloss had been drafted by the Congress itself." *Shearson/American Express Inc. v. McMahon,* 482 U.S. 220, 268, 107 S.Ct. 2332, 2359, 96 L.Ed.2d 185 (1987) (STEVENS, J., concurring in part and dissenting in part); see also *Chesapeake & Ohio R. Co. v. Schwalb,* 493 U.S. 40, 51, 110 S.Ct. 381, 387, 107 L.Ed.2d 278 (1989) (STEVENS, J., concurring in judgment). What I have said before of taxation applies equally to securities regulation: "there is a strong interest in enabling" those affected "to predict the legal consequences of their proposed actions, and there is an even stronger general interest in ensuring that the responsibility for making changes in settled law rests squarely on *75 the shoulders of Congress." *Commissioner v. Fink,* 483 U.S. 89, 101, 107 S.Ct. 2729, 2736, 97 L.Ed.2d 74 (1987) (dissenting opinion). Past errors may in rare cases be "sufficiently blatant" to overcome the " 'strong presumption of continued validity that adheres in the judicial interpretation of a statute,' " but this is not such a case. *Id.,* at 103, 107 S.Ct., at 2737 (quoting *Square D Co. v. Niagara Frontier Tariff Bureau, Inc.,* 476 U.S. 409, 424, 106 S.Ct. 1922, 1930, 90 L.Ed.2d 413 (1986)).

Indeed, the agreement among the Courts of Appeals is made all the more impressive in this case because it is buttressed by the views of the Securities and Exchange Commission. See Securities Act Release No. 33–4412, 26 Fed.Reg. 9158 (1961) (construing § 3(a)(3) of the Securities Act of 1933, the 1933 Act's counterpart to § 3(a)(10) of the 1934 Act). We have ourselves referred to the exclusion for notes with a maturity not exceeding nine months as an exclusion for "commercial paper." *Securities Industry Assn. v. Board of Governors of Federal Reserve System,* 468 U.S. 137, 150–152, 104 S.Ct. 2979, 2986–87, 82 L.Ed.2d 107 (1984). Perhaps because the restriction of the exclusion to commercial paper is so well established, respondents admit that they did not even argue before the Court of Appeals that their notes were covered by the exclusion. A departure from this reliable consensus would upset the justified expectations of both the legal and investment communities.

Moreover, I am satisfied that the interpretation of the statute expounded by Judge Sprecher and Judge Friendly was entirely correct. As Judge Friendly has observed, the exclusion for short-term notes must be read in light of the prefatory language in § 2 of the 1933 Act and § 3 of the 1934 Act. See *Exchange Nat. Bank of Chicago v. Touche Ross & Co.,* 544 F.2d 1126, 1131–1132, and nn. 7–10 (CA2 1976). Pursuant to that language, definitions specified by the Acts may not apply if the "context otherwise requires." *Marine Bank v. Weaver,* 455 U.S. 551, 556, 102 S.Ct. 1220, 1223, 71 L.Ed.2d 409 (1982) (the "broad statutory definition is preceded, however, by the statement that the terms **957 mentioned are not to be considered securities if 'the context otherwise requires ...' "); accord, *76 *Landreth Timber Co. v. Landreth,* 471 U.S. 681, 697–698, 105 S.Ct. 2297, 2312–13, 85 L.Ed.2d 692 (1985) (STEVENS, J., dissenting). The context clause thus permits a judicial construction of the statute which harmonizes the facially rigid terms of the 9-month exclusion with the evident intent of Congress. *Exchange Nat. Bank,* 544 F.2d, at 1132–1133. The legislative history of § 3(a)(3) of the 1933 Act indicates that the exclusion was intended to cover only commercial paper, and the SEC has so construed it. *Sanders,* 463 F.2d, at 1079, and nn. 12–13; *Zeller,* 476 F.2d, at 799–800, and n. 6. As the Courts of Appeals have agreed, there is no apparent reason to construe § 3(a)(10) of the 1934 Act differently. *Sanders,* 463 F.2d, at 1079–1080, and n. 15; *Zeller,* 476 F.2d, at 800. See also Comment, The Commercial Paper Market and the Securities Acts, 39 U.Chi.L.Rev. 362, 398 (1972).

For these reasons and those stated in the opinion of the Court, I conclude that the notes issued by respondents are securities within the meaning of the 1934 Act.

Chief Justice REHNQUIST, with whom Justice WHITE, Justice O'CONNOR, and Justice SCALIA join, concurring in part and dissenting in part.

I join Part II of the Court's opinion, but dissent from Part III and the statements of the Court's judgment in Parts I and IV. In Part III, the Court holds that these notes were not covered by the statutory exemption for "any note ... which has a maturity at the time of issuance of not exceeding nine months." Treating demand notes as if they were a recent development in the law of negotiable instruments, the Court says "if it is plausible to regard a demand note as having an immediate maturity because demand *could* be made immediately, it is also plausible to regard the maturity of a demand note as being in excess of nine months because demand *could* be made many years or decades into the future. Given this ambiguity, the exclusion must be interpreted in accordance with its purpose." *Ante,* at 955.

***77** But the terms "note" and "maturity" did not spring full blown from the head of Congress in 1934. Neither are demand notes of recent vintage. "Note" and "maturity" have been terms of art in the legal profession for centuries, and a body of law concerning the characteristics of demand notes, including their maturity, was in existence at the time Congress passed the 1934 Act.

In construing any terms whose meanings are less than plain, we depend on the common understanding of those terms at the time of the statute's creation. See *Gilbert v. United States,* 370 U.S. 650, 655, 82 S.Ct. 1399, 1402, 8 L.Ed.2d 750 (1962) ("[I]n the absence of anything to the contrary it is fair to assume that Congress use[s a] word in [a] statute in its common-law sense"); *Roadway Express, Inc. v. Piper,* 447 U.S. 752, 759, 100 S.Ct. 2455, 2460, 65 L.Ed.2d 488 (1980) (in construing a word in a statute, "we may look to the contemporaneous understanding of the term"); *Standard Oil Co. of New Jersey v. United States,* 221 U.S. 1, 59, 31 S.Ct. 502, 516, 55 L.Ed. 619 (1911) (common-law meaning "presumed" to have been Congress' intent); see also *Lorillard v. Pons,* 434 U.S. 575, 583, 98 S.Ct. 866, 871, 55 L.Ed.2d 40 (1978); *United States v. Spencer,* 839 F.2d 1341, 1344 (CA9 1988). Contemporaneous editions of legal dictionaries defined "maturity" as "[t]he time when a ... note becomes due." Black's Law Dictionary 1170 (3d ed. 1933); Cyclopedic Law Dictionary 649 (2d ed. 1922). Pursuant to the dominant consensus in the case law, instruments payable on demand were considered immediately "due" such that an action could be brought at any time without any other demand than the suit. See, *e.g.,* M. Bigelow, Law of Bills, Notes, and Checks § 349, p. 265 (3d ed. W. Lile rev. 1928); 8 C.J., Bills and Notes § 602, p. 406, and n. 83 (1916). According to Bigelow:

> ****958** "So far as maker and acceptor are concerned, paper payable ... 'on demand' is due from the moment of its delivery, and payment may be required on any business day, including the day of its issue, within the statute of limitations. In other words, as to these parties *the paper is at maturity all the time,* and no demand of payment is necessary ***78** before suit thereon." Bigelow, *supra,* § 349, at 265 (emphasis added; emphasis in original deleted; footnote omitted).

To be sure, demand instruments were considered to have "the peculiar quality of having two maturity dates—one for the purpose of holding to his obligation the party primarily liable (*e.g.* maker), and the other for enforcing the contracts of parties secondarily liable (*e.g.* drawer and indorsers)." Bigelow, *supra,* § 350, at 266 (emphasis omitted). But only the rule of immediate maturity respecting makers of demand notes has any bearing on our examination of the exemption; the language in the Act makes clear that it is the "maturity at time of issuance" with which we are concerned. 15 U.S.C. § 78c(a)(10). Accordingly, in the absence of some compelling indication to the contrary, the maturity date exemption must encompass demand notes because they possess "maturity at the time of issuance of not exceeding nine months." *

***79** Petitioners and the lower court decisions cited by Justice STEVENS rely, virtually exclusively, on the legislative history of § 3(a)(3) of the 1933 Act for the proposition that the term "any note" in the exemption in § 3(a)(10) of the 1934 Act encompass only notes having the character of short-term "commercial paper" exchanged among sophisticated traders. I am not altogether convinced that the legislative history of § 3(a)(3) supports that interpretation even with respect to the term "any note" in the exemption in § 3(a)(3), and to bodily transpose that legislative history to another statute has little to commend it as a method of statutory construction.

The legislative history of the 1934 Act—under which this case arises—contains nothing which would support a restrictive reading of the exemption in question. Nor does the legislative history of § 3(a)(3) of the 1933 Act support the asserted limited construction of the exemption in § 3(a)(10) of the 1934 Act. Though the two most pertinent sources of congressional commentary on § 3(a)(3)—H.R.Rep. No. 85, 73d Cong., 1st Sess., 15 (1933) and S.Rep. No. 47, 73d Cong., 1st ****959** Sess., 3–4 (1933)—do suggest an intent to limit § 3(a)(3)'s exemption to short-term commercial paper, the references in those Reports to commercial paper simply did not survive in the language of the enactment. Indeed, the Senate Report stated "[n]otes, drafts, bills of exchange, and bankers' acceptances *which are commercial paper* and arise out of current *commercial, agricultural, or industrial* transactions, *and which are not intended to be marketed to the public,* are exempted...." S.Rep. No. 47, *supra,* at 3–4 (emphasis added). Yet the provision enacted in § 3(a)(3) ***80** of the 1933 Act exempts "*[a]ny* note, draft, bill of exchange, or banker's acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine months...." 15 U.S.C. § 77c(a)(3) (emphasis added).

Such broadening of the language in the enacted version of § 3(a)(3), relative to the prototype from which it sprang, cannot easily be dismissed in interpreting § 3(a)(3). *A fortiori,* the legislative history's restrictive meaning cannot be imputed to the facially broader language in a different provision of another Act. Although I do not doubt that both the 1933 and 1934 Act exemptions encompass short-term commercial paper, the expansive language in the statutory provisions is strong evidence that, in the end, Congress meant for commercial paper merely to be a subset of a larger class of exempted short-term instruments.

The plausibility of imputing a restrictive reading to § 3(a)(10) from the legislative history of § 3(a)(3) is further weakened by the imperfect analogy between the two provisions in terms of both phraseology and nature. Section 3(a)(10) lacks the cryptic phrase in § 3(a)(3) which qualifies the class of instruments eligible for exemption as those arising "out of ... current transaction[s] or the proceeds of which have been or are to be used for current transactions...." While that passage somehow may strengthen an argument for limiting the exemption in § 3(a)(3) to commercial paper, its absence in § 3(a)(10) conversely militates against placing the same limitation thereon.

The exemption in § 3(a)(3) excepts the short-term instruments it covers solely from the registration requirements of the 1933 Act. The same instruments are not exempted from the 1933 Act's antifraud provisions. Compare 15 U.S.C. § 77c(a)(3) with 15 U.S.C. §§ 77*l* (2) and 77q(c); see also ***81** *Securities Industry Assn. v. Board of Governors of Federal Reserve System,* 468 U.S. 137, 151, 104 S.Ct. 2979, 2986–87, 82 L.Ed.2d 107 (1984). By contrast, the exemption in § 3(a)(10) of the 1934 Act exempts instruments encompassed thereunder from the entirety of the coverage of the 1934 Act including, conspicuously, the Act's antifraud provisions.

Justice STEVENS argues that the suggested limited reading of the exemption in § 3(a)(10) of the 1934 Act "harmonizes" the plain terms of that provision with the legislative history of the 1933 Act. *Ante,* at 957. In his view, such harmony is required by the "context clause" at the beginning of the 1934 Act's general definition of "security." It seems to me, instead, that harmony is called for primarily between § 3(a)(10)'s general definition and its specific exemption. The fairest reading of the exemption in light of the context clause is that the situation described in the exemption—notes with maturities at issue of less than nine months—is one contextual exception Congress especially wanted courts to recognize. Such a reading does not render the context clause superfluous; it merely leaves it to the judiciary to flesh out additional "context clause" exceptions.

Justice STEVENS also states that we have previously referred to the exemption in § 3(a)(10) as an exclusion for commercial paper. *Ante,* at 957 (citing *Securities Industry Assn., supra,* 468 U.S., at 150–152, 104 S.Ct., at 2986–87). In the *Securities Industry Assn.* dictum, however, we described the exemption in § 3(a)(10) merely as "encompass[ing]" ****960** commercial paper and in no way concluded that the exemption was limited to commercial paper. See 468 U.S., at 150–151, 104 S.Ct., at 2986. Indeed, in *Securities Industry Assn.,* our purpose in referring to § 3(a)(10) was to assist our determination whether commercial paper was even *included* in the 73d Congress' use of the words "notes ...

or other securities" in the Glass–Steagall Banking Act of 1933.

In sum, there is no justification for looking beyond the plain terms of § 3(a)(10), save for ascertaining the meaning of "maturity" with respect to demand notes. That inquiry reveals ***82** that the Co-Op's demand notes come within the purview of the section's exemption for short-term securities. I would therefore affirm the judgment of the Court of Appeals, though on different reasoning.

All Citations

494 U.S. 56, 110 S.Ct. 945, 108 L.Ed.2d 47, Blue Sky L. Rep. P 73,213, 58 USLW 4208, Fed. Sec. L. Rep. P 94,939

Footnotes

* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

1 We have consistently held that "[t]he definition of a security in § 3(a)(10) of the 1934 Act, ... is virtually identical [to the definition in the Securities Act of 1933] and, for present purposes, the coverage of the two Acts may be considered the same." *United Housing Foundation, Inc. v. Forman,* 421 U.S. 837, 847, n. 12, 95 S.Ct. 2051, 2058, n. 12, 44 L.Ed.2d 621 (1975) (citations omitted). We reaffirm that principle here.

2 An approach founded on economic reality rather than on a set of *per se* rules is subject to the criticism that whether a particular note is a "security" may not be entirely clear at the time it is issued. Such an approach has the corresponding advantage, though, of permitting the SEC and the courts sufficient flexibility to ensure that those who market investments are not able to escape the coverage of the Securities Acts by creating new instruments that would not be covered by a more determinate definition. One could question whether, at the expense of the goal of clarity, Congress overvalued the goal of avoiding manipulation by the clever and dishonest. If Congress erred, however, it is for that body, and not this Court, to correct its mistake.

3 The Second Circuit's version of the family resemblance test provided that only notes *with a term of more than nine months* are presumed to be "securities." See *supra,* at 950. No presumption of any kind attached to notes of less than nine months' duration. The Second Circuit's refusal to extend the presumption to *all* notes was apparently founded on its interpretation of the statutory exception for notes with a maturity of nine months or less. Because we do not reach the question of how to interpret that exception, see *infra,* at 954, we likewise express no view on how that exception might affect the presumption that a note is a "security."

4 We emphasize that by "profit" in the context of notes, we mean "a valuable return on an investment," which undoubtedly includes interest. We have, of course, defined "profit" more restrictively in applying the *Howey* test to what are claimed to be "investment contracts." See, *e.g., Forman,* 421 U.S., at 852, 95 S.Ct., at 2060 ("[P]rofit" under the *Howey* test means either "capital appreciation" or "a participation in earnings"). To apply this restrictive definition to the determination whether an instrument is a "note" would be to suggest that notes paying a rate of interest not keyed to the earning of the enterprise are not "notes" within the meaning of the Securities Acts. Because the *Howey* test is irrelevant to the issue before us today, see *supra,* at 950, we decline to extend its definition of "profit" beyond the realm in which that definition applies.

* Reference to the state common law of negotiable instruments does not suggest that "Congress intended the Securities Acts to apply differently to the same transactions depending on the accident of which State's

law happens to apply." See *ante,* at 954. Rather, in the absence of a *federal* law of negotiable instruments, cf. *De Sylva v. Ballentine,* 351 U.S. 570, 580, 76 S.Ct. 974, 980, 100 L.Ed. 1415 (1956) ("[T]here is no federal law of domestic relations, which is primarily a matter of state concern"), or other alternative sources for discerning the applicability of the statutory term "maturity" to demand notes, we are dependent on the state common law at the time of the Act's creation as a basis for a nationally uniform answer to this "federal question." As we said in *Mississippi Band of Choctaw Indians v. Holyfield,* 490 U.S. 30, 47, 109 S.Ct. 1597, 1608, 104 L.Ed.2d 29 (1989):

"That we are dealing with a uniform federal rather than a state definition does not, of course, prevent us from drawing on general state-law principles to determine 'the ordinary meaning of the words used.' Well-settled state law can inform our understanding of what Congress had in mind when it employed a term it did not define."

See also 2A C. Sutherland on Statutory Construction § 50.04, pp. 438–439 (4th ed. 1984) (noting the "utility" found by various courts, including this Court, in "examining a federal statute with reference to the common law of the various states as it existed at the time the statute was enacted"). In 1934, when this statute was enacted, as is true today, the American law of negotiable instruments was found in the state-court reporters. Though the States were not unanimous on the issue of the time of maturity of demand notes, virtually every matter of state common law evokes a majority and minority position. The vast number of courts that adopted the majority view of immediate maturity, see 8 C.J., Bills and Notes § 602, p. 406, n. 83 (1916), compels the conclusion that the immediate maturity rule constituted "well-settled state law" or a "general state-law principle" at the time § 3(a)(10) was enacted.

118TH CONGRESS
2D SESSION

H. R. 4763

AN ACT

To provide for a system of regulation of digital assets by the Commodity Futures Trading Commission and the Securities and Exchange Commission, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the ''Financial Innovation and Technology for the 21st Century Act''.

(b) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

Sec. 1. Short title; table of contents.

TITLE I—DEFINITIONS; RULEMAKING; NOTICE OF INTENT TO REGISTER

Sec. 101. Definitions under the Securities Act of 1933.
Sec. 102. Definitions under the Securities Exchange Act of 1934.
Sec. 103. Definitions under the Commodity Exchange Act.
Sec. 104. Definitions under this Act.
Sec. 105. Rulemakings.
Sec. 106. Notice of intent to register for digital commodity exchanges, brokers, and dealers.
Sec. 107. Notice of intent to register for digital asset brokers, dealers, and trading systems.
Sec. 108. Commodity Exchange Act savings provisions.
Sec. 109. Administrative requirements.
Sec. 110. International harmonization.
Sec. 111. Implementation.
Sec. 112. Application of the Bank Secrecy Act.

TITLE II—CLARITY FOR ASSETS OFFERED AS PART OF AN INVESTMENT CONTRACT

Sec. 201. Short title.
Sec. 202. Treatment of investment contract assets.

TITLE III—OFFERS AND SALES OF DIGITAL ASSETS

Sec. 301. Exempted transactions in digital assets.
Sec. 302. Requirements for offers and sales of certain digital assets.
Sec. 303. Enhanced disclosure requirements.
Sec. 304. Certification of certain digital assets.
Sec. 305. Effective date.

TITLE IV—REGISTRATION FOR DIGITAL ASSET INTERMEDIARIES AT THE SECURITIES AND EXCHANGE COMMISSION

Sec. 401. Treatment of digital commodities and other digital assets.
Sec. 402. Authority over permitted payment stablecoins and restricted digital assets.
Sec. 403. Registration of digital asset trading systems.
Sec. 404. Requirements for digital asset trading systems.
Sec. 405. Registration of digital asset brokers and digital asset dealers.
Sec. 406. Requirements of digital asset brokers and digital asset dealers.

Sec. 407. Rules related to conflicts of interest.
Sec. 408. Treatment of certain digital assets in connection with federally regulated intermediaries.
Sec. 409. Exclusion for decentralized finance activities.
Sec. 410. Registration and requirements for notice-registered digital asset clearing agencies.
Sec. 411. Treatment of custody activities by banking institutions.
Sec. 412. Effective date; administration.
Sec. 413. Discretionary Surplus Fund.
Sec. 414. Studies on foreign adversary participation.

TITLE V—REGISTRATION FOR DIGITAL ASSET INTERMEDIARIES AT THE COMMODITY FUTURES TRADING COMMISSION

Sec. 501. Commission jurisdiction over digital commodity transactions.
Sec. 502. Requiring futures commission merchants to use qualified digital commodity custodians.
Sec. 503. Trading certification and approval for digital commodities.
Sec. 504. Registration of digital commodity exchanges.
Sec. 505. Qualified digital commodity custodians.
Sec. 506. Registration and regulation of digital commodity brokers and dealers.
Sec. 507. Registration of associated persons.
Sec. 508. Registration of commodity pool operators and commodity trading advisors.
Sec. 509. Exclusion for decentralized finance activities.
Sec. 510. Funding for implementation and enforcement.
Sec. 511. Effective date.
Sec. 512. Sense of the Congress.

TITLE VI—INNOVATION AND TECHNOLOGY IMPROVEMENTS

Sec. 601. Findings; sense of Congress.
Sec. 602. Codification of the SEC Strategic Hub for Innovation and Financial Technology.
Sec. 603. Codification of LabCFTC.
Sec. 604. CFTC-SEC Joint Advisory Committee on Digital Assets.
Sec. 605. Study on decentralized finance.
Sec. 606. Study on non-fungible digital assets.
Sec. 607. Study on expanding financial literacy amongst digital asset holders.
Sec. 608. Study on financial market infrastructure improvements.

TITLE I—DEFINITIONS; RULEMAKING; NOTICE OF INTENT TO REGISTER

SEC. 101. DEFINITIONS UNDER THE SECURITIES ACT OF 1933.

Section 2(a) of the Securities Act of 1933 (15 U.S.C. 77b(a)) is amended by adding at the end the following:

"(20) AFFILIATED PERSON.—

"(A) IN GENERAL.—The term 'affiliated person' means a person (including a related person) that—

"(i) with respect to a digital asset issuer—

"(I) directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such digital asset issuer; or

"(II) was described under clause (i) at any point in the previous 3-month period; or

"(ii) with respect to any digital asset—

"(I) beneficially owns 5 percent or more of the units of such digital asset that are then outstanding; or

"(II) was described under clause (i) at any point in the previous 3-month period.

"(B) BENEFICIAL OWNERSHIP DISCLOSURE.—The Commission shall issue rules to require a person that beneficially owns 5 percent

or more of the units of a digital asset that are then outstanding to file with the Commission a report at such time as the Commission determines appropriate.

''(21) BLOCKCHAIN.—The term 'blockchain' means any technology—

''(A) where data is—

''(i) shared across a network to create a public ledger of verified transactions or information among network participants;

''(ii) linked using cryptography to maintain the integrity of the public ledger and to execute other functions; and

''(iii) distributed among network participants in an automated fashion to concurrently update network participants on the state of the public ledger and any other functions; and

''(B) composed of source code that is publicly available.

''(22) BLOCKCHAIN PROTOCOL.—The term 'blockchain protocol' means any executable software deployed to a blockchain composed of source code that is publicly available and accessible, including a smart contract or any network of smart contracts.

"(23) BLOCKCHAIN SYSTEM.—The term 'blockchain system' means any blockchain or blockchain protocol.

"(24) DECENTRALIZED GOVERNANCE SYSTEM.—

"(A) IN GENERAL.—The term 'decentralized governance system' means, with respect to a blockchain system, any rules-based system permitting persons using the blockchain system or the digital assets related to such blockchain system to form consensus or reach agreement in the development, provision, publication, management, or administration of such blockchain system.

"(B) RELATIONSHIP OF PERSONS TO DECENTRALIZED GOVERNANCE SYSTEMS.—Persons acting through a decentralized governance system shall be treated as separate persons unless such persons are under common control.

"(C) EXCLUSION.—The term 'decentralized governance system' does not include a system in which—

"(i) a person or group of persons under common control have the ability to—

''(I) unilaterally alter the rules of consensus or agreement for the blockchain system; or

''(II) determine the final outcome of decisions related to the development, provision, publication, management, or administration of such blockchain system;

''(ii) a person or group of persons is directly engaging in an activity that requires registration with the Commission or the Commodity Futures Trading Commission other than—

''(I) developing, providing, publishing, managing, or administering a blockchain system; or

''(II) an activity with respect to which the organization is exempt from such registration; or

''(iii) a person or group of persons seeking to knowingly evade the requirements imposed on a digital asset issuer, a related person, an affiliated person, or any other person registered (or required to be registered) under the securities laws, the

Financial Innovation and Technology for the 21st Century Act, or the Commodity Exchange Act.

''(25) DECENTRALIZED SYSTEM.—With respect to a blockchain system to which a digital asset relates, the term 'decentralized system' means the following conditions are met:

''(A) During the previous 12-month period, no person—

''(i) had the unilateral authority, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise, to control or materially alter the functionality or operation of the blockchain system; or

''(ii) had the unilateral authority to restrict or prohibit any person who is not a digital asset issuer, related person, or an affiliated person from—

''(I) using, earning, or transmitting the digital asset;

''(II) deploying software that uses or integrates with the blockchain system;

"(III) participating in a decentralized governance system with respect to the blockchain system; or

"(IV) operating a node, validator, or other form of computational infrastructure with respect to the blockchain system.

"(B) During the previous 12-month period—

"(i) no digital asset issuer or affiliated person beneficially owned, in the aggregate, 20 percent or more of the total amount of units of such digital asset that—

"(I) can be created, issued, or distributed in such blockchain system; and

"(II) were freely transferrable or otherwise used or available to be used for the purposes of such blockchain system;

"(ii) no digital asset issuer or affiliated person had the unilateral authority to direct the voting, in the aggregate, of 20 percent or more of the outstanding voting

power of such digital asset or related decentralized governance system; or

''(iii) the digital asset did not include voting power with respect to any decentralized governance system of the blockchain system.

''(C) During the previous 3-month period, the digital asset issuer, any affiliated person, or any related person has not implemented or contributed any intellectual property to the source code of the blockchain system that materially alters the functionality or operation of the blockchain system, unless such implementation or contribution to the source code—

''(i) addressed vulnerabilities, errors, regular maintenance, cybersecurity risks, or other technical changes to the blockchain system; or

''(ii) were adopted through the consensus or agreement of a decentralized governance system.

''(D) During the previous 3-month period, neither any digital asset issuer nor any affiliated person described under paragraph (20)(A)

has marketed to the public the digital assets as an investment.

''(E) During the previous 12-month period, all issuances of units of such digital asset through the programmatic functioning of the blockchain system were end user distributions. For purposes of the previous sentence, any units of such digital asset that are made available over time and were created in the initial block of the blockchain system shall be considered issued at the point in time of creation.

''(26) DIGITAL ASSET.—

''(A) IN GENERAL.—The term 'digital asset' means any fungible digital representation of value that can be exclusively possessed and transferred, person to person, without necessary reliance on an intermediary, and is recorded on a cryptographically secured public distributed ledger.

''(B) EXCLUSIONS.—The term 'digital asset' does not include—

''(i) 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, collateral-trust certificate, preorganization certificate or subscription, transferable share, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof); or

''(ii) any asset which, based on its terms and other characteristics, is, represents, or is functionally equivalent to an agreement, contract, or transaction that is—

''(I) a contract of sale of a commodity (as defined under section 1a of the Commodity Exchange Act) for future delivery or an option thereon;

''(II) a security futures product;

''(III) a swap;

''(IV) an agreement, contract, or transaction described in section 2(c)(2)(C)(i) or 2(c)(2)(D)(i) of the Commodity Exchange Act;

"(V) a commodity option authorized under section 4c of the Commodity Exchange Act; or

"(VI) a leverage transaction authorized under section 19 of the Commodity Exchange Act.

"(C) RULE OF CONSTRUCTION.—Nothing in this paragraph shall be construed to create a presumption that a digital asset is a representation of any type of security not excluded from the definition of digital asset.

"(D) RELATIONSHIP TO A BLOCKCHAIN SYSTEM.—A digital asset is considered to relate to a blockchain system if the digital asset is intrinsically linked to the blockchain system, including—

"(i) where the digital asset's value is reasonably expected to be generated by the programmatic functioning of the blockchain system;

"(ii) where the digital asset has voting rights with respect to the decentralized governance system of the blockchain system; or

"(iii) where the digital asset is issued through the programmatic functioning of the blockchain system.

"(E) TREATMENT OF CERTAIN DIGITAL ASSETS SOLD PURSUANT TO AN INVESTMENT CONTRACT.—A digital asset offered or sold or intended to be offered or sold pursuant to an investment contract is not and does not become a security as a result of being sold or otherwise transferred pursuant to that investment contract.

"(27) DIGITAL ASSET ISSUER.—

"(A) IN GENERAL.—With respect to a digital asset, the term 'digital asset issuer' means any person that, in exchange for any consideration—

"(i) issues or causes to be issued a unit of such digital asset to a person; or

"(ii) offers or sells a right to a future issuance of a unit of such digital asset to a person.

"(B) EXCLUSION.—The term 'digital asset issuer' does not include any person solely because such person deploys source code that cre-

ates or issues units of a digital asset that are only distributed in end user distributions.

"(C) PROHIBITION ON EVASION.—It shall be unlawful for any person to knowingly evade classification as a 'digital asset issuer' and facilitate an arrangement for the primary purpose of effecting a sale, distribution, or other issuance of a digital asset.

"(28) DIGITAL ASSET MATURITY DATE.—The term 'digital asset maturity date' means, with respect to any digital asset, the first date on which 20 percent or more of the total units of such digital asset that are then outstanding as of such date are—

"(A) digital commodities; or

"(B) digital assets that have been registered with the Commission.

"(29) DIGITAL COMMODITY.—The term 'digital commodity' has the meaning given that term under section 1a of the Commodity Exchange Act (7 U.S.C. 1a).

"(30) END USER DISTRIBUTION.—

"(A) IN GENERAL.—The term 'end user distribution' means an issuance of a unit of a digital asset that—

"(i) does not involve an exchange of more than a nominal value of cash, property, or other assets; and

"(ii) is distributed in a broad, equitable, and non-discretionary manner based on conditions capable of being satisfied by any participant in the blockchain system, including, as incentive-based rewards—

"(I) to users of the digital asset or any blockchain system to which the digital asset relates;

"(II) for activities directly related to the operation of the blockchain system, such as mining, validating, staking, or other activity directly tied to the operation of the blockchain system; or

"(III) to the existing holders of another digital asset, in proportion to the total units of such other digital asset as are held by each person.

"(B) PROHIBITION ON EVASION.—It shall be unlawful for any person to facilitate an end user distribution to knowingly evade classification as a digital asset issuer, related person, or

an affiliated person, or the requirements related to a digital asset issuance.

''(31) FUNCTIONAL SYSTEM.—With respect to a blockchain system to which a digital asset relates, the term 'functional system' means the network allows network participants to use such digital asset for—

''(A) the transmission and storage of value on the blockchain system;

''(B) the participation in services provided by or an application running on the blockchain system; or

''(C) the participation in the decentralized governance system of the blockchain system.

''(32) PERMITTED PAYMENT STABLECOIN.—

''(A) IN GENERAL.—The term 'permitted payment stablecoin' means a digital asset—

''(i) that is or is designed to be used as a means of payment or settlement;

''(ii) the issuer of which—

''(I) is obligated to convert, redeem, or repurchase for a fixed amount of monetary value; or

''(II) represents will maintain or creates the reasonable expectation

that it will maintain a stable value relative to the value of a fixed amount of monetary value;

"(iii) the issuer of which is subject to regulation by a Federal or State regulator with authority over entities that issue payment stablecoins; and

"(iv) that is not—

"(I) a national currency; or

"(II) a security issued by an investment company registered under section 8(a) of the Investment Company Act of 1940 (15 U.S.C. 80a–8(a)).

"(B) MONETARY VALUE DEFINED.—For purposes of subparagraph (A), the term 'monetary value' means a national currency, deposit (as defined under section 3 of the Federal Deposit Insurance Act), or an equivalent instrument that is denominated in a national currency.

"(33) RELATED PERSON.—With respect to a digital asset issuer, the term 'related person' means—

"(A) a founder, promoter, employee, consultant, advisor, or person serving in a similar capacity;

"(B) any person that is or was in the previous 6-month period an executive officer, director, trustee, general partner, advisory board member, or person serving in a similar capacity;

"(C) any equity holder or other security holder; or

"(D) any other person that received a unit of digital asset from such digital asset issuer through—

"(i) an exempt offering, other than an offering made in reliance on section 4(a)(8); or

"(ii) a distribution that is not an end user distribution described under section 42(d)(1) of the Securities Exchange Act of 1934.

"(34) RESTRICTED DIGITAL ASSET.—

"(A) IN GENERAL.—The term 'restricted digital asset' means—

"(i) prior to the first date on which each blockchain system to which a digital asset relates is a functional system and

certified to be a decentralized system under section 44 of the Securities Exchange Act of 1934, any unit of the digital asset held by a person, other than the digital asset issuer, a related person, or an affiliated person, that was—

"(I) issued to such person through a distribution, other than an end user distribution described under section 42(d)(1) of the Securities Exchange Act of 1934; or

"(II) acquired by such person in a transaction that was not executed on a digital commodity exchange;

"(ii) during any period when any blockchain system to which a digital asset relates is not a functional system or not certified to be a decentralized system under section 44 of the Securities Exchange Act of 1934, any digital asset held by a related person or an affiliated person; and

"(iii) any unit of a digital asset held by the digital asset issuer.

''(B) EXCLUSION.—The term 'restricted digital asset' does not include a permitted payment stablecoin.

''(35) SECURITIES LAWS.—The term 'securities laws' has the meaning given that term under section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)).

''(36) SOURCE CODE.—With respect to a blockchain system, the term 'source code' means a listing of commands to be compiled or assembled into an executable computer program.''.

SEC. 102. DEFINITIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934.

Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is amended—

(8) by redesignating the second paragraph (80) (relating to funding portals) as paragraph (81); and

(9) by adding at the end the following:

''(82) BANK SECRECY ACT.—The term 'Bank Secrecy Act' means—

''(A) section 21 of the Federal Deposit Insurance Act (12 U.S.C. 1829b);

''(B) chapter 2 of title I of Public Law 91–508 (12 U.S.C. 1951 et seq.); and

"(C) subchapter II of chapter 53 of title 31, United States Code.

"(83) DIGITAL ASSET BROKER.—The term 'digital asset broker'—

"(A) means any person engaged in the business of effecting transactions in restricted digital assets for the account of others; and

"(B) does not include—

"(i) a blockchain protocol or a person or group of persons solely because of their development of a blockchain protocol; or

"(ii) a bank engaging in certain banking activities with respect to a restricted digital asset in the same manner as a bank is excluded from the definition of a broker under paragraph (4).

"(84) DIGITAL ASSET CUSTODIAN.—The term 'digital asset custodian' means an entity in the business of providing custodial or safekeeping services for restricted digital assets for others.

"(85) DIGITAL ASSET DEALER.—The term 'digital asset dealer'—

"(A) means any person engaged in the business of buying and selling restricted digital

assets for such person's own account through a broker or otherwise; and

"(B) does not include—

"(i) a person that buys or sells restricted digital assets for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business;

"(ii) a blockchain protocol or a person or group of persons solely because of their development of a blockchain protocol; or

"(iii) a bank engaging in certain banking activities with respect to a restricted digital asset in the same manner as a bank is excluded from the definition of a dealer under paragraph (5).

"(86) DIGITAL ASSET TRADING SYSTEM.—The term 'digital asset trading system'—

"(A) means any organization, association, person, or group of persons, whether incorporated or unincorporated, that constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of restricted digital assets or for otherwise performing with respect to restricted digital assets

the functions commonly performed by a stock exchange within the meaning of section 240.3b–16 of title 17, Code of Federal Regulations, as in effect on the date of enactment of this paragraph; and

"(B) does not include a blockchain protocol or a person or group of persons solely because of their development of a blockchain protocol.

"(87) NOTICE-REGISTERED DIGITAL ASSET CLEARING AGENCY.—The term 'notice-registered digital asset clearing agency' means a clearing agency that has registered with the Commission pursuant to section 17A(b)(9).

"(88) ADDITIONAL DIGITAL ASSET-RELATED TERMS.—

"(A) SECURITIES ACT OF 1933.—The terms 'affiliated person', 'blockchain system', 'decentralized governance system', 'decentralized system', 'digital asset', 'digital asset issuer', 'digital asset maturity date', 'end user distribution', 'functional system', 'permitted payment stablecoin', 'related person', 'restricted digital asset', and 'source code' have the meaning given those terms, respectively, under sec-

tion 2(a) of the Securities Act of 1933 (15 U.S.C. 77b(a)).

''(B) COMMODITY EXCHANGE ACT.—The terms 'digital commodity', 'digital commodity broker', 'digital commodity dealer', and 'digital commodity exchange' have the meaning given those terms, respectively, under section 1a of the Commodity Exchange Act (7 U.S.C. 1a).''.

SEC. 103. DEFINITIONS UNDER THE COMMODITY EXCHANGE ACT.

Section 1a of the Commodity Exchange Act (7 U.S.C. 1a) is amended—

(1) in paragraph (10)(A)—

(A) by redesignating clauses (iii) and (iv) as clauses (iv) and (v), respectively; and

(B) by inserting after clause (ii) the following:

''(iii) digital commodity;'';

(2) in paragraph (11)—

(A) in subparagraph (A)(i)—

(i) by redesignating subclauses (III) and (IV) as subclauses (IV) and (V), respectively; and

(ii) by inserting after subclause (II) the following:

''(III) digital commodity;''; and

(B) by redesignating subparagraph (B) as subparagraph (C) and inserting after subparagraph (A) the following:

''(B) EXCLUSION.—The term 'commodity pool operator' does not include—

''(i) a decentralized governance system; or

''(ii) any excluded activity, as described in section 4v.'';

(3) in paragraph (12)(A)(i)—

(A) in subclause (II), by adding at the end a semicolon;

(B) by redesignating subclauses (III) and (IV) as subclauses (IV) and (V), respectively; and

(C) by inserting after subclause (II) the following:

''(III) a digital commodity;'';

(4) in paragraph (40)—

(A) by striking ''and'' at the end of subparagraph (E);

(B) by striking the period at the end of subparagraph (F) and inserting ''; and''; and

(C) by adding at the end the following:

''(G) a digital commodity exchange registered under section 5i.''; and

(5) by adding at the end the following:

''(52) ASSOCIATED PERSON OF A DIGITAL COMMODITY BROKER.—

''(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'associated person of a digital commodity broker' means a person who is associated with a digital commodity broker as a partner, officer, employee, or agent (or any person occupying a similar status or performing similar functions) in any capacity that involves—

''(i) the solicitation or acceptance of an order for the purchase or sale of a digital commodity; or

''(ii) the supervision of any person engaged in the solicitation or acceptance of an order for the purchase or sale of a digital commodity.

''(B) EXCLUSION.—The term 'associated person of a digital commodity broker' does not include any person associated with a digital commodity broker the functions of which are solely clerical or ministerial.

''(53) ASSOCIATED PERSON OF A DIGITAL COMMODITY DEALER.—

''(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'associated person of a digital commodity dealer' means a person who is associated with a digital commodity dealer as a partner, officer, employee, or agent (or any person occupying a similar status or performing similar functions) in any capacity that involves—

''(i) the solicitation or acceptance of an order for the purchase or sale of a digital commodity; or

''(ii) the supervision of any person engaged in the solicitation or acceptance of an order for the purchase or sale of a digital commodity.

''(B) EXCLUSION.—The term 'associated person of a digital commodity dealer' does not include any person associated with a digital commodity dealer the functions of which are solely clerical or ministerial.

''(54) BANK SECRECY ACT.—The term 'Bank Secrecy Act' means—

"(A) section 21 of the Federal Deposit Insurance Act (12 U.S.C. 1829b);

"(B) chapter 2 of title I of Public Law 91–508 (12 U.S.C. 1951 et seq.); and

"(C) subchapter II of chapter 53 of title 31, United States Code.

"(55) DIGITAL COMMODITY.—

"(A) IN GENERAL.—The term 'digital commodity' means—

"(i) any unit of a digital asset held by a person, other than the digital asset issuer, a related person, or an affiliated person, before the first date on which each blockchain system to which the digital asset relates is a functional system and certified to be a decentralized system under section 44 of the Securities Exchange Act of 1934, that was—

"(I) issued to the person through an end user distribution described under section 42(d)(1) of the Securities Exchange Act of 1934; or

"(II) acquired by such person in a transaction that was executed on a digital commodity exchange;

"(ii) any unit of a digital asset held by a person, other than the digital asset issuer, a related person, or an affiliated person, after the first date on which each blockchain system to which the digital asset relates is a functional system and certified to be a decentralized system under section 44 of the Securities Exchange Act of 1934; and

"(iii) any unit of a digital asset held by a related person or an affiliated person during any period when any blockchain system to which the digital asset relates is a functional system and certified to be a decentralized system under section 44 of the Securities Exchange Act of 1934.

"(B) EXCLUSION.—The term 'digital commodity' does not include a permitted payment stablecoin.

"(C) TREATMENT OF ADJUDICATED NON-SECURITIES.—If, before enactment of this paragraph, a Federal court in a Securities and Exchange Commission enforcement action determines that a digital asset transaction is not an offer or sale of a security, any unit of a digital

asset transferred pursuant to the transaction shall be considered a digital commodity, unless the determination is overturned.

''(56) DIGITAL COMMODITY BROKER.—

''(A) IN GENERAL.—The term 'digital commodity broker' means any person who, in a digital commodity cash or spot market, is—

''(i) engaged in soliciting or accepting orders for the purchase or sale of a unit of a digital commodity from a person that is not an eligible contract participant;

''(ii) engaged in soliciting or accepting orders for the purchase or sale of a unit of a digital commodity from a person on or subject to the rules of a registered entity; or

''(iii) registered with the Commission as a digital commodity broker.

''(B) EXCEPTIONS.—The term 'digital commodity broker' does not include a person solely because the person—

''(i) enters into a digital commodity transaction the primary purpose of which is to make, send, receive, or facilitate pay-

ments, whether involving a payment service provider or on a peer-to-peer basis;

"(ii) validates a digital commodity transaction, operates a node, or engages in similar activity to participate in facilitating, operating, or securing a blockchain system; or

"(iii) is a bank (as defined under section 3(a) of the Securities Exchange Act of 1934) engaging in certain banking activities with respect to a digital commodity in the same manner as a bank is excluded from the definition of a broker under section 3(a)(4) of the Securities Exchange Act of 1934.

"(57) DIGITAL COMMODITY CUSTODIAN.—The term 'digital commodity custodian' means an entity in the business of holding, maintaining, or safeguarding digital commodities for others.

"(58) DIGITAL COMMODITY DEALER.—

"(A) IN GENERAL.—The term 'digital commodity dealer' means any person who—

"(i) in digital commodity cash or spot markets—

''(I) holds itself out as a dealer in a digital commodity;

''(II) makes a market in a digital commodity;

''(III) has an identifiable business of dealing in a digital commodity as principal for its own account; or

''(IV) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in a digital commodity;

''(ii) has an identifiable business of entering into any agreement, contract, or transaction described in subsection (c)(2)(D)(i) involving a digital commodity; or

''(iii) is registered with the Commission as a digital commodity dealer.

''(B) EXCEPTION.—The term 'digital commodity dealer' does not include a person solely because the person—

''(i) enters into a digital commodity transaction with an eligible contract participant;

"(ii) enters into a digital commodity transaction on or through a registered digital commodity exchange;

"(iii) enters into a digital commodity transaction for the person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business;

"(iv) enters into a digital commodity transaction the primary purpose of which is to make, send, receive, or facilitate payments, whether involving a payment service provider or on a peer-to-peer basis;

"(v) validates a digital commodity transaction, operates a node, or engages in similar activity to participate in facilitating, operating, or securing a blockchain system; or

"(vi) is a bank (as defined under section 3(a) of the Securities Exchange Act of 1934) engaging in certain banking activities with respect to a digital commodity in the same manner as a bank is excluded from the definition of a dealer under section 3(a)(5) of the Securities Exchange Act of 1934.

''(59) DIGITAL COMMODITY EXCHANGE.—The term 'digital commodity exchange' means a trading facility that offers or seeks to offer a cash or spot market in at least 1 digital commodity.

''(60) DIGITAL ASSET-RELATED DEFINITIONS.—

''(A) SECURITIES ACT OF 1933.—The terms 'affiliated person', 'blockchain system', 'decentralized governance system', 'decentralized system', 'digital asset', 'digital asset issuer', 'end user distribution', 'functional system', 'permitted payment stablecoin', 'related person', and 'restricted digital asset' have the meaning given the terms, respectively, under section 2(a) of the Securities Act of 1933 (15 U.S.C. 77b(a)).

''(B) SECURITIES EXCHANGE ACT OF 1934.—The terms 'digital asset broker' and 'digital asset dealer' have the meaning given those terms, respectively, under section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)).

''(61) MIXED DIGITAL ASSET TRANSACTION.—The term 'mixed digital asset transaction' means an

agreement, contract, or transaction involving a digital commodity and—

''(A) a security; or

''(B) a restricted digital asset.''.

SEC. 104. DEFINITIONS UNDER THIS ACT.

In this Act:

(1) DEFINITIONS UNDER THE COMMODITY EXCHANGE ACT.—The terms ''digital commodity'', ''digital commodity broker'', ''digital commodity dealer'', ''digital commodity exchange'', and ''mixed digital asset transaction'' have the meaning given those terms, respectively, under section 1a of the Commodity Exchange Act (7 U.S.C. 1a).

(2) DEFINITIONS UNDER THE SECURITIES ACT OF 1933.—The terms ''affiliated person'', ''blockchain'', ''blockchain system'', ''blockchain protocol'', ''decentralized system'', ''digital asset'', ''digital asset issuer'', ''digital asset maturity date'', ''digital asset trading system'', ''end user distribution'', ''functional system'', ''permitted payment stablecoin'', ''restricted digital asset'', ''securities laws'', and ''source code'' have the meaning given those terms, respectively, under section 2(a) of the Securities Act of 1933 (15 U.S.C. 77b(a)).

(3) DEFINITIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934.—The terms ''Bank Secrecy Act'', ''digital asset broker'', ''digital asset dealer'', ''digital asset trading system'', and ''self-regulatory organization'' have the meaning given those terms, respectively, under section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)).

SEC. 105. RULEMAKINGS.

(a) DEFINITIONS.—The Commodity Futures Trading Commission and the Securities and Exchange Commission shall jointly issue rules to further define the following terms:

(1) The terms ''affiliated person'', ''blockchain'', ''blockchain system'', ''blockchain protocol'', ''decentralized system'', ''decentralized governance system'', ''digital asset'', ''digital asset issuer'', ''digital asset maturity date'', ''end user distribution'', ''functional system'', ''related person'', ''restricted digital asset'', and ''source code'', as defined under section 2(a) of the Securities Act of 1933.

(2) The term ''digital commodity'', as defined under section 1a of the Commodity Exchange Act.

(b) JOINT RULEMAKING FOR EXCHANGES AND INTERMEDIARIES.—The Commodity Futures Trading

Commission and the Securities and Exchange Commission shall jointly issue rules to exempt persons dually registered with the Commodity Futures Trading Commission and the Securities and Exchange Commission from duplicative, conflicting, or unduly burdensome provisions of this Act, the securities laws, and the Commodity Exchange Act and the rules thereunder, to the extent such exemption would foster the development of fair and orderly markets in digital assets, be necessary or appropriate in the public interest, and be consistent with the protection of investors.

(c) JOINT RULEMAKING FOR MIXED DIGITAL ASSET TRANSACTIONS.—The Commodity Futures Trading Commission and the Securities and Exchange Commission shall jointly issue rules applicable to mixed digital asset transactions under this Act and the amendments made by this Act, including by further defining such term.

(d) PROTECTION OF SELF-CUSTODY.—

(1) IN GENERAL.—The Financial Crimes Enforcement Network may not issue any rule or order that would prohibit a U.S. individual from—

(A) maintaining a hardware wallet, software wallet, or other means to facilitate such individual's own custody of digital assets; or

(B) conducting transactions with and self-custody of digital assets for any lawful purpose.

(2) RULE OF CONSTRUCTION.—Paragraph (1) may not be construed to limit the ability of Financial Crimes Enforcement Network to carry out any enforcement action.

(e) JOINT RULEMAKING, PROCEDURES, OR GUIDANCE FOR DELISTING.—Not later than 30 days after the date of the enactment of this Act, the Commodity Futures Trading Commission and the Securities and Exchange Commission shall jointly issue rules, procedures, or guidance (as determined appropriate by the Commissions) regarding the process to delist an asset for trading under sections 106 and 107 of this Act if the Commissions determine that the listing is inconsistent with the Commodity Exchange Act, the securities laws (including regulations under those laws), or this Act.

(f) JOINT RULEMAKING FOR CAPITAL REQUIREMENTS.—The Commodity Futures Trading Commission and the Securities and Exchange Commission shall jointly issue rules to require a person with multiple registrations with the Commodity Futures Trading Commission, the Securities and Exchange Commission, or both such agencies to maintain sufficient capital to comply with the stricter of any applicable capital requirements to which such person is subject to by reason of such registrations.

SEC. 106. NOTICE OF INTENT TO REGISTER FOR DIGITAL COMMODITY EXCHANGES, BROKERS, AND DEALERS.

(a) IN GENERAL.—

(1) NOTICE OF INTENT TO REGISTER.—Any person may file a notice of intent to register with the Commodity Futures Trading Commission (in this subsection referred to as the ''Commission'') as a—

(A) digital commodity exchange, for a person intending to register as a digital commodity exchange under section 5i of the Commodity Exchange Act;

(B) digital commodity broker, for a person intending to register as a digital commodity broker under section 4u of such Act; or

(C) digital commodity dealer, for a person intending to register as a digital commodity dealer under section 4u of such Act.

(2) CONDITIONS.—A person filing a notice of intent to register under paragraph (1) shall be in compliance with this section if the person—

(A) submits to the Commission and continues to materially update a statement of the nature of the registrations the filer intends to pursue;

(B) submits to the Commission and continues to materially update the information required by subsections (b) and (c);

(C) complies with subsection (d);

(D) is a member of a futures association registered under section 17 of the Commodity Exchange Act, and complies with the rules of the association, including the rules of the association pertaining to customer disclosures and protection of customer assets; and

(E) pays all fees and penalties imposed on the person under section 510 of this Act.

(b) DISCLOSURE OF GENERAL INFORMATION.—A person filing a notice of intent to register under subsection (a) shall disclose to the Commission the following:

(1) Information concerning the management of the person, including information describing—

(A) the ownership and management of the person;

(B) the financial condition of the person;

(C) affiliated entities;

(D) potential conflicts of interest;

(E) the address of the person, including—

(i) the place of incorporation;

(ii) principal place of business; and

(iii) an address for service of process; and

(F) a list of the States in which the person has operations.

(2) Information concerning the operations of the person, including—

(A) a general description of the person's business and the terms of service for United States customers;

(B) a description of the person's account approval process;

(C) any rulebook or other customer order fulfilment rules;

(D) risk management procedures;

(E) a description of the product listing process; and

(F) anti-money laundering policies and procedures.

(c) LISTING INFORMATION.—A person filing a notice of intent to register under subsection (a) shall provide to the Commission and the Securities and Exchange Commission a detailed description of—

(1) the specific characteristics of each digital asset listed or offered by the person, including infor-

mation regarding the digital asset's market activity, distribution, and functional use; and

(2) the product listing determination made by the person for each asset listed or offered for trading by the person.

(d) REQUIREMENTS.—A person filing a notice of intent to register under subsection (a) shall comply with the following requirements:

(1) STATUTORY DISQUALIFICATIONS.—Except to the extent otherwise specifically provided by Commission or registered futures association rule, regulation, or order, the person shall not permit an individual who is subject to a statutory disqualification under paragraph (2) or (3) of section 8a of the Commodity Exchange Act to effect or be involved in effecting transactions on behalf of the person, if the person knew, or in the exercise of reasonable care should have known, of the statutory disqualification.

(2) BOOKS AND RECORDS.—The person shall keep their books and records open to inspection and examination by the Commission and by any registered futures association of which the person is a member.

(3) CUSTOMER DISCLOSURES.—The person shall disclose to customers—

(A) information about the material risks and characteristics of the assets listed for trading on the person;

(B) information about the material risks and characteristics of the transactions facilitated by the person;

(C) information about the location and manner in which the digital assets of the customer will be and are custodied;

(D) information concerning the policies and procedures of the person that are related to the protection of the data of customers of the person; and

(E) in their disclosure documents, offering documents, and promotional material—

(i) in a prominent manner, that they are not registered with or regulated by the Commission; and

(ii) the contact information for the whistleblower, complaint, and reparation programs of the Commission.

(4) CUSTOMER ASSETS.—

(A) IN GENERAL.—The person shall—

(i) hold customer money, assets, and property in a manner to minimize the risk

of loss to the customer or unreasonable delay in customer access to money, assets, and property of the customer;

(ii) treat and deal with all money, assets, and property, including any rights associated with any such money, assets, or property, of any customer received as belonging to the customer;

(iii) calculate the total digital asset obligations of the person, and at all times hold money, assets, or property equal to or in excess of the total digital asset obligations; and

(iv) not commingle such money, assets and property held to meet the total commodity obligation with the funds of the person or use the money, assets, or property to margin, secure, or guarantee any trade or contract, or to secure or extend the credit, of any customer or person other than the one for whom the same are held, except that—

(I) the money, assets, and property of any customer may be commin-

gled with that of any other customer, if separately accounted for; and

(II) the share of the money, assets, and property, as in the normal course of business are necessary to margin, guarantee, secure, transfer, adjust, or settle a contract of sale of a commodity asset, may be withdrawn and applied to do so, including the payment of commissions, brokerage, interest, taxes, storage, and other charges lawfully accruing in connection with the contract of sale of a digital commodity.

(B) ADDITIONAL RESOURCES.—

(i) IN GENERAL.—This section shall not prevent or be construed to prevent the person from adding to the customer money, assets, and property required to be segregated under subparagraph (A), additional amounts of money, assets, or property from the account of the person as the person determines necessary to hold money, assets, or property equal to or in

excess of the total digital asset obligations of the person.

(ii) TREATMENT AS CUSTOMER FUNDS.—Any money, assets, or property deposited pursuant to clause (i) shall be considered customer property within the meaning of this subsection.

(e) COMPLIANCE.—

(1) IN GENERAL.—A person who has filed a notice of intent to register under this section and is in compliance with this section shall be exempt from Securities and Exchange Commission rules and regulations pertaining to registering as a national securities exchange, broker, dealer, or clearing agency, for activities related to a digital asset.

(2) NONCOMPLIANCE.—Paragraph (1) shall not apply if, after notice from the Commission and a reasonable opportunity to correct the deficiency, a person who has submitted a notice of intent to register is not in compliance with this section.

(3) ANTI-FRAUD AND ANTI-MANIPULATION.—Paragraph (1) shall not be construed to limit any anti-fraud, anti-manipulation, or false reporting enforcement authority of the Commission, the Securi-

ties and Exchange Commission, a registered futures association, or a national securities association.

(4) DELISTING.—Paragraph (1) shall not be construed to limit the authority of the Commission and the Securities and Exchange Commission to jointly require a person to delist an asset for trading if the Commission and the Securities and Exchange Commission determines that the listing is inconsistent with the Commodity Exchange Act, the securities laws (including regulations under those laws), or this Act.

(f) REGISTRATION.—

(1) IN GENERAL.—A person may not file a notice of intent to register with the Commission after the Commission has finalized its rules for the registration of digital commodity exchanges, digital commodity brokers, or digital commodity dealers, as appropriate.

(2) TRANSITION TO REGISTRATION.—Subsection (e)(1) shall not apply to a person who has submitted a notice of intent to register if—

(A) the Commission—

(i) determines that the person has failed to comply with the requirements of this section; or

(ii) denies the application of the person to register; or

(B) the digital commodity exchange, digital commodity broker, or digital commodity dealer that filed a notice of intent to register failed to apply for registration as such with the Commission within 180 days after the effective date of the final rules of the Commission for the registration of digital commodity exchanges, digital commodity brokers, or digital commodity dealers, as appropriate.

(g) RULEMAKING.—

(1) IN GENERAL.—Within 180 days after the date of the enactment of this Act, a registered futures association shall adopt and enforce rules applicable to persons required by subsection (a)(3) to be members of the association.

(2) FEES.—The rules adopted under paragraph (1) may provide for dues in accordance with section 17(b)(6) of the Commodity Exchange Act.

(3) EFFECT.—A registered futures association shall submit to the Commission any rule adopted under paragraph (1), which shall take effect pursuant to the requirements of section 17(j) of the Commodity Exchange Act.

(h) LIABILITY OF THE FILER.—It shall be unlawful for any person to provide false information in support of a filing under this section if the person knew or reasonably should have known that the information was false.

(i) WHISTLEBLOWER ENFORCEMENT.—For purposes of section 23 of the Commodity Exchange Act, the term ''this Act'' includes this section.

SEC. 107. NOTICE OF INTENT TO REGISTER FOR DIGITAL ASSET BROKERS, DEALERS, AND TRADING SYSTEMS.

(a) IN GENERAL.—

(1) NOTICE OF INTENT TO REGISTER.—Any person may file a notice of intent to register with the Securities and Exchange Commission (in this section referred to as the ''Commission'') as—

(A) a digital asset trading system, for a person intending to register as a digital asset trading system under section 6(m) of the Securities Exchange Act of 1934;

(B) a digital asset broker, for a person intending to register as a digital asset broker under section 15H of the Securities Exchange Act of 1934; or

(C) a digital asset dealer, for a person intending to register as a digital asset dealer

under section 15H of the Securities Exchange Act of 1934.

(2) CONDITIONS.—A person filing a notice of intent to register under paragraph (1) shall be in compliance with this section if the person—

(A) submits to the Commission and continues to materially update a statement of the nature of the registrations the filer intends to pursue;

(B) submits to the Commission and continues to materially update the information required by subsections (b) and (c);

(C) complies with the requirements of subsection (d); and

(D) is a member of a national securities association registered under section 15A of the Securities Exchange Act of 1934 (15 U.S.C. 78o–3) and complies with the rules of the association, including the rules of the association pertaining to customer disclosures and protection of customer assets.

(b) DISCLOSURE OF GENERAL INFORMATION.—A person filing a notice of intent to register under subsection (a) shall disclose to the Commission the following:

(1) Information concerning the management of the person, including information describing—

(A) the ownership and management of the person;

(B) the financial condition of the person;

(C) affiliated entities;

(D) potential conflicts of interest;

(E) the address of the person, including—

(i) the place of incorporation;

(ii) the principal place of business; and

(iii) an address for service of process; and

(F) a list of the States in which the person has operations.

(2) Information concerning the operations of the person, including—

(A) a general description of the person's business and the terms of service for United States customers;

(B) a description of the person's account approval process;

(C) any rulebook or other customer order fulfilment rules;

(D) risk management procedures;

(E) a description of the product listing process; and

(F) anti-money laundering policies and procedures.

(c) LISTING INFORMATION.—A person filing a notice of intent to register under subsection (a) shall provide to the Commission and the Commodity Futures Trading Commission a detailed description of—

(1) the specific characteristics of each digital asset listed or offered for trading by the person, including information regarding the digital asset's market activity, distribution, and functional use; and

(2) the product listing determination made by the person for each asset listed or offered for trading by the person.

(d) REQUIREMENTS.—A person filing a notice of intent to register under subsection (a) shall comply with the following requirements:

(1) STATUTORY DISQUALIFICATION.—Except to the extent otherwise specifically provided by Commission or a national securities association rule, regulation, or order, the person may not permit an individual who is subject to a statutory disqualification (as defined under section 3(a) of the Securities Exchange Act of 1934) to effect or be involved in ef-

fecting transactions on behalf of the person if the person knows, or in the exercise of reasonable discretion should know, the individual is subject to a statutory disqualification.

(2) BOOKS AND RECORDS.—The person shall keep their books and records open to inspection and examination by the Commission and any national securities association of which they are a member.

(3) CUSTOMER DISCLOSURES.—The person shall disclose to customers—

(A) information about the material risks and characteristics of the assets listed for trading on the person;

(B) information about the material risks and characteristics of the transactions facilitated by the person;

(C) information about the location and manner in which the digital assets of the customer will be and are custodied;

(D) information concerning the person's policies and procedures related to the protection of customers' data; and

(E) in their disclosure documents, offering documents, and promotional material—

(i) in a prominent manner, that they are not registered with or regulated by the Commission; and

(ii) the contact information for the whistleblower, complaint, and reparation programs of the Commission.

(4) CUSTOMER ASSETS.—

(A) IN GENERAL.—The person shall—

(i) hold customer money, assets, and property in a manner to minimize the risk of loss to the customer or unreasonable delay in customer access to money, assets, and property of the customer;

(ii) treat and deal with all money, assets, and property, including any rights associated with any such money, assets, or property, of any customer received as belonging to the customer;

(iii) segregate all money, assets, and property received from any customer of the person from the funds of the person, except that—

(I) the money, assets, and property of any customer may be commin-

gled with that of any other customer, if separately accounted for; and

(II) the share of the money, assets, and property, as in the normal course of business are necessary to margin, guarantee, secure, transfer, adjust, or settle a contract of sale of a digital asset, may be withdrawn and applied to do so, including the payment of commissions, brokerage, interest, taxes, storage, and other charges lawfully accruing in connection with the contract of sale of a digital asset.

(B) ADDITIONAL RESOURCES.—

(i) IN GENERAL.—This section shall not prevent or be construed to prevent the person from adding to the customer money, assets, and property required to be segregated under subparagraph (A) additional amounts of money, assets, or property from the account of the person as the person determines necessary to hold money, assets, or property equal to or in

excess of the total digital asset obligation of the person.

(ii) TREATMENT AS CUSTOMER FUNDS.—Any money, assets, or property deposited pursuant to clause (i) shall be considered customer property within the meaning of this subsection.

(e) COMPLIANCE.—

(1) IN GENERAL.—A person who has filed a notice of intent to register under this section and is in compliance with this section shall be exempt from Commission rules and regulations pertaining to registering as a national securities exchange, broker, dealer, or clearing agency, for activities related to a digital asset.

(2) NONCOMPLIANCE.—Paragraph (1) shall not apply if, after notice from the Commission and a reasonable opportunity to correct the deficiency, a person who has submitted a notice of intent to register is not in compliance with this section.

(3) ANTI-FRAUD AND ANTI-MANIPULATION.—Paragraph (1) shall not be construed to limit any fraud, anti-manipulation, or false reporting enforcement authority of the Commission, the Commodity

Futures Trading Commission, a registered futures association, or a national securities association.

(4) DELISTING.—Paragraph (1) shall not be construed to limit the authority of the Commission and the Commodity Futures Trading Commission to jointly require a person to delist an asset for trading if the Commission and the Commodity Futures Trading Commission determines that the listing is inconsistent with the Commodity Exchange Act, the securities laws (including regulations under those laws), or this Act.

(f) REGISTRATION.—

(1) IN GENERAL.—A person may not file a notice of intent to register with the Commission after the Commission has finalized its rules for the registration of digital asset brokers, digital asset dealers, digital asset trading systems, and notice-registered clearing agencies, as appropriate.

(2) TRANSITION TO REGISTRATION.—Subsection (e)(1) shall not apply to a person who has submitted a notice of intent to register if—

(A) the Commission—

(i) determines that the person has failed to comply with the requirements of this section; or

(ii) denies the application of the person to register; or

(B) the digital asset broker, digital asset dealer, or digital asset trading system that filed a notice of intent to register failed to apply for registration as such with the Commission within 180 days after the effective date of the Commission's final rules for the registration of digital asset brokers, digital asset dealers, and digital asset trading systems, as appropriate.

(g) LIABILITY OF THE FILER.—It shall be unlawful for any person to provide false information in support of a filing under this section if the person knew or reasonably should have known that the information was false.

(h) NATIONAL SECURITIES ASSOCIATION.—

(1) IN GENERAL.—A national securities association may adopt and enforce rules written specifically for persons filing a notice of intent to register under subsection (a), including rules that prescribe reasonable fees and charges to defray the costs of the national securities association related to overseeing such persons.

(2) APPROVAL BY THE COMMISSION.—With respect to a provisional rule described under para-

graph (1) filed with the Commission, the Commission shall—

(A) not later than 90 days following the date of such filing, approve the rule if the Commission determines that the rule effectuates the purposes of this section; and

(B) make such approval on a summary basis pursuant to section 19(b)(3)(B) of the Securities Exchange Act of 1934.

(i) WHISTLEBLOWER ENFORCEMENT.—For purposes of section 21F of the Securities Exchange Act of 1934 (15 U.S.C. 78u-6), the term ''securities laws'' includes this section.

SEC. 108. COMMODITY EXCHANGE ACT SAVINGS PROVISIONS.

(a) IN GENERAL.—Nothing in this Act shall affect or apply to, or be interpreted to affect or apply to—

(1) any agreement, contract, or transaction that is subject to the Commodity Exchange Act as—

(A) a contract of sale of a commodity for future delivery or an option on such a contract;

(B) a swap;

(C) a security futures product;

(D) an option authorized under section 4c of such Act;

(E) an agreement, contract, or transaction described in section 2(c)(2)(C)(i) of such Act; or

(F) a leverage transaction authorized under section 19 of such Act; or

(2) the activities of any person with respect to any such agreement, contract, or transaction.

(b) PROHIBITIONS ON SPOT DIGITAL COMMODITY ENTITIES.—Nothing in this Act authorizes, or shall be interpreted to authorize, a digital commodity exchange, digital commodity broker, or digital commodity dealer to engage in any activities involving any transaction, contract, or agreement described in subsection (a)(1), solely by virtue of being registered or filing notice of intent to register as a digital commodity exchange, digital commodity broker, or digital commodity dealer.

(c) DEFINITIONS.—In this section, each term shall have the meaning provided in the Commodity Exchange Act or the regulations prescribed under such Act.

SEC. 109. ADMINISTRATIVE REQUIREMENTS.

(a) SECURITIES AND EXCHANGE ACT OF 1934.—Section 21A of the Securities and Exchange Act of 1934 (15 U.S.C. 78u-1) is amended by adding at the end the following:

''(j) DUTY OF MEMBERS AND FEDERAL EMPLOYEES RELATED TO DIGITAL ASSETS.—

''(1) IN GENERAL.—Solely for purposes of the insider trading prohibitions arising under this Act, including section 10 and Rule 10b–5 thereunder, each individual who is a Member of Congress, an employee of Congress, or an employee or agent of any department or agency of the Federal Government owes a duty arising from a relationship of trust and confidence to the Congress, the United States Government, and the citizens of the United States with respect to material, nonpublic information related to a restricted digital asset that is derived from such individual's position as a Member of Congress, employee of Congress, or as an employee or agent of a department or agency of the Federal Government or gained from the performance of such individual's official responsibilities.

''(2) DEFINITIONS.—In this subsection, the terms 'Member of Congress' and 'employee of Congress' have the meaning given those terms, respectively, under subsection (g)(2).''.

(b) COMMODITY EXCHANGE ACT.—Section 4c(a) of the Commodity Exchange Act (7 U.S.C. 6c(a)) is amended—

(1) in paragraph (3)—

(A) in subparagraph (B), by striking ''or'' at the end;

(B) in subparagraph (C), by striking the period and inserting ''; or''; and

(C) by adding at the end the following:

''(D) a contract of sale of a digital commodity.'';

(2) in paragraph (4)—

(A) in subparagraph (A)—

(i) in clause (ii), by striking ''or'' at the end;

(ii) in clause (iii), by striking the period and inserting ''; or''; and

(iii) by adding at the end the following:

''(iv) a contract of sale of a digital commodity.'';

(B) in subparagraph (B)—

(i) in clause (ii), by striking ''or'' at the end;

(ii) in clause (iii), by striking the period and inserting ''; or''; and

(iii) by adding at the end the following:

''(iv) a contract of sale of a digital commodity.''; and

(C) in subparagraph (C)—

(i) in clause (ii), by striking ''or'' at the end;

(ii) by striking ''(iii) a swap, provided however,'' and inserting the following:

''(iii) a swap; or

''(iv) a contract of sale of a digital commodity,

provided, however,''; and

(iii) by striking ''clauses (i), (ii), or (iii)'' and insert ''any of clauses (i) through (iv)''.

SEC. 110. INTERNATIONAL HARMONIZATION.

In order to promote effective and consistent global regulation of digital assets, the Commodity Futures Trading Commission and the Securities and Exchange Commission, as appropriate—

(1) shall consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation of digital assets, restricted digital assets, and digital commodities; and

(2) may agree to such information-sharing arrangements as may be deemed to be necessary or appropriate in the public interest or for the protection of investors, customers, and users of digital assets.

SEC. 111. IMPLEMENTATION.

(a) GLOBAL RULEMAKING TIMEFRAME.—Unless otherwise provided in this Act or an amendment made by this Act, the Commodity Futures Trading Commission and the Securities and Exchange Commission, or both, shall individually, and jointly where required, promulgate rules and regulations required of each Commission under this Act or an amendment made by this Act not later than 360 days after the date of enactment of this Act.

(b) RULES AND REGISTRATION BEFORE FINAL EFFECTIVE DATES.—

(1) IN GENERAL.—In order to prepare for the implementation of this Act, the Commodity Futures Trading Commission and the Securities and Exchange Commission may, before any effective date provided in this Act—

(A) promulgate rules, regulations, or orders permitted or required by this Act;

(B) conduct studies and prepare reports and recommendations required by this Act;

(C) register persons under this Act; and

(D) exempt persons, agreements, contracts, or transactions from provisions of this Act, under the terms contained in this Act.

(2) LIMITATION ON EFFECTIVENESS.—An action by the Commodity Futures Trading Commission or the Securities and Exchange Commission under paragraph (1) shall not become effective before the effective date otherwise applicable to the action under this Act.

SEC. 112. APPLICATION OF THE BANK SECRECY ACT.

(a) IN GENERAL.—Section 5312 of title 31, United States Code, is amended—

(1) in subsection (a)(2)(G), by striking ''or dealer'' and inserting '', dealer, digital asset broker, digital asset dealer, or digital asset trading system''; and

(2) in subsection (c)(1)(A)—

(A) by inserting ''digital commodity broker, digital commodity dealer,'' after ''futures commission merchant,''; and

(B) by inserting before the period the following: ''and any digital commodity exchange registered, or required to register, under the

Commodity Exchange Act which permits direct customer access''.

(b) GAO STUDY.—

(1) IN GENERAL.—The Comptroller General of the United States, in consultation with the Secretary of the Treasury, shall conduct a study to—

(A) assess the risks posed by centralized intermediaries that are primarily located in foreign jurisdictions that provide services to U.S. persons without regulatory requirements that are substantially similar to the requirements of the Bank Secrecy Act; and

(B) provide any regulatory or legislative recommendations to address these risks under subparagraph (A).

(2) REPORT.—Not later than 1 year after the date of enactment of this Act, the Comptroller General shall issue a report to Congress containing all findings and determinations made in carrying out the study required under paragraph (1).

TITLE II—CLARITY FOR ASSETS OFFERED AS PART OF AN INVESTMENT CONTRACT

SEC. 201. SHORT TITLE.

This title may be referred to as the ''Securities Clarity Act of 2024''.

SEC. 202. TREATMENT OF INVESTMENT CONTRACT ASSETS.

(a) SECURITIES ACT OF 1933.—Section 2(a) of the Securities Act of 1933 (15 U.S.C. 77b(a)), as amended by section 101, is further amended—

(1) in paragraph (1), by adding at the end the following: ''The term 'security' does not include an investment contract asset.''; and

(2) by adding at the end the following:

''(37) The term 'investment contract asset' means a fungible digital representation of value—

''(A) that can be exclusively possessed and transferred, person to person, without necessary reliance on an intermediary, and is recorded on a cryptographically secured public distributed ledger;

''(B) sold or otherwise transferred, or intended to be sold or otherwise transferred, pursuant to an investment contract; and

''(C) that is not otherwise a security pursuant to the first sentence of paragraph (1).''.

(b) INVESTMENT ADVISERS ACT OF 1940.—Section 202(a)(18) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2(a)(18)) is amended by adding at the end the following: ''The term 'security' does not include an investment contract asset (as such term is defined under section 2(a) of the Securities Act of 1933).''.

(c) INVESTMENT COMPANY ACT OF 1940.—Section 2(a)(36) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(36)) is amended by adding at the end the following: ''The term 'security' does not include an investment contract asset (as such term is defined under section 2(a) of the Securities Act of 1933).''.

(d) SECURITIES EXCHANGE ACT OF 1934.—Section 3(a)(10) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(10)) is amended by adding at the end the following: ''The term 'security' does not include an investment contract asset (as such term is defined under section 2(a) of the Securities Act of 1933).''.

(e) SECURITIES INVESTOR PROTECTION ACT OF 1970.—Section 16(14) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78lll(14)) is amended by adding at the end the following: ''The term 'security' does not include an investment contract asset (as such term

is defined under section 2(a) of the Securities Act of 1933).''.

TITLE III—OFFERS AND SALES OF DIGITAL ASSETS

SEC. 301. EXEMPTED TRANSACTIONS IN DIGITAL ASSETS.

(a) IN GENERAL.—The Securities Act of 1933 (15 U.S.C. 77a et seq.) is amended—

(1) in section 4(a), by adding at the end the following:

''(8) transactions involving the offer or sale of units of a digital asset by a digital asset issuer, if—

''(A) the aggregate amount of units of the digital asset sold by the digital asset issuer in reliance on the exemption provided under this paragraph, during the 12-month period preceding the date of such transaction, including the amount sold in such transaction, is not more than $75,000,000 (as such amount is annually adjusted by the Commission to reflect the change in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics of the Department of Labor);

''(B) with respect to a transaction involving the purchase of units of a digital asset by a person who is not an accredited investor, the

aggregate amount of all units of digital assets purchased by such person during the 12-month period preceding the date of such transaction, including the unit of a digital asset purchased in such transaction, does not exceed the greater of—

"(i) 10 percent of the person's annual income or joint income with that person's spouse or spousal equivalent; or

"(ii) 10 percent of the person's net worth or joint net worth with the person's spouse or spousal equivalent;

"(C) after the completion of the transaction, the purchaser does not own more than 10 percent of the total amount of the units of the digital asset sold in reliance on the exemption under this paragraph;

"(D) the transaction does not involve the offer or sale of any digital asset not offered as part of an investment contract;

"(E) the transaction does not involve the offer or sale of a unit of a digital asset by a digital asset issuer that—

"(i) is not organized under the laws of a State, a territory of the United States, or the District of Columbia;

"(ii) is a development stage company that either—

"(I) has no specific business plan or purpose; or

"(II) has indicated that the business plan of the company is to merge with or acquire an unidentified company;

"(iii) is an investment company, as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), or is excluded from the definition of investment company by section 3(b) or section 3(c) of that Act (15 U.S.C. 80a–3(b) or 80a–3(c));

"(iv) is issuing fractional undivided interests in oil or gas rights, or a similar interest in other mineral rights;

"(v) is, or has been, subject to any order of the Commission entered pursuant to section 12(j) of the Securities Exchange

Act of 1934 during the 5-year period before the filing of the offering statement; or

"(vi) is disqualified pursuant to section 230.262 of title 17, Code of Federal Regulations; and

"(F) the issuer meets the requirements of section 4B(a)."; and

(2) by inserting after section 4A the following:

"SEC. 4B. REQUIREMENTS WITH RESPECT TO CERTAIN DIGITAL ASSET TRANSACTIONS.

"(a) REQUIREMENTS FOR DIGITAL ASSET ISSUERS.—

"(1) INFORMATION REQUIRED IN STATEMENT.—A digital asset issuer offering or selling a unit of digital asset in reliance on section 4(a)(8) shall file with the Commission a statement containing the following information:

"(A) The name, legal status (including the jurisdiction in which the issuer is organized and the date of organization), and website of the digital asset issuer.

"(B) The address and telephone number of the issuer or a legal representative of the issuer.

"(C) A certification that the digital asset issuer meets the relevant requirements described under section 4(a)(8).

"(D) An overview of the material aspects of the offering.

"(E) A description of the purpose and intended use of the offering proceeds.

"(F) A description of the plan of distribution of any unit of a digital asset that is to be offered.

"(G) A description of the material risks surrounding ownership of a unit of a digital asset.

"(H) A description of the material aspects of the digital asset issuer's business.

"(I) A description of exempt offerings conducted within the past three years by the digital asset issuer.

"(J) A description of the digital asset issuer and the current number of employees of the digital asset issuer.

"(K) A description of any material transactions or relationships between the digital asset issuer and affiliated persons.

"(L) A description of exempt offerings conducted within the past three years.

"(2) INFORMATION REQUIRED FOR PURCHASERS.—A digital asset issuer that has filed a statement under paragraph (1) to offer and sell a unit of a digital asset in reliance on section 4(a)(8) shall disclose the information described under section 43 of the Securities Exchange Act of 1934 on a freely accessible public website.

"(3) ONGOING DISCLOSURE REQUIREMENTS.—A digital asset issuer that has filed a statement under paragraph (1) to offer and sell a unit of a digital asset in reliance on section 4(a)(8) shall file the following with the Commission:

"(A) ANNUAL REPORTS.—An annual report that includes any material changes to the information described under paragraph (2) for the current fiscal year and for any fiscal year thereafter, unless the issuer is no longer obligated to file such annual report pursuant to paragraph (4).

"(B) SEMIANNUAL REPORTS.—Along with each annual report required under subparagraph (A), and separately six months thereafter, a report containing—

''(i) an updated description of the current state and timeline for the development of the blockchain system to which the digital asset relates, showing how and when the blockchain system intends or intended to be considered a functional system and a decentralized system;

''(ii) the amount of money raised by the digital asset issuer in reliance on section 4(a)(8), how much of that money has been spent, and the general categories and amounts on which that money has been spent; and

''(iii) any material changes to the information in the most recent annual report.

''(C) CURRENT REPORTS.—A current report shall be filed with the Commission reflecting any material changes to the information previously reported to the Commission by the digital asset issuer.

''(4) TERMINATION OF REPORTING REQUIREMENTS.—

''(A) IN GENERAL.—The ongoing reporting requirements under paragraph (3) shall not

apply to a digital asset issuer 180 days after the end of the covered fiscal year.

''(B) COVERED FISCAL YEAR DEFINED.—In this paragraph, the term 'covered fiscal year' means the first fiscal year of an issuer in which the blockchain system to which the digital asset relates is a functional system and certified to be a decentralized system under section 44 of the Securities Exchange Act of 1934.

''(b) REQUIREMENTS FOR INTERMEDIARIES.—

''(1) IN GENERAL.—A person acting as an intermediary in a transaction involving the offer or sale of a unit of a digital asset in reliance on section 4(a)(8) shall—

''(A) register with the Commission as a digital asset broker; and

''(B) be a member of a national securities association registered under section 15A of the Securities Exchange Act of 1934 (15 U.S.C. 78o–3).

''(2) PURCHASER QUALIFICATION.—

''(A) IN GENERAL.—Each time, before accepting any commitment (including any additional commitment from the same person), an intermediary or digital asset issuer shall have a

reasonable basis for believing that the purchaser satisfies the requirements of section 4(a)(8).

"(B) RELIANCE ON PURCHASER'S REPRESENTATIONS.—For purposes of subparagraph (A), an intermediary or digital asset issuer may rely on a purchaser's representations concerning the purchaser's annual income and net worth and the amount of the purchaser's other investments made, unless the intermediary or digital asset issuer has reason to question the reliability of the representation.

"(C) RELIANCE ON ISSUER.—For purposes of determining whether a transaction meets the requirements described under subparagraph (A) through (C) of section 4(a)(8), an intermediary may rely on the efforts of a digital asset issuer.

"(c) ADDITIONAL PROVISIONS.—

"(1) ACCEPTANCE OF WRITTEN OFFERS; SALES.—After an issuer files a statement under paragraph (1) to offer and sell a digital asset in reliance on section 4(a)(8)—

"(A) written offers of the digital asset may be made; and

"(B) the issuer may sell the digital assets in reliance on section 4(a)(8), if such sales meet all other requirements.

"(2) SOLICITATION OF INTEREST.—

"(A) IN GENERAL.—At any time before the filing of a statement under paragraph (1), a digital asset issuer may communicate orally or in writing to determine whether there is any interest in a contemplated offering. Such communications are deemed to be an offer of a unit of a digital asset for sale for purposes of the anti-fraud provisions of the Federal securities laws. No solicitation or acceptance of money or other consideration, nor of any commitment, binding or otherwise, from any person is permitted until the statement is filed.

"(B) CONDITIONS.—In any communication described under subparagraph (A), the digital asset issuer shall—

"(i) state that no money or other consideration is being solicited, and if sent in response, will not be accepted;

"(ii) state that no offer to buy a unit of a digital asset can be accepted and no part of the purchase price can be received

until the statement is filed and then only through an intermediary; and

"(iii) state that a person's indication of interest involves no obligation or commitment of any kind.

"(C) INDICATIONS OF INTEREST.—Any written communication described under subparagraph (A) may include a means by which a person may indicate to the digital asset issuer that such person is interested in a potential offering. A digital asset issuer may require a name, address, telephone number, or email address in any response form included with a communication described under subparagraph (A).

"(3) DISQUALIFICATION PROVISIONS.—The Commission shall issue rules to apply the disqualification provisions under section 230.262 of title 17, Code of Federal Regulations, to the exemption provided under section 4(a)(8).".

(b) ADDITIONAL EXEMPTIONS.—

(1) CERTAIN REGISTRATION REQUIREMENTS.—Section 12(g)(6) of the Securities Exchange Act of 1934 (15 U.S.C. 78l(g)(6)) is amended by striking

"under section 4(6)" and inserting "under section 4(a)(6) or 4(a)(8)".

(2) EXEMPTION FROM STATE REGULATION.—Section 18(b)(4) of the Securities Act of 1933 (15 U.S.C. 77r(b)(4)) is amended—

(A) in section (B), by striking "section 4(4)" and inserting "section 4(a)(4)";

(B) in section (C), by striking "section 4(6)" and inserting "section 4(a)(6)";

(C) in subparagraph (F)—

(i) by striking "section 4(2)" each place such term appears and inserting "section 4(a)(2)";

(ii) by striking "or" at the end;

(D) in subparagraph (G), by striking the period and inserting "; or"; and

(E) by adding at the end the following:

"(H) section 4(a)(8).".

SEC. 302. REQUIREMENTS FOR OFFERS AND SALES OF CERTAIN DIGITAL ASSETS.

(a) IN GENERAL.—Title I of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by adding at the end the following:

"SEC. 42. REQUIREMENTS FOR OFFERS AND SALES OF CERTAIN DIGITAL ASSETS.

"(a) OFFERS AND SALES OF CERTAIN RESTRICTED DIGITAL ASSETS.—

"(1) IN GENERAL.—Notwithstanding any other provision of law, subject to paragraph (2), a restricted digital asset may be offered and sold on a digital asset trading system by any person other than a digital asset issuer if, at the time of such offer or sale, any blockchain system to which the restricted digital asset relates is a functional system and the information described in section 43 has been certified and made publicly available for any blockchain system to which the restricted digital asset relates.

"(2) ADDITIONAL RULES FOR RELATED PERSONS AND AFFILIATED PERSONS.—Except as provided under subsection (c), a restricted digital asset owned by a related person or an affiliated person may only be offered or sold after 12 months after the later of—

"(A) the date on which such restricted digital asset was acquired; or

"(B) the digital asset maturity date.

"(b) OFFERS AND SALES OF CERTAIN DIGITAL COMMODITIES.—

''(1) IN GENERAL.—Subject to paragraph (2), a digital commodity may be offered and sold by any person.

''(2) RULES FOR RELATED AND AFFILIATED PERSONS.—Except as provided under subsection (c), a digital commodity may only be offered or sold by a related person or an affiliated person if—

''(A) the holder of the digital commodity originally acquired the digital asset while it was a restricted digital asset not less than 12 months after the later of—

''(i) the date on which such restricted digital asset was acquired; or

''(ii) the digital asset maturity date;

''(B) any blockchain system to which the digital commodity relates is certified to be a decentralized system under section 44; and

''(C) the digital commodity is offered or sold on or subject to the rules of a digital commodity exchange registered under section 5i of the Commodity Exchange Act.

''(3) NOT AN INVESTMENT CONTRACT.—For purposes of the securities laws, an offer or sale of a digital commodity that does not violate paragraph

(2) shall not be a transaction in an investment contract.

"(c) SALES RESTRICTIONS FOR AFFILIATED PERSONS.—A digital asset may be offered and sold by an affiliated person under subsection (a) or (b) if—

"(1) the aggregate amount of such digital assets sold in any 3-month period by the affiliated person is not greater than one percent of the digital assets then outstanding; or

"(2) the affiliated person promptly, following the placement of an order to sell one percent or more of the digital assets then outstanding during any 3-month period, reports the sale to—

"(A) the Commodity Futures Trading Commission, in the case of an order to sell a digital commodity on or subject to the rules of a digital commodity exchange; or

"(B) the Securities and Exchange Commission, in the case of a sell order for a restricted digital asset placed with a digital asset trading system.

"(d) TREATMENT OF CERTAIN END USER DISTRIBUTIONS UNDER THE SECURITIES LAWS.—

''(1) IN GENERAL.—With respect to a digital asset, an end user distribution is described under this paragraph if—

''(A) each blockchain system to which such digital asset relates is a functional system; and

''(B) with respect to the digital asset and each blockchain system to which such digital asset relates, the information described in section 43 has been certified and made publicly available.

''(2) NOT AN INVESTMENT CONTRACT.—For purposes of the securities laws, an end user distribution described under paragraph (1) shall not be a transaction in an investment contract.

''(3) EXEMPTION.—Section 5 of the Securities Act of 1933 (15 U.S.C. 77e) shall not apply to an end user distribution described under paragraph (1) or a transaction in a unit of digital asset issued in such a distribution.''.

(b) RULE OF CONSTRUCTION.—Nothing in this Act or the amendments made by this Act may be construed to restrict the use of a digital asset, except as expressly provided in connection with—

(1) the offer or sale of a restricted digital asset or digital commodity; or

(2) an intermediary's custody of a restricted digital asset or digital commodity.

SEC. 303. ENHANCED DISCLOSURE REQUIREMENTS.

Title I of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), as amended by section 302, is further amended by adding at the end the following:

"SEC. 43. ENHANCED DISCLOSURE REQUIREMENTS WITH RESPECT TO DIGITAL ASSETS.

''(a) DISCLOSURE INFORMATION.—With respect to a digital asset and any blockchain system to which the digital asset relates, the information described under this section is as follows:

''(1) SOURCE CODE.—The source code for any blockchain system to which the digital asset relates.

''(2) TRANSACTION HISTORY.—A description of the steps necessary to independently access, search, and verify the transaction history of any blockchain system to which the digital asset relates.

''(3) DIGITAL ASSET ECONOMICS.—A description of the purpose of any blockchain system to which the digital asset relates and the operation of any such blockchain system, including—

''(A) information explaining the launch and supply process, including the number of digital assets to be issued in an initial alloca-

tion, the total number of digital assets to be created, the release schedule for the digital assets, and the total number of digital assets then outstanding;

"(B) information on any applicable consensus mechanism or process for validating transactions, method of generating or mining digital assets, and any process for burning or destroying digital assets on the blockchain system;

"(C) an explanation of governance mechanisms for implementing changes to the blockchain system or forming consensus among holders of such digital assets; and

"(D) sufficient information for a third party to create a tool for verifying the transaction history of the digital asset.

"(4) PLAN OF DEVELOPMENT.—The current state and timeline for the development of any blockchain system to which the digital asset relates, showing how and when the blockchain system intends or intended to be considered a functional system and decentralized system.

"(5) DEVELOPMENT DISCLOSURES.—A list of all persons who are related persons or affiliated per-

sons who have been issued a unit of a digital asset by a digital asset issuer or have a right to a unit of a digital asset from a digital asset issuer.

''(6) RISK FACTOR DISCLOSURES.—A description of the material risks surrounding ownership of a unit of a digital asset.

''(b) CERTIFICATION.—

''(1) IN GENERAL.—With respect to a digital asset and any blockchain system to which the digital asset relates, the information described under this section has been certified if the digital asset issuer, an affiliated person, a decentralized governance system, or a digital commodity exchange certifies on a quarterly basis to the Commodity Futures Trading Commission and the Securities and Exchange Commission that the information is true and correct.

''(2) PRIOR DISCLOSURES.—Information described under this section which was made available to the public prior to the date of enactment of this section may be certified as true and correct on the date such information was published in final form.

''(3) RULEMAKING.—The Commission and the Commodity Futures Trading Commission may jointly issue rules regarding the certification process described under paragraph (1).''.

SEC. 304. CERTIFICATION OF CERTAIN DIGITAL ASSETS.

Title I of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), as amended by section 303, is further amended by adding at the end the following:

"SEC. 44. CERTIFICATION OF CERTAIN DIGITAL ASSETS.

"(a) CERTIFICATION.—Any person may certify to the Securities and Exchange Commission that the blockchain system to which a digital asset relates is a decentralized system.

"(b) FILING REQUIREMENTS.—A certification described under subsection (a) shall be filed with the Commission, and include—

"(1) information regarding the person making the certification;

"(2) a description of the blockchain system and the digital asset which relates to such blockchain system, including—

"(A) the operation of the blockchain system;

"(B) the functionality of the related digital asset;

"(C) any decentralized governance system which relates to the blockchain system; and

"(D) the process to develop consensus or agreement within such decentralized governance system;

"(3) a description of the development of the blockchain system and the digital asset which relates to the blockchain system, including—

"(A) a history of the development of the blockchain system and the digital asset which relates to such blockchain system;

"(B) a description of the issuance process for the digital asset which relates to the blockchain system;

"(C) information identifying the digital asset issuer of the digital asset which relates to the blockchain system; and

"(D) a list of any affiliated person related to the digital asset issuer;

"(4) an analysis of the factors on which such person based the certification that the blockchain system is a decentralized system, including—

"(A) an explanation of the protections and prohibitions available during the previous 12 months against any one person being able to—

"(i) control or materially alter the blockchain system;

"(ii) exclude any other person from using or participating on the blockchain system; and

"(iii) exclude any other person from participating in a decentralized governance system;

"(B) information regarding the beneficial ownership of the digital asset which relates to such blockchain system and the distribution of voting power in any decentralized governance system during the previous 12 months;

"(C) information regarding the history of upgrades to the source code for such blockchain system during the previous 3 months, including—

"(i) a description of any consensus or agreement process utilized to process or approve changes to the source code;

"(ii) a list of any material changes to the source code, the purpose and effect of the changes, and the contributor of the changes, if known; and

"(iii) any changes to the source code made by the digital asset issuer, a related person, or an affiliated person;

"(D) information regarding any activities conducted to market the digital asset which relates to the blockchain system during the pre-

vious 3 months by the digital asset issuer or an affiliated person of the digital asset issuer; and

''(E) information regarding any issuance of a unit of the digital asset which relates to such blockchain system during the previous 12 months; and

''(5) with respect to a blockchain system for which a certification has previously been rebutted under this section or withdrawn under section 5i(m) of the Commodity Exchange Act, specific information relating to the analysis provided in subsection (f)(2) in connection with such rebuttal or such section 5i(m)(1)(C) in connection with such withdrawal.

''(c) REBUTTABLE PRESUMPTION.—The Commission may rebut a certification described under subsection (a) with respect to a blockchain system if the Commission, within 60 days of receiving such certification, determines that the blockchain system is not a decentralized system.

''(d) CERTIFICATION REVIEW.—

''(1) IN GENERAL.—Any blockchain system that relates to a digital asset for which a certification has been made under subsection (a) shall be considered a decentralized system 60 days after the date on which the Commission receives a certification under subsection (a), unless the Commission notifies the

person who made the certification within such time that the Commission is staying the certification due to—

"(A) an inadequate explanation by the person making the certification; or

"(B) any novel or complex issues which require additional time to consider.

"(2) PUBLIC NOTICE.—The Commission shall make the following available to the public and provide a copy to the Commodity Futures Trading Commission:

"(A) Each certification received under subsection (a).

"(B) Each stay of the Commission under this section, and the reasons therefore.

"(C) Any response from a person making a certification under subsection (a) to a stay of the certification by the Commission.

"(3) CONSOLIDATION.—The Commission may consolidate and treat as one submission multiple certifications made under subsection (a) for the same blockchain system which relates to a digital asset which are received during the review period provided under this subsection.

"(e) STAY OF CERTIFICATION.—

"(1) IN GENERAL.—A notification by the Commission pursuant to subsection (d)(1) shall stay the certification once for up to an additional 120 days from the date of the notification.

"(2) PUBLIC COMMENT PERIOD.—Before the end of the 60-day period described under subsection (d)(1), the Commission may begin a public comment period of at least 30 days in conjunction with a stay under this section.

"(f) DISPOSITION OF CERTIFICATION.—

"(1) IN GENERAL.—A certification made under subsection (a) shall—

"(A) become effective—

"(i) upon the publication of a notification from the Commission to the person who made the certification that the Commission does not object to the certification; or

"(ii) at the expiration of the certification review period; and

"(B) not become effective upon the publication of a notification from the Commission to the person who made the certification that the Commission has rebutted the certification.

''(2) DETAILED ANALYSIS INCLUDED WITH REBUTTAL.—The Commission shall include, with each publication of a notification of rebuttal described under paragraph (1)(B), a detailed analysis of the factors on which the decision was based.

''(g) RECERTIFICATION.—With respect to a blockchain system for which a certification has been rebutted under this section, no person may make a certification under subsection (a) with respect to such blockchain system during the 90-day period beginning on the date of such rebuttal.

''(h) APPEAL OF REBUTTAL.—

''(1) IN GENERAL.—If a certification is rebutted under this section, the person making such certification may appeal the decision to the United States Court of Appeals for the District of Columbia, not later than 60 days after the notice of rebuttal is made.

''(2) REVIEW.—In an appeal under paragraph (1), the court shall have de novo review of the determination to rebut the certification.''.

SEC. 305. EFFECTIVE DATE.

Unless otherwise provided in this title, this title and the amendments made by this title shall take effect 360 days after the date of enactment of this Act, except that,

to the extent a provision of this title requires a rulemaking, the provision shall take effect on the later of—

(1) 360 days after the date of enactment of this Act; or

(2) 60 days after the publication in the Federal Register of the final rule implementing the provision.

TITLE IV—REGISTRATION FOR DIGITAL ASSET INTERMEDIARIES AT THE SECURITIES AND EXCHANGE COMMISSION

SEC. 401. TREATMENT OF DIGITAL COMMODITIES AND OTHER DIGITAL ASSETS.

(a) SECURITIES ACT OF 1933.—Section 2(a)(1) of the Securities Act of 1933 (15 U.S.C. 77b(a)(1)) is amended by adding at the end the following: ''The term does not include a digital commodity or permitted payment stablecoin.''.

(b) SECURITIES EXCHANGE ACT OF 1934.—Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is amended—

(1) in paragraph (1), by adding at the end the following: ''The term 'exchange' does not include a digital asset trading system or a blockchain protocol offering digital assets, or any person or group of

persons solely because of their development of such a blockchain protocol.'';

(2) in paragraph (2), by adding at the end the following: ''A digital asset trading system is not a 'facility' of an exchange.'';

(3) in paragraph (4)(A), by inserting '', other than restricted digital assets,'' after ''securities'';

(4) in paragraph (5)(A), by inserting ''restricted digital assets or'' after ''not including'';

(5) in paragraph (26) by inserting ''(other than a notice-registered digital asset clearing agency)'' after ''or registered clearing agency'';

(6) in paragraph (28) by inserting ''(other than a notice-registered digital asset clearing agency)'' after ''registered clearing agency''; and

(7) in paragraph (10), by adding at the end the following: ''The term does not include a digital commodity or permitted payment stablecoin.''.

(c) INVESTMENT ADVISERS ACT OF 1940.—Section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2) is amended—

(1) in paragraph (18), by adding at the end the following: ''The term does not include a digital commodity or permitted payment stablecoin.'';

(2) by redesignating the second paragraph (29) (relating to commodity pools) as paragraph (31);

(3) by adding at the end, the following:

''(32) DIGITAL ASSET-RELATED TERMS.—The terms 'digital commodity' and 'permitted payment stablecoin' have the meaning given those terms, respectively, under section 2(a) of the Securities Act of 1933 (15 U.S.C. 77b(a)).''.

(d) INVESTMENT COMPANY ACT OF 1940.—Section 2(a) of the Investment Company Act of 1940 (15 U.S.C. 80a–2) is amended—

(1) in paragraph (36), by adding at the end the following: ''The term does not include a digital commodity or permitted payment stablecoin.''; and

(2) by adding at the end, the following:

''(55) DIGITAL ASSET-RELATED TERMS.—The terms 'digital commodity' and 'permitted payment stablecoin' have the meaning given those terms, respectively, under section 2(a) of the Securities Act of 1933 (15 U.S.C. 77b(a)).''.

SEC. 402. AUTHORITY OVER PERMITTED PAYMENT STABLECOINS AND RESTRICTED DIGITAL ASSETS.

(a) IN GENERAL.—Section 10 of the Securities Exchange Act of 1934 (15 U.S.C. 78j) is amended—

(1) by moving subsection (c) so as to appear after subsection (b);

(2) by designating the undesignated matter at the end of that section as subsection (d); and

(3) by adding at the end the following:

''(e)(1) Rules promulgated under subsection (b) that prohibit fraud, manipulation, or insider trading (but not rules imposing or specifying reporting or recordkeeping requirements, procedures, or standards as prophylactic measures against fraud, manipulation, or insider trading), and judicial precedents decided under subsection (b) and rules promulgated thereunder that prohibit fraud, manipulation, or insider trading, shall apply with respect to permitted payment stablecoin transactions and restricted digital assets transactions engaged in by a broker, dealer, digital asset broker, or digital asset dealer or through an alternative trading system or digital asset trading system to the same extent as they apply to securities transactions.

''(2) Judicial precedents decided under section 17(a) of the Securities Act of 1933 and sections 9, 15, 16, 20, and 21A of this title, and judicial precedents decided under applicable rules promulgated under such sections, shall apply to permitted payment stablecoins and restricted digital assets with respect to those circumstances in which the permitted payment stablecoins or restricted

digital assets are brokered, traded, or custodied by a broker, dealer, digital asset broker, digital asset dealer, or through an alternative trading system or digital asset trading system to the same extent as they apply to securities.

''(3) Nothing in this subsection may be construed to provide the Commission authority to make any rule, regulation, or requirement or impose any obligation or limitation on a permitted payment stablecoin issuer or a digital asset issuer regarding any aspect of the operations of a permitted payment stablecoin issuer, a digital asset issuer, a permitted payment stablecoin, or a restricted digital asset.''.

(b) TREATMENT OF PERMITTED PAYMENT STABLECOINS.—Title I of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), as amended by section 404, is amended by inserting after section 6B the following:

''SEC. 6C. TREATMENT OF TRANSACTIONS IN PERMITTED PAYMENT STABLECOINS.

''(a) AUTHORITY TO BROKER, TRADE, AND CUSTODY PERMITTED PAYMENT STABLECOINS.—Permitted payment stablecoins may be brokered, traded, or custodied by a broker, dealer, digital asset broker, or digital asset dealer or through an alternative trading system or digital asset trading system.

''(b) COMMISSION JURISDICTION.—The Commission shall only have jurisdiction over a transaction in a permitted payment stablecoin with respect to those circumstances in which a permitted payment stablecoin is brokered, traded, or custodied—

''(1) by a broker, dealer, digital asset broker, or digital asset dealer; or

''(2) through an alternative trading system or digital asset trading system.

''(c) LIMITATION.—Subsection (b) shall only apply to a transaction described in subsection (b) for the purposes of regulating the offer, execution, solicitation, or acceptance of a permitted payment stablecoin in those circumstances in which the permitted payment stablecoin is brokered, traded, or custodied—

''(1) by a broker, dealer, digital asset broker, or digital asset dealer; or

''(2) through an alternative trading system or digital asset trading system.''.

SEC. 403. REGISTRATION OF DIGITAL ASSET TRADING SYSTEMS.

Section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f) is amended by adding at the end the following:

''(m) DIGITAL ASSET TRADING SYSTEM.—

''(1) IN GENERAL.—It shall be unlawful for any digital asset trading system to make use of the mails or any means or instrumentality of interstate commerce within or subject to the jurisdiction of the United States to effect any transaction in a restricted digital asset, unless such digital asset trading system is registered with the Commission.

''(2) APPLICATION.—A person desiring to register as a digital asset trading system shall submit to the Commission an application in such form and containing such information as the Commission may require for the purpose of making the determinations required for approval.

''(3) EXEMPTIONS.—A digital asset trading system that offers or seeks to offer at least one restricted digital asset shall not be required to register under this section (and paragraph (1) shall not apply to such digital asset trading system) if the trading system satisfies any exemption contained on a list of exemptions prepared by the Commission to be as close as practicable to those exemptions set forth in section 240.3b–16(b) of title 17, Code of Federal Regulations, applicable to the definition of an exchange.

''(4) ADDITIONAL REGISTRATIONS.—

"(A) WITH THE COMMISSION.—

"(i) IN GENERAL.—A registered digital asset trading system shall be permitted to maintain any other registration with the Commission relating to the other activities of the registered digital asset trading system, including as a—

"(I) national securities exchange;

"(II) broker;

"(III) dealer;

"(IV) alternative trading system, pursuant to part 242 of title 17, Code of Federal Regulations, as in effect on the date of enactment of this subsection;

"(V) digital asset broker; or

"(VI) digital asset dealer.

"(ii) RULEMAKING.—The Commission shall prescribe rules for an entity with multiple registrations described under clause (i) to exempt the entity from duplicative, conflicting, or unduly burdensome provisions of this Act and the rules under this Act, to the extent such an exemption would protect investors, maintain fair, or-

derly, and efficient markets, and facilitate capital formation.

''(B) WITH THE COMMODITY FUTURES TRADING COMMISSION.—A registered digital asset trading system shall be permitted to maintain a registration with the Commodity Futures Trading Commission as a digital commodity exchange to offer contracts of sale for digital commodities.''.

SEC. 404. REQUIREMENTS FOR DIGITAL ASSET TRADING SYSTEMS.

Title I of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 6 the following:

''SEC. 6A. REQUIREMENTS FOR DIGITAL ASSET TRADING SYSTEMS.

''(a) HOLDING OF CUSTOMER ASSETS.—

''(1) QUALIFIED DIGITAL ASSET CUSTODIAN REQUIRED.—A digital asset trading system shall hold customer restricted digital assets with a qualified digital asset custodian described under section 6B.

''(2) CUSTODY PROHIBITED.—A digital asset trading system, in its capacity as such, may not hold custody of customer money, assets, or property.

"(3) CUSTODY IN OTHER CAPACITY.—Nothing in this Act may be construed to prohibit a person registered as a digital asset trading system from holding custody of customer money, assets, or property in any other permitted capacity, including as a digital asset broker, digital asset dealer, or qualified digital asset custodian in compliance with the requirements of this Act.

"(b) RULEMAKING.—The Commission shall prescribe rules for digital asset trading systems relating to the following:

"(1) NOTICE.—Notice to the Commission of the initial operation of a digital asset trading system or any material change to the operation of the digital asset trading system.

"(2) ORDER DISPLAY.—The thresholds at which a digital asset trading system is required to display the orders of the digital asset trading system, and the manner of such display.

"(3) FAIR ACCESS.—The thresholds at which a digital asset trading system is required to have policies regarding providing fair access to the digital asset trading system.

"(4) CAPACITY, INTEGRITY, AND SECURITY OF AUTOMATED SYSTEMS.—Policies and procedures rea-

sonably designed to ensure the capacity, integrity, and security of the digital asset trading system, taking into account the particular nature of digital asset trading systems.

''(5) EXAMINATIONS, INSPECTIONS, AND INVESTIGATIONS.—The examination and inspection of the premises, systems, and records of the digital asset trading system by the Commission or by a self-regulatory organization of which such digital asset trading system is a member.

''(6) RECORDKEEPING.—The making, keeping current, and preservation of records related to trading activity on the digital asset trading system.

''(7) REPORTING.—The reporting of transactions in digital assets that occur through the digital asset trading system.

''(8) PROCEDURES.—The establishment of adequate written safeguards and written procedures to protect confidential trading information.

''(c) NAME REQUIREMENT.—A digital asset trading system may not use the word 'exchange' in the name of the digital asset trading system, unless the digital asset trading system—

''(1) is operated by a registered national securities exchange; and

''(2) is clearly indicated as being provided outside of the system's capacity as a national securities exchange.

"SEC. 6B. REQUIREMENTS FOR QUALIFIED DIGITAL ASSET CUSTODIANS.

''(a) IN GENERAL.—A digital asset custodian is a qualified digital asset custodian if the digital asset custodian complies with the requirements of this section.

''(b) SUPERVISION REQUIREMENT.—A digital asset custodian that is not subject to supervision and examination by an appropriate Federal banking agency, the National Credit Union Administration, the Commodity Futures Trading Commission, or the Securities and Exchange Commission shall be subject to adequate supervision and appropriate regulation by—

''(1) a State bank supervisor (within the meaning of section 3 of the Federal Deposit Insurance Act);

''(2) a State credit union supervisor, as defined under section 6003 of the Anti-Money Laundering Act of 2020; or

''(3) an appropriate foreign governmental authority in the home country of the digital asset custodian.

''(c) OTHER REQUIREMENTS.—

"(1) NOT OTHERWISE PROHIBITED.—The digital asset custodian has not been prohibited by a supervisor of the digital asset custodian from engaging in an activity with respect to the custody and safekeeping of digital assets.

"(2) INFORMATION SHARING.—

"(A) IN GENERAL.—A digital asset custodian shall share information with the Commission on request and comply with such requirements for periodic sharing of information regarding customer accounts that the digital asset custodian holds on behalf of an entity registered with the Commission as the Commission determines by rule are reasonably necessary to effectuate any of the provisions, or to accomplish any of the purposes, of this Act.

"(B) PROVISION OF INFORMATION.—Any entity that is subject to regulation and examination by an appropriate Federal banking agency may satisfy any information request described in subparagraph (A) by providing the Commission with a detailed listing, in writing, of the restricted digital assets of a customer within the custody or use of the entity.

"(d) ADEQUATE SUPERVISION AND APPROPRIATE REGULATION.—

"(1) IN GENERAL.—For purposes of subsection (b), the terms 'adequate supervision' and 'appropriate regulation' mean such minimum standards for supervision and regulation as are reasonably necessary to protect the digital assets of customers of an entity registered with the Commission, including standards relating to the licensing, examination, and supervisory processes that require the digital asset custodian to, at a minimum—

"(A) receive a review and evaluation of ownership, character and fitness, conflicts of interest, business model, financial statements, funding resources, and policies and procedures of the digital asset custodian;

"(B) hold capital sufficient for the financial integrity of the digital asset custodian;

"(C) protect customer assets;

"(D) establish and maintain books and records regarding the business of the digital asset custodian;

"(E) submit financial statements and audited financial statements to the applicable supervisor described in subsection (b);

"(F) provide disclosures to the applicable supervisor described in subsection (b) regarding actions, proceedings, and other items as determined by such supervisor;

"(G) maintain and enforce policies and procedures for compliance with applicable State and Federal laws, including those related to anti-money laundering and cybersecurity;

"(H) establish a business continuity plan to ensure functionality in cases of disruption; and

"(I) establish policies and procedures to resolve complaints.

"(2) RULEMAKING WITH RESPECT TO DEFINITIONS.—

"(A) IN GENERAL.—For purposes of this section, the Commission may, by rule, further define the terms 'adequate supervision' and 'appropriate regulation' as necessary in the public interest, as appropriate for the protection of investors, and consistent with the purposes of this Act.

"(B) CONDITIONAL TREATMENT OF CERTAIN CUSTODIANS BEFORE RULEMAKING.—Before the effective date of a rulemaking under

subparagraph (A), a trust company is deemed subject to adequate supervision and appropriate regulation if—

"(i) the trust company is expressly permitted by a State bank supervisor to engage in the custody and safekeeping of digital assets;

"(ii) the State bank supervisor has established licensing, examination, and supervisory processes that require the trust company to, at a minimum, meet the conditions described in subparagraphs (A) through (I) of paragraph (1); and

"(iii) the trust company is in good standing with its State bank supervisor.

"(C) TRANSITION PERIOD FOR CERTAIN CUSTODIANS.—In implementing the rulemaking under subparagraph (A), the Commission shall provide a transition period of not less than two years for any trust company which is deemed subject to adequate supervision and appropriate regulation under subparagraph (B) on the effective date of the rulemaking.".

SEC. 405. REGISTRATION OF DIGITAL ASSET BROKERS AND DIGITAL ASSET DEALERS.

The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 15G the following:

"SEC. 15H. REGISTRATION OF DIGITAL ASSET BROKERS AND DIGITAL ASSET DEALERS.

''(a) REGISTRATION.—

''(1) IN GENERAL.—It shall be unlawful for any digital asset broker or digital asset dealer (other than a natural person associated with a registered digital asset broker or registered digital asset dealer, and other than such a digital asset broker or digital asset dealer whose business is exclusively intrastate and who does not make use of a digital asset trading system) to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any restricted digital asset unless such digital asset broker or digital asset dealer is registered in accordance with this section.

''(2) APPLICATION.—A person desiring to register as a digital asset broker or digital asset dealer shall submit to the Commission an application in such form and containing such information as the

Commission may require for the purpose of making the determinations required for approval.

"(b) NATIONAL SECURITIES ASSOCIATION MEMBERSHIP.—

"(1) IN GENERAL.—A digital asset broker or digital asset dealer may not register or maintain registration under this section unless such digital asset broker or digital asset dealer is a member of a national securities association registered under section 15A.

"(2) TREATMENT UNDER SECTION 15A.—

"(A) IN GENERAL.—For purposes of section 15A—

"(i) the term 'broker' includes a digital asset broker and the term 'registered broker' includes a registered digital asset broker;

"(ii) the term 'dealer' includes a digital asset dealer and the term 'registered dealer' includes a registered digital asset dealer; and

"(iii) the term 'security' includes a restricted digital asset.

"(B) CLARIFICATION.—Notwithstanding subparagraph (A), a national securities associa-

tion shall, with respect to the restricted digital asset activities of a digital asset broker or a digital asset dealer, only examine for and enforce against such digital asset broker or digital asset dealer—

"(i) rules of such national securities association written specifically for digital asset brokers or digital asset dealers;

"(ii) the provisions of the Financial Innovation and Technology for the 21st Century Act and rules issued thereunder applicable to digital asset brokers and digital asset dealers; and

"(iii) the provisions of the securities laws and the rules thereunder applicable to digital asset brokers and digital asset dealers.

"(c) ADDITIONAL REGISTRATIONS WITH THE COMMISSION.—

"(1) IN GENERAL.—A registered digital asset broker or registered digital asset dealer shall be permitted to maintain any other registration with the Commission relating to the other activities of the registered digital asset broker or registered digital asset dealer, including as—

"(A) a national securities exchange;

"(B) a broker;

"(C) a dealer;

"(D) an alternative trading system, pursuant to part 242 of title 17, Code of Federal Regulations, as in effect on the date of enactment of this section; or

"(E) a digital asset trading system.

"(2) RULEMAKING.—The Commission shall prescribe rules for an entity with multiple registrations described under paragraph (1) to exempt the entity from duplicative, conflicting, or unduly burdensome provisions of this Act and the rules under this Act, to the extent such an exemption would protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.

"(3) SELF-REGULATORY ORGANIZATIONS.—The Commission shall require any self-regulatory organization with a registered digital asset broker or registered digital asset dealer as a member to provide such rules as may be necessary to further compliance with this section, protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.

''(d) ADDITIONAL REGISTRATIONS WITH THE COMMODITY FUTURES TRADING COMMISSION.—A registered digital asset broker or registered digital asset dealer shall be permitted to maintain a registration with the Commodity Futures Trading Commission as a digital commodity broker or digital commodity dealer, to list or trade contracts of sale for digital commodities.''.

SEC. 406. REQUIREMENTS OF DIGITAL ASSET BROKERS AND DIGITAL ASSET DEALERS.

(a) IN GENERAL.—Section 15H of the Securities Exchange Act of 1934, as added by section 405, is amended by adding at the end the following:

''(e) ANTI-FRAUD.—No digital asset broker or digital asset dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any restricted digital asset by means of any manipulative, deceptive, or other fraudulent device or contrivance.

''(f) HOLDING OF CUSTOMER ASSETS.—

''(1) IN GENERAL.—A digital asset broker or digital asset dealer shall hold customer money, assets, and property in a manner to minimize the risk of loss to the customer or unreasonable delay in the

access to the money, assets, and property of the customer.

''(2) QUALIFIED DIGITAL ASSET CUSTODIAN REQUIRED.—A digital asset broker or digital asset dealer shall hold customer restricted digital assets described in paragraph (1) with a qualified digital asset custodian described under section 6B.

''(3) SEGREGATION OF FUNDS.—

''(A) IN GENERAL.—A digital asset broker or digital asset dealer shall treat and deal with all money, assets, and property held for a customer of the digital asset broker or digital asset dealer, or that accrues to a customer as a result of trading in restricted digital assets, as belonging to the customer.

''(B) COMMINGLING PROHIBITED.—Money, assets, and property of a customer described in subparagraph (A) shall be separately accounted for and shall not be commingled with the funds of the digital asset broker or digital asset dealer or be used to margin, secure, or guarantee any trades of any person other than the customer of the digital asset broker or digital asset dealer for whom the same are held.

''(4) EXCEPTIONS.—

"(A) USE OF FUNDS.—

"(i) IN GENERAL.—Notwithstanding paragraph (4), money, assets, and property of customers of a digital asset broker or digital asset dealer described in paragraph (4) may be maintained and deposited in the same account or accounts with any bank, trust company, or qualified digital asset custodian described under section 6B, if the money, assets, and property remain segregated from the money, assets, and property of the digital asset broker or digital asset dealer.

"(ii) WITHDRAWAL.—Notwithstanding paragraph (4), such share of the money, assets, and property described in paragraph (4) as in the normal course of business shall be necessary to transfer, adjust, or settle a restricted digital asset transaction pursuant to a customer's instruction (standing or otherwise) may be withdrawn and applied to such purposes, including the withdrawal and payment of commissions, brokerage, interest, taxes, storage, and other charges lawfully accruing in connec-

tion with a restricted digital asset transaction.

"(iii) COMMISSION ACTION.—In accordance with such terms and conditions as the Commission may prescribe by rule, regulation, or order, any money, assets, or property of a customer of a digital asset broker or digital asset dealer described in paragraph (4) may be commingled and deposited as provided in this section with any other money, assets, or property received by the digital asset broker or digital asset dealer and required by the Commission to be separately accounted for and treated and dealt with as belonging to the customer of the digital asset broker or digital asset dealer.

"(B) PARTICIPATION IN BLOCKCHAIN SERVICES.—

"(i) IN GENERAL.—A customer shall have the right to waive the restrictions in paragraph (4) for any unit of a digital asset to be used under clause (ii), by affirmatively electing, in writing to the dig-

ital asset broker or digital asset dealer, to waive the restrictions.

"(ii) USE OF FUNDS.—Customer digital assets removed from segregation under clause (i) may be pooled and used by the digital asset broker or digital asset dealer or its designee to provide a blockchain service for a blockchain system to which the unit of the digital asset removed from segregation under clause (i) relates.

"(iii) LIMITATIONS.—

"(I) IN GENERAL.—The Commission may, by rule, establish notice and disclosure requirements, and any other limitations and rules related to the waiving of any restrictions under this subparagraph that are reasonably necessary to protect customers.

"(II) CUSTOMER CHOICE.—A digital asset broker or digital asset dealer may not require a waiver from a customer described in clause (i) as a condition of doing business with the digital asset broker or digital asset dealer.

"(iv) BLOCKCHAIN SERVICE DEFINED.—In this subparagraph, the term 'blockchain service' means any activity relating to validating transactions on a blockchain system, providing security for a blockchain system, or other similar activity required for the ongoing operation of a blockchain system.

"(5) FURTHER LIMITATIONS.—No person shall treat or deal with a restricted digital asset held on behalf of any customer pursuant to paragraph (4) by utilizing any unit of such restricted digital asset to participate in a blockchain service (as defined in paragraph (5)(B)(iv)) or a decentralized governance system associated with the restricted digital asset or the blockchain system to which the restricted digital asset relates in any manner other than that which is expressly directed by the customer from which such unit of a restricted digital asset was received.

"(g) CAPITAL REQUIREMENTS.—

"(1) IN GENERAL.—Each registered digital asset broker and registered digital asset dealer shall meet such minimum capital requirements as the Commission may prescribe to ensure that the digital asset broker or digital asset dealer is able to—

"(A) conduct an orderly wind-down of the activities of the digital asset broker or digital asset dealer; and

"(B) fulfill the customer obligations of the digital asset broker or digital asset dealer.

"(2) CALCULATION.—For purposes of any Commission rule or order adopted under this section or any interpretation thereof regulating a digital asset broker or digital asset dealer's financial responsibility obligations and capital requirements, a registered digital asset broker or digital asset dealer that maintains control of customer digital assets in a manner that satisfies the rules issued by the Commission under subsection (f)(2) shall not be required to include the custodial obligation with respect to such digital assets as liabilities or such digital assets as assets of the digital asset broker or digital asset dealer.

"(h) REPORTING AND RECORDKEEPING.—Each registered digital asset broker and digital asset dealer—

"(1) shall make such reports as are required by the Commission by rule or regulation regarding the transactions, positions, and financial condition of the digital asset broker or digital asset dealer;

''(2) shall keep books and records in such form and manner and for such period as may be prescribed by the Commission by rule or regulation; and

''(3) shall keep the books and records open to inspection and examination by any representative of the Commission.''.

(b) DEFINITION OF CLEARING AGENCY.—Section 3(a)(23)(B) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(23)(B)) is amended by inserting ''digital asset broker, digital asset dealer,'' after ''broker, dealer,'' each place such term appears.

SEC. 407. RULES RELATED TO CONFLICTS OF INTEREST.

The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 10D the following:

''SEC. 10E. CONFLICTS OF INTEREST RELATED TO DIGITAL ASSETS.

''Each registered digital asset trading system, registered digital asset broker, registered digital asset dealer, and notice-registered digital asset clearing agency shall establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of such person's business, to mitigate any conflicts of interest and transactions or arrangements with affiliates.''.

SEC. 408. TREATMENT OF CERTAIN DIGITAL ASSETS IN CONNECTION WITH FEDERALLY REGULATED INTERMEDIARIES.

Section 18(b) of the Securities Act of 1933 (15 U.S.C. 77r(b)) is amended by adding at the end the following:

"(5) EXEMPTION FOR CERTAIN DIGITAL ASSETS IN CONNECTION WITH FEDERALLY REGULATED INTERMEDIARIES.—A restricted digital asset is treated as a covered security with respect to a transaction that is exempt from registration under this Act when it is—

"(A) brokered, traded, custodied, or cleared by a digital asset broker or digital asset dealer registered under section 15H of the Securities Exchange Act of 1934; or

"(B) traded through a digital asset trading system.".

SEC. 409. EXCLUSION FOR DECENTRALIZED FINANCE ACTIVITIES.

The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), as amended by section 405, is further amended by inserting after section 15H the following:

"SEC. 15I. DECENTRALIZED FINANCE ACTIVITIES NOT SUBJECT TO THIS ACT.

"(a) IN GENERAL.—Notwithstanding any other provision of this Act, a person shall not be subject to this Act and the regulations thereunder based on the person directly or indirectly engaging in any of the following activities, whether singly or in combination thereof, in relation to the operation of a blockchain system or in relation to decentralized finance (as defined in section 605(d) of the Financial Innovation and Technology for the 21st Century Act):

"(1) Compiling network transactions, operating or participating in a liquidity pool, relaying, searching, sequencing, validating, or acting in a similar capacity with respect to a digital asset.

"(2) Providing computational work, operating a node, or procuring, offering, or utilizing network bandwidth, or other similar incidental services with respect to a digital asset.

"(3) Providing a user-interface that enables a user to read and access data about a blockchain system, send messages, or otherwise interact with a blockchain system.

"(4) Developing, publishing, constituting, administering, maintaining, or otherwise distributing a blockchain system.

''(5) Developing, publishing, constituting, administering, maintaining, or otherwise distributing software or systems that create or deploy a hardware or software wallet or other system facilitating an individual user's own personal ability to keep, safeguard, or custody such user's digital assets or related private keys.

''(b) EXCEPTIONS.—Subsection (a) shall not be construed to apply to the anti-fraud and anti-manipulation authorities of the Commission.''.

SEC. 410. REGISTRATION AND REQUIREMENTS FOR NOTICE-REGISTERED DIGITAL ASSET CLEARING AGENCIES.

Section 17A(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1(b)) is amended—

(1) in subsection (1), by inserting after the first sentence the following: ''The previous sentence shall not apply to a notice-registered digital asset clearing agency with respect to a restricted digital asset.''; and

(2) by adding at the end the following:

''(9) REGISTRATION AND REQUIREMENTS FOR NOTICE-REGISTERED DIGITAL ASSET CLEARING AGENCY.—

"(A) ELIGIBILITY.—A person may register with the Commission as a notice-registered digital asset clearing agency if the person—

"(i) is otherwise registered as a digital asset broker or digital asset dealer with the Commission and is engaging in a business involving restricted digital assets, in compliance with Commission rules pursuant to section 15H(f);

"(ii) is a bank; or

"(iii) is a clearing agency already registered with the Commission pursuant to this section.

"(B) REGISTRATION.—A person may register with the Commission as a notice-registered digital asset clearing agency by filing with the Commission a notice of the activities of the person or planned activities in such form as the Commission determines appropriate.

"(C) EFFECTIVENESS OF REGISTRATION.—

"(i) IN GENERAL.—The registration of a person filing a notice described under subparagraph (B) as a notice-registered digital asset clearing agency shall be effec-

tive upon publication by the Commission of such notice, which shall occur no later than 14 days after the date of such filing.

"(ii) INITIAL REGISTRATIONS.—

"(I) IN GENERAL.—A person registered as a notice-registered digital asset clearing agency before the date on which the Commission adopts rules under subparagraph (D) shall, after such rules are adopted, renew the person's registration pursuant to such rules.

"(II) EXCEPTION.—Notwithstanding subclause (I), a person registered as a notice-registered digital asset clearing agency before the end of the 2-year period beginning on the date of the enactment of this section shall have such registration remain in effect until the end of such 2-year period.

"(D) RULEMAKING.—The Commission may adopt rules, which may not take effect until at least 360 days following the date of enactment of this paragraph, with regard to the

activities of notice-registered digital asset clearing agencies, taking into account the nature of restricted digital assets.''.

SEC. 411. TREATMENT OF CUSTODY ACTIVITIES BY BANKING INSTITUTIONS.

(a) TREATMENT OF CUSTODY ACTIVITIES.—The appropriate Federal banking agency (as defined under section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)), the National Credit Union Administration (in the case of a credit union), and the Securities and Exchange Commission may not require, or take supervisory action that would cause, a depository institution, national bank, Federal credit union, State credit union, or trust company, or any affiliate (as such term is defined under section 2 of the Bank Holding Company Act of 1956) thereof—

(1) to include assets held in custody or safekeeping, or the assets associated with a cryptographic key held in custody or safekeeping, as a liability on such institution's financial statement or balance sheet, except that cash held for a third party by such institution that is commingled with the general assets of such institution may be reflected as a liability on a financial statement or balance sheet;

(2) to hold additional regulatory capital against assets in custody or safekeeping, or the assets asso-

ciated with a cryptographic key held in custody or safekeeping, except as necessary to mitigate against operational risks inherent with the custody or safekeeping services, as determined by—

(A) the appropriate Federal banking agency;

(B) the National Credit Union Administration (in the case of a credit union);

(C) a State bank supervisor (as defined under section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)); or

(D) a State credit union supervisor (as defined under section 6003 of the Anti-Money Laundering Act of 2020);

(3) to recognize a liability for any obligations related to activities or services performed for digital assets with respect to which such institution does not have beneficial ownership if that liability would exceed the expense recognized in the income statement as a result of the corresponding obligation.

(b) DEFINITIONS.—In this section:

(1) DEPOSITORY INSTITUTION.—The term ''depository institution'' has the meaning given that term under section 3 of the Federal Deposit Insurance Act.

(2) CREDIT UNION TERMS.—The terms ''Federal credit union'' and ''State credit union'' have the meaning given those terms, respectively, under section 101 of the Federal Credit Union Act.

SEC. 412. EFFECTIVE DATE; ADMINISTRATION.

Except as otherwise provided under this title, this title and the amendments made by this title shall take effect 360 days after the date of enactment of this Act, except that, to the extent a provision of this title requires a rulemaking, the provision shall take effect on the later of—

(1) 360 days after the date of enactment of this Act; or

(2) 60 days after the publication in the Federal Register of the final rule implementing the provision.

SEC. 413. DISCRETIONARY SURPLUS FUND.

(a) IN GENERAL.—The dollar amount specified under section 7(a)(3)(A) of the Federal Reserve Act (12 U.S.C. 289(a)(3)(A)) is reduced by $15,000,000.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on September 30, 2034.

SEC. 414. STUDIES ON FOREIGN ADVERSARY PARTICIPATION.

(a) IN GENERAL.—The Secretary of the Treasury, in consultation with the Commodity Futures Trading Com-

mission and the Securities and Exchange Commission, shall, not later than 1 year after date of the enactment of this section, conduct a study and submit a report to the relevant congressional committees that—

(1) identifies any digital asset registrants which are owned by governments of foreign adversaries;

(2) determines whether any governments of foreign adversaries are collecting personal data or trading data about United States persons in the digital asset markets; and

(3) evaluates whether any proprietary intellectual property of digital asset registrants is being misused or stolen by any governments of foreign adversaries.

(b) GAO STUDY AND REPORT.—

(1) IN GENERAL.—The Comptroller General shall, not later than 1 year after date of the enactment of this section, conduct a study and submit a report to the relevant congressional committees that—

(A) identifies any digital asset registrants which are owned by governments of foreign adversaries;

(B) determines whether any governments of foreign adversaries are collecting personal

data or trading data about United States persons in the digital asset markets; and

(C) evaluates whether any proprietary intellectual property of digital asset registrants is being misused or stolen by any governments of foreign adversaries.

(c) DEFINITIONS.—In this section:

(1) DIGITAL ASSET REGISTRANT.—The term ''digital asset registrant'' means any person required to register as a digital asset trading system, digital asset broker, digital asset dealer, digital commodity exchange, digital commodity broker, or digital commodity dealer under this Act.

(2) FOREIGN ADVERSARIES.—The term ''foreign adversaries'' means the foreign governments and foreign non-government persons determined by the Secretary of Commerce to be foreign adversaries under section 7.4(a) of title 15, Code of Federal Regulations.

(3) RELEVANT CONGRESSIONAL COMMITTEES.—The term ''relevant congressional committees'' means—

(A) the Committees on Financial Services and Agriculture of the House of Representatives; and

(B) the Committees on Banking, Housing, and Urban Affairs and Agriculture, Nutrition, and Forestry of the Senate.

TITLE V—REGISTRATION FOR DIGITAL ASSET INTERMEDIARIES AT THE COMMODITY FUTURES TRADING COMMISSION

SEC. 501. COMMISSION JURISDICTION OVER DIGITAL COMMODITY TRANSACTIONS.

(a) SAVINGS CLAUSE.—Section 2(a)(1) of the Commodity Exchange Act (7 U.S.C. 2(a)(1)) is amended by adding at the end the following:

"(J) Except as expressly provided in this Act, nothing in the Financial Innovation and Technology for the 21st Century Act shall affect or apply to, or be interpreted to affect or apply to—

"(i) any agreement, contract, or transaction that is subject to this Act as—

"(I) a contract of sale of a commodity for future delivery or an option on such a contract;

"(II) a swap;

"(III) a security futures product;

"(IV) an option authorized under section 4c of this Act;

"(V) an agreement, contract, or transaction described in subparagraph (C)(i) or (D)(i) of subsection (c)(2) of this section; or

"(VI) a leverage transaction authorized under section 19 of this Act; or

"(ii) the activities of any person with respect to any such an agreement, contract, or transaction.".

(b) LIMITATION ON AUTHORITY OVER PERMITTED PAYMENT STABLECOINS.—Section 2(c)(1) of the Commodity Exchange Act (7 U.S.C. 2(c)(1)) is amended—

(1) in subparagraph (F), by striking "or" at the end;

(2) in subparagraph (G), by striking the period and inserting "; or"; and

(3) by adding at the end the following:

"(H) permitted payment stablecoins.".

(c) COMMISSION JURISDICTION OVER DIGITAL ASSET TRANSACTIONS.—Section 2(c)(2) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)) is amended—

(1) in subparagraph (D)—

(A) in clause (ii)—

(i) in subclause (I) by inserting ''(other than an agreement, contract, or transaction in a permitted payment stablecoin)'' after ''paragraph (1)'';

(ii) in subclause (III)—

(I) in the matter that precedes item (aa), by inserting ''of a commodity, other than a digital commodity or a permitted payment stablecoin,'' before ''that''; and

(II) in item (bb), by striking ''or'' at the end; and

(iii) by redesignating subclauses (IV) and (V) as subclauses (VI) and (VII) and inserting after subclause (III) the following:

''(IV) a contract of sale of a digital commodity or a permitted payment stablecoin that results in actual delivery, as the Commission shall by rule determine, within 2 days or such other period as the Commission may determine by rule or regulation based upon the typical commercial practice

in cash or spot markets for the digital commodity involved;

''(V) a contract of sale of a digital commodity or a permitted payment stablecoin that—

''(aa) is executed with a registered digital commodity dealer—

''(AA) directly;

''(BB) through a registered digital commodity broker; or

''(CC) on or subject to the rules of a registered digital commodity exchange; and

''(bb) is not a contract of sale of—

''(AA) a digital commodity or a permitted payment stablecoin that references, represents an interest in, or is functionally equivalent to an agricultural commodity, an excluded

commodity, or an exempt commodity, other than the digital commodity itself, as shall be further defined by the Commission; or

"(BB) a digital commodity or a permitted payment stablecoin to which the Commission determines, by rule or regulation, it is not in the public interest for this section to apply;"; and

(B) by redesignating clause (iv) as clause (v) and inserting after clause (iii) the following:

"(iv) The Commission shall adopt rules and regulations applicable to digital commodity dealers and digital commodity brokers in connection with the agreements, contracts or transactions in digital commodities or permitted payment stablecoins described in clause (ii)(V) of this subparagraph, which shall set forth minimum requirements related to disclosure, recordkeeping, margin and financing arrangements, capital, reporting, business conduct,

documentation, and supervision of employees and agents. Except as prohibited in subparagraph (G)(iii), the Commission may also make, promulgate, and enforce such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions of, or to accomplish any of the purposes of, this Act in connection with agreements, contracts, or transactions described in such clause (ii)(V), which may include, without limitation, requirements regarding registration with the Commission and membership in a registered futures association.''; and

(2) by adding at the end the following:

''(F) COMMISSION JURISDICTION WITH RESPECT TO DIGITAL COMMODITY TRANSACTIONS.—

''(i) IN GENERAL.—Subject to sections 6d and 12(e), the Commission shall have exclusive jurisdiction with respect to any account, agreement, contract, or transaction involving a contract of sale of a digital commodity in interstate commerce, including in a digital commodity cash or spot market, that

is offered, solicited, traded, facilitated, executed, cleared, reported, or otherwise dealt in—

"(I) on or subject to the rules of a registered entity or an entity that is required to be registered as a registered entity; or

"(II) by any other entity registered, or required to be registered, with the Commission.

"(ii) LIMITATIONS.—Clause (i) shall not apply with respect to custodial or depository activities for a digital commodity, or custodial or depository activities for any promise or right to a future digital commodity, of an entity regulated by an appropriate Federal banking agency or a State bank supervisor (within the meaning of section 3 of the Federal Deposit Insurance Act).

"(iii) MIXED DIGITAL ASSET TRANSACTIONS.—

"(I) IN GENERAL.—Clause (i) shall not apply to a mixed digital asset transaction.

"(II) REPORTS ON MIXED DIGITAL ASSET TRANSACTIONS.—A digital asset issuer, related person, affiliated person, or other person registered with the Securities and Exchange Commission that engages in a mixed digital asset transaction, shall, on request, open to inspection and examination by the Commodity Fu-

tures Trading Commission all books and records relating to the mixed digital asset transaction, subject to the confidentiality and disclosure requirements of section 8.

"(G) AGREEMENTS, CONTRACTS, AND TRANSACTIONS IN STABLECOINS.—

"(i) TREATMENT OF PERMITTED PAYMENT STABLECOINS ON COMMISSION-REGISTERED ENTITIES.—Subject to clauses (ii) and (iii), the Commission shall have jurisdiction over a cash or spot agreement, contract, or transaction in a permitted payment stablecoin that is offered, offered to enter into, entered into, executed, confirmed the execution of, solicited, or accepted—

"(I) on or subject to the rules of a registered entity; or

"(II) by any other entity registered with the Commission.

"(ii) PERMITTED PAYMENT STABLECOIN TRANSACTION RULES.—This Act shall apply to a transaction described in clause (i) only for the purpose of regulating the offer, execution, solicitation, or acceptance of a cash or spot permitted payment stablecoin transaction on a registered entity or by any other entity registered with the Commission, as

if the permitted payment stablecoin were a digital commodity.

''(iii) NO AUTHORITY OVER PERMITTED PAYMENT STABLECOINS.—Notwithstanding clauses (i) and (ii), the Commission shall not make a rule or regulation, impose a requirement or obligation on a registered entity or other entity registered with the Commission, or impose a requirement or obligation on a permitted payment stablecoin issuer, regarding the operation of a permitted payment stablecoin issuer or a permitted payment stablecoin.''.

(d) CONFORMING AMENDMENT.—Section 2(a)(1)(A) of such Act (7 U.S.C. 2(a)(1)(A)) is amended in the 1st sentence by inserting ''subparagraphs (F) and (G) of subsection (c)(2) of this section or'' before ''section 19''.

SEC. 502. REQUIRING FUTURES COMMISSION MERCHANTS TO USE QUALIFIED DIGITAL COMMODITY CUSTODIANS.

Section 4d of the Commodity Exchange Act (7 U.S.C. 6d) is amended—

(1) in subsection (a)(2)—

(A) in the 1st proviso, by striking ''any bank or trust company'' and inserting ''any bank, trust company, or qualified digital commodity custodian''; and

(B) by inserting ": *Provided further,* That any such property that is a digital commodity shall be held in a qualified digital commodity custodian'' before the period at the end; and

(2) in subsection (f)(3)(A)(i), by striking ''any bank or trust company'' and inserting ''any bank, trust company, or qualified digital commodity custodian''.

SEC. 503. TRADING CERTIFICATION AND APPROVAL FOR DIGITAL COMMODITIES.

Section 5c of the Commodity Exchange Act (7 U.S.C. 7a–2) is amended—

(1) in subsection (a), by striking ''5(d) and 5b(c)(2)'' and inserting ''5(d), 5b(c)(2), and 5i(c)'';

(2) in subsection (b)—

(A) in each of paragraphs (1) and (2), by inserting ''digital commodity exchange,'' before ''derivatives''; and

(B) in paragraph (3), by inserting ''digital commodity exchange,'' before ''derivatives'' each place it appears;

(3) in subsection (c)—

(A) in paragraph (2), by inserting ''or participants'' before ''(in'';

(B) in paragraph (4)(B), by striking ''1a(10)'' and inserting ''1a(9)''; and

(C) in paragraph (5), by adding at the end the following:

''(D) SPECIAL RULES FOR DIGITAL COMMODITY CONTRACTS.—In certifying any new rule or rule amendment, or listing any new contract or instrument, in connection with a contract of sale of a commodity for future delivery, option, swap, or other agreement, contract, or transaction, that is based on or references a digital commodity, a registered entity shall make or rely on a certification under subsection (d) for the digital commodity.''; and

(4) by inserting after subsection (c) the following:

''(d) CERTIFICATIONS FOR DIGITAL COMMODITY TRADING.—

''(1) IN GENERAL.—Notwithstanding subsection (c), for the purposes of listing or offering a digital commodity for trading in a digital commodity cash or spot market, an eligible entity shall issue a written certification that the digital commodity meets the requirements of this Act (including the regulations prescribed under this Act).

"(2) CONTENTS OF THE CERTIFICATION.—

"(A) IN GENERAL.—In making a written certification under this paragraph, the eligible entity shall furnish to the Commission—

"(i) an analysis of how the digital commodity meets the requirements of section 5i(c)(3);

"(ii) information about the digital commodity regarding—

"(I) its purpose and use;

"(II) its unit creation or release process;

"(III) its consensus mechanism;

"(IV) its governance structure;

"(V) its participation and distribution; and

"(VI) its current and proposed functionality; and

"(iii) any other information, analysis, or documentation the Commission may, by rule, require.

"(B) RELIANCE ON PRIOR DISCLOSURES.—In making a certification under this subsection, an eligible entity may rely on the records and disclosures of any relevant person

registered with the Securities and Exchange Commission or other State or Federal agency.

''(3) MODIFICATIONS.—

''(A) IN GENERAL.—An eligible entity shall modify a certification made under paragraph (1) to—

''(i) account for significant changes in any information provided to the Commission under paragraph (2)(A)(ii); or

''(ii) permit or restrict trading in units of a digital commodity held by a related person or an affiliated person.

''(B) RECERTIFICATION.—Modifications required by this subsection shall be subject to the same disapproval and review process as a new certification under paragraphs (4) and (5).

''(4) DISAPPROVAL.—

''(A) IN GENERAL.—The written certification described in paragraph (1) shall become effective unless the Commission finds that the digital asset does not meet the requirements of this Act or the rules and regulations thereunder.

''(B) ANALYSIS REQUIRED.—The Commission shall include, with any findings referred to

in subparagraph (A), a detailed analysis of the factors on which the decision was based.

"(C) PUBLIC FINDINGS.—The Commission shall make public any disapproval decision, and any related findings and analysis, made under this paragraph.

"(5) REVIEW.—

"(A) IN GENERAL.—Unless the Commission makes a disapproval decision under paragraph (4), the written certification described in paragraph (1) shall become effective, pursuant to the certification by the eligible entity and notice of the certification to the public (in a manner determined by the Commission) on the date that is—

"(i) 20 business days after the date the Commission receives the certification (or such shorter period as determined by the Commission by rule or regulation), in the case of a digital commodity that has not been certified under this section or for which a certification is being modified under paragraph (3); or

"(ii) 2 business days after the date the Commission receives the certification

(or such shorter period as determined by the Commission by rule or regulation) for any digital commodity that has been certified under this section.

''(B) EXTENSIONS.—The time for consideration under subparagraph (A) may be extended through notice to the eligible entity that there are novel or complex issues that require additional time to analyze, that the explanation by the submitting eligible entity is inadequate, or of a potential inconsistency with this Act—

''(i) once, for 30 business days, through written notice to the eligible entity by the Chairman; and

''(ii) once, for an additional 30 business days, through written notice to the digital commodity exchange from the Commission that includes a description of any deficiencies with the certification, including any—

''(I) novel or complex issues which require additional time to analyze;

''(II) missing information or inadequate explanations; or

"(III) potential inconsistencies with this Act.

"(6) CERTIFICATION REQUIRED.—Notwithstanding any other provision of this Act, a registered entity or other entity registered with the Commission shall not list for trading, accept for clearing, offer to enter into, enter into, execute, confirm the execution of, or conduct any office or business anywhere in the United States, its territories or possessions, for the purpose of soliciting, or accepting any order for, or otherwise dealing in, any transaction in, or in connection with, a digital commodity, unless a certification has been made under this section for the digital commodity.

"(7) PRIOR APPROVAL BEFORE REGISTRATION.—

"(A) IN GENERAL.—A person applying for registration with the Commission for the purposes of listing or offering a digital commodity for trading in a digital commodity cash or spot market may request that the Commission grant prior approval for the person to list or offer the digital commodity on being registered with the Commission.

"(B) REQUEST FOR PRIOR APPROVAL.—A person seeking prior approval under subparagraph (A) shall furnish the Commission with a written certification that the digital commodity meets the requirements of this Act (including the regulations prescribed under this Act) and the information described in paragraph (2).

"(C) DEADLINE.—The Commission shall take final action on a request for prior approval not later than 90 business days after submission of the request, unless the person submitting the request agrees to an extension of the time limitation established under this subparagraph.

"(D) DISAPPROVAL.—

"(i) IN GENERAL.—The Commission shall approve a new contract or other instrument unless the Commission finds that the new contract or other instrument would violate this Act (including a regulations prescribed under this Act).

"(ii) ANALYSIS REQUIRED.—The Commission shall include, with any findings made under clause (i), a detailed anal-

ysis of the factors on which the decision is based.

''(iii) PUBLIC FINDINGS.—The Commission shall make public any disapproval decision, and any related findings and analysis, made under this paragraph.

''(8) ELIGIBLE ENTITY DEFINED.—In this subsection, the term 'eligible entity' means a registered entity or group of registered entities acting jointly.''.

SEC. 504. REGISTRATION OF DIGITAL COMMODITY EXCHANGES.

The Commodity Exchange Act (7 U.S.C. 1 et seq.) is amended by inserting after section 5h the following:

''SEC. 5i. REGISTRATION OF DIGITAL COMMODITY EXCHANGES.

''(a) IN GENERAL.—

''(1) REGISTRATION.—

''(A) IN GENERAL.—A trading facility that offers or seeks to offer a cash or spot market in at least 1 digital commodity shall register with the Commission as a digital commodity exchange.

''(B) APPLICATION.—A person desiring to register as a digital commodity exchange shall submit to the Commission an application in

such form and containing such information as the Commission may require for the purpose of making the determinations required for approval.

''(C) EXEMPTIONS.—A trading facility that offers or seeks to offer a cash or spot market in at least 1 digital commodity shall not be required to register under this section if the trading facility—

''(i) permits no more than a de minimis amount of trading activity in a digital commodity; or

''(ii) serves only customers in a single State or territory.

''(2) ADDITIONAL REGISTRATIONS.—

''(A) WITH THE COMMISSION.—

''(i) IN GENERAL.—A registered digital commodity exchange may also register as—

''(I) a designated contract market; or

''(II) a swap execution facility.

''(ii) RULES.—For an entity with multiple registrations under clause (i), the Commission—

"(I) shall prescribe rules to exempt the entity from duplicative, conflicting, or unduly burdensome provisions of this Act and the rules under this Act, to the extent such an exemption would foster the development of fair and orderly cash or spot markets in digital commodities, be necessary or appropriate in the public interest, and be consistent with the protection of customers; and

"(II) may, after an analysis of the risks and benefits, prescribe rules to provide for portfolio margining, as may be necessary to protect market participants, promote fair and equitable trading in digital commodity markets, and promote responsible economic or financial innovation.

"(B) WITH THE SECURITIES AND EXCHANGE COMMISSION.—A registered digital commodity exchange may register with the Securities and Exchange Commission as a digital asset trading system to list or trade contracts of sale for restricted digital assets.

"(C) WITH A REGISTERED FUTURES ASSOCIATION.—

"(i) IN GENERAL.—A registered digital commodity exchange shall also be a member of a registered futures association and comply with rules related to such activity, if the registered digital commodity exchange accepts customer funds required to be segregated under subsection (d).

"(ii) RULEMAKING REQUIRED.—The Commission shall require any registered futures association with a digital commodity exchange as a member to provide such rules as may be necessary to further compliance with subsection (d), protect customers, and promote the public interest.

"(D) REGISTRATION REQUIRED.—A person required to be registered as a digital commodity exchange under this section shall register with the Commission as such regardless of whether the person is registered with another State or Federal regulator.

"(b) TRADING.—

"(1) PROHIBITION ON CERTAIN TRADING PRACTICES.—

"(A) Section 4b shall apply to any agreement, contract, or transaction in a digital commodity as if the agreement, contract, or transaction were a contract of sale of a commodity for future delivery.

"(B) Section 4c shall apply to any agreement, contract, or transaction in a digital commodity as if the agreement, contract, or transaction were a transaction involving the purchase or sale of a commodity for future delivery.

"(C) Section 4b-1 shall apply to any agreement, contract, or transaction in a digital commodity as if the agreement, contract, or transaction were a contract of sale of a commodity for future delivery.

"(2) PROHIBITION ON ACTING AS A COUNTERPARTY.—

"(A) IN GENERAL.—A digital commodity exchange or any affiliate of such an exchange shall not trade on or subject to the rules of the digital commodity exchange for its own account.

"(B) EXCEPTIONS.—The Commission shall, by rule, permit a digital commodity exchange or any affiliate of a digital commodity exchange to engage in trading on an affiliated

exchange so long as the trading is not solely for the purpose of the profit of the exchange, including the following:

"(i) CUSTOMER DIRECTION.—A transaction for, or entered into at the direction of, or for the benefit of, an unaffiliated customer.

"(ii) RISK MANAGEMENT.—A transaction to manage the risks associated with the digital commodity business of the exchange.

"(iii) FUNCTIONAL USE.—A transaction related to the functional operation of a blockchain network.

"(C) NOTICE REQUIREMENT.—In order for a digital commodity exchange or any affiliate of a digital commodity exchange to engage in trading on the affiliated exchange pursuant to subsection (B), notice must be given to the Commission that shall enumerate how any proposed activity is consistent with the exceptions in subsection (B) and the principles of the Act.

"(D) DELEGATION.—The Commission may, by rule, delegate authority to the Director of the Division of Market Oversight, or such

other employee or employees as the Director of the Division of Market Oversight may designate from time to time, to carry out these provisions.

''(3) TRADING SECURITIES.—A registered digital commodity exchange that is also registered with the Securities and Exchange Commission may offer a contract of sale of a restricted digital asset.

''(4) RULES FOR CERTAIN DIGITAL ASSET SALES.—The digital commodity exchange shall have in place such rules as may be necessary to reasonably ensure the orderly sale of any unit of a digital commodity sold by a related person or an affiliated person.

''(c) CORE PRINCIPLES FOR DIGITAL COMMODITY EXCHANGES.—

''(1) COMPLIANCE WITH CORE PRINCIPLES.—

''(A) IN GENERAL.—To be registered, and maintain registration, as a digital commodity exchange, a digital commodity exchange shall comply with—

''(i) the core principles described in this subsection; and

''(ii) any requirement that the Commission may impose by rule or regulation pursuant to section 8a(5).

"(B) REASONABLE DISCRETION OF A DIGITAL COMMODITY EXCHANGE.—Unless otherwise determined by the Commission by rule or regulation, a digital commodity exchange described in subparagraph (A) shall have reasonable discretion in establishing the manner in which the digital commodity exchange complies with the core principles described in this subsection.

"(2) COMPLIANCE WITH RULES.—A digital commodity exchange shall—

"(A) establish and enforce compliance with any rule of the digital commodity exchange, including—

"(i) the terms and conditions of the trades traded or processed on or through the digital commodity exchange; and

"(ii) any limitation on access to the digital commodity exchange;

"(B) establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules, including means—

"(i) to provide market participants with impartial access to the market; and

"(ii) to capture information that may be used in establishing whether rule violations have occurred; and

"(C) establish rules governing the operation of the exchange, including rules specifying trading procedures to be used in entering and executing orders traded or posted on the facility.

"(3) LISTING STANDARDS FOR DIGITAL COMMODITIES.—

"(A) IN GENERAL.—A digital commodity exchange shall permit trading only in a digital commodity that is not readily susceptible to manipulation.

"(B) PUBLIC INFORMATION REQUIREMENTS.—

"(i) IN GENERAL.—A digital commodity exchange shall permit trading only in a digital commodity if the information required in clause (ii) is correct, current, and available to the public.

"(ii) REQUIRED INFORMATION.—With respect to a digital commodity and

each blockchain system to which the digital commodity relates for which the digital commodity exchange will make the digital commodity available to the customers of the digital commodity exchange, the information required in this clause is as follows:

"(I) SOURCE CODE.—The source code for any blockchain system to which the digital commodity relates.

"(II) TRANSACTION HISTORY.—A narrative description of the steps necessary to independently access, search, and verify the transaction history of any blockchain system to which the digital commodity relates.

"(III) DIGITAL ASSET ECONOMICS.—A narrative description of the purpose of any blockchain system to which the digital asset relates and the operation of any such blockchain system, including—

"(aa) information explaining the launch and supply process, including the number of digital assets to be issued in an initial

allocation, the total number of digital assets to be created, the release schedule for the digital assets, and the total number of digital assets then outstanding;

"(bb) information detailing any applicable consensus mechanism or process for validating transactions, method of generating or mining digital assets, and any process for burning or destroying digital assets on the blockchain system;

"(cc) an explanation of governance mechanisms for implementing changes to the blockchain system or forming consensus among holders of the digital assets; and

"(dd) sufficient information for a third party to create a tool for verifying the transaction history of the digital asset.

"(IV) TRADING VOLUME AND VOLATILITY.—The trading volume

and volatility of the digital commodity.

''(V) ADDITIONAL INFORMATION.—Such additional information as the Commission may, by rule, determine to be necessary for a customer to understand the financial and operational risks of a digital commodity, and to be in the public interest or in furtherance of the requirements of this Act.

''(iii) FORMAT.—The Commission shall prescribe rules and regulations for the standardization and simplification of disclosures under clause (ii), including requiring that disclosures—

''(I) be conspicuous;

''(II) use plain language comprehensible to customers; and

''(III) succinctly explain the information that is required to be communicated to the customer.

''(C) ADDITIONAL LISTING CONSIDERATIONS.—In addition to the requirements of

subparagraphs (A) and (B), a digital commodity exchange shall consider—

"(i) if a sufficient percentage of the units of the digital asset are units of a digital commodity to permit robust price discovery;

"(ii) if it is reasonably unlikely that the transaction history can be fraudulently altered by any person or group of persons acting collectively;

"(iii) if the operating structure and system of the digital commodity is secure from cybersecurity threats;

"(iv) if the functionality of the digital commodity will protect holders from operational failures;

"(v) if sufficient public information about the operation, functionality, and use of the digital commodity is available; and

"(vi) any other factor which the Commission has, by rule, determined to be in the public interest or in furtherance of the requirements of this Act.

"(D) RESTRICTED DIGITAL ASSETS.—A digital commodity exchange shall not permit the

trading of a unit of a digital asset that is a restricted digital asset.

''(4) TREATMENT OF CUSTOMER ASSETS.—A digital commodity exchange shall establish standards and procedures that are designed to protect and ensure the safety of customer money, assets, and property.

''(5) MONITORING OF TRADING AND TRADE PROCESSING.—

''(A) IN GENERAL.—A digital commodity exchange shall provide a competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process of trading on the exchange.

''(B) PROTECTION OF MARKETS AND MARKET PARTICIPANTS.—A digital commodity exchange shall establish and enforce rules—

''(i) to protect markets and market participants from abusive practices committed by any party, including abusive practices committed by a party acting as an agent for a participant; and

''(ii) to promote fair and equitable trading on the exchange.

"(C) TRADING PROCEDURES.—A digital commodity exchange shall—

"(i) establish and enforce rules or terms and conditions defining, or specifications detailing—

"(I) trading procedures to be used in entering and executing orders traded on or through the facilities of the digital commodity exchange; and

"(II) procedures for trade processing of digital commodities on or through the facilities of the digital commodity exchange; and

"(ii) monitor trading in digital commodities to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance, compliance, and disciplinary practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.

"(6) ABILITY TO OBTAIN INFORMATION.—A digital commodity exchange shall—

"(A) establish and enforce rules that will allow the facility to obtain any necessary information to perform any of the functions described in this section;

"(B) provide the information to the Commission on request; and

"(C) have the capacity to carry out such international information-sharing agreements as the Commission may require.

"(7) EMERGENCY AUTHORITY.—A digital commodity exchange shall adopt rules to provide for the exercise of emergency authority, in consultation or cooperation with the Commission or a registered entity, as is necessary and appropriate, including the authority to facilitate the liquidation or transfer of open positions in any digital commodity or to suspend or curtail trading in a digital commodity.

"(8) TIMELY PUBLICATION OF TRADING INFORMATION.—

"(A) IN GENERAL.—A digital commodity exchange shall make public timely information on price, trading volume, and other trading data on digital commodities to the extent prescribed by the Commission.

"(B) CAPACITY OF DIGITAL COMMODITY EXCHANGE.—A digital commodity exchange shall have the capacity to electronically capture and transmit trade information with respect to transactions executed on the exchange.

"(9) RECORDKEEPING AND REPORTING.—

"(A) IN GENERAL.—A digital commodity exchange shall—

"(i) maintain records of all activities relating to the business of the facility, including a complete audit trail, in a form and manner acceptable to the Commission for a period of 5 years;

"(ii) report to the Commission, in a form and manner acceptable to the Commission, such information as the Commission determines to be necessary or appropriate for the Commission to perform the duties of the Commission under this Act; and

"(iii) keep any such records of digital commodities which relate to a security open to inspection and examination by the Securities and Exchange Commission.

"(B) INFORMATION-SHARING.—Subject to section 8, and on request, the Commission shall share information collected under subparagraph (A) with—

"(i) the Board;

"(ii) the Securities and Exchange Commission;

"(iii) each appropriate Federal banking agency;

"(iv) each appropriate State bank supervisor (within the meaning of section 3 of the Federal Deposit Insurance Act);

"(v) the Financial Stability Oversight Council;

"(vi) the Department of Justice; and

"(vii) any other person that the Commission determines to be appropriate, including—

"(I) foreign financial supervisors (including foreign futures authorities);

"(II) foreign central banks; and

"(III) foreign ministries.

"(C) CONFIDENTIALITY AGREEMENT.—Before the Commission may share information with any entity described in subparagraph (B),

the Commission shall receive a written agreement from the entity stating that the entity shall abide by the confidentiality requirements described in section 8 relating to the information on digital commodities that is provided.

''(D) PROVIDING INFORMATION.—A digital commodity exchange shall provide to the Commission (including any designee of the Commission) information under subparagraph (A) in such form and at such frequency as is required by the Commission.

''(10) ANTITRUST CONSIDERATIONS.—Unless necessary or appropriate to achieve the purposes of this Act, a digital commodity exchange shall not—

''(A) adopt any rules or take any actions that result in any unreasonable restraint of trade; or

''(B) impose any material anticompetitive burden on trading.

''(11) CONFLICTS OF INTEREST.—A registered digital commodity exchange shall implement conflict-of-interest systems and procedures that—

''(A) establish structural and institutional safeguards—

"(i) to minimize conflicts of interest that might potentially bias the judgment or supervision of the digital commodity exchange and contravene the principles of fair and equitable trading and the business conduct standards described in this Act, including conflicts arising out of transactions or arrangements with affiliates (including affiliates engaging in digital commodity activities) or between self-regulatory obligations and commercial interests, which may include information partitions, restrictions on employees and directors, and the legal separation of different persons or entities involved in digital commodity activities; and

"(ii) to ensure that the activities of any person within the digital commodity exchange or any affiliated entity relating to research or analysis of the price or market for any digital commodity or acting in a role of providing dealing, brokering, or advising activities are separated by appropriate informational partitions within the digital commodity exchange or any affili-

ated entity from the review, pressure, or oversight of persons whose involvement in pricing, trading, exchange, or clearing activities might potentially bias their judgment or supervision and contravene the core principles of open access and the business conduct standards described in this Act; and

''(B) address such other issues as the Commission determines to be appropriate.

''(12) FINANCIAL RESOURCES.—

''(A) IN GENERAL.—A digital commodity exchange shall have adequate financial, operational, and managerial resources, as determined by the Commission, to discharge each responsibility of the digital commodity exchange.

''(B) MINIMUM AMOUNT OF FINANCIAL RESOURCES.—A digital commodity exchange shall possess financial resources that, at a minimum, exceed the greater of—

''(i) the total amount that would enable the digital commodity exchange to conduct an orderly wind-down of its activities or

"(ii) the total amount that would enable the digital commodity exchange to cover the operating costs of the digital commodity exchange for a 1-year period, as calculated on a rolling basis.

"(13) DISCIPLINARY PROCEDURES.—A digital commodity exchange shall establish and enforce disciplinary procedures that authorize the digital commodity exchange to discipline, suspend, or expel members or market participants that violate the rules of the digital commodity exchange, or similar methods for performing the same functions, including delegation of the functions to third parties.

"(14) GOVERNANCE FITNESS STANDARDS.—

"(A) GOVERNANCE ARRANGEMENTS.—A digital commodity exchange shall establish governance arrangements that are transparent to fulfill public interest requirements.

"(B) FITNESS STANDARDS.—A digital commodity exchange shall establish and enforce appropriate fitness standards for—

"(i) directors; and

"(ii) any individual or entity with direct access to, or control of, customer assets.

''(15) SYSTEM SAFEGUARDS.—A digital commodity exchange shall—

''(A) establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational and security risks, through the development of appropriate controls and procedures, and automated systems, that—

''(i) are reliable and secure; and

''(ii) have adequate scalable capacity;

''(B) establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allow for—

''(i) the timely recovery and resumption of operations; and

''(ii) the fulfillment of the responsibilities and obligations of the digital commodity exchange; and

''(C) periodically conduct tests to verify that the backup resources of the digital commodity exchange are sufficient to ensure continued—

''(i) order processing and trade matching;

''(ii) price reporting;

''(iii) market surveillance; and

"(iv) maintenance of a comprehensive and accurate audit trail.

"(d) HOLDING OF CUSTOMER ASSETS.—

"(1) IN GENERAL.—A digital commodity exchange shall hold customer money, assets, and property in a manner to minimize the risk of loss to the customer or unreasonable delay in the access to the money, assets, and property of the customer.

"(A) SEGREGATION OF FUNDS.—

"(i) IN GENERAL.—A digital commodity exchange shall treat and deal with all money, assets, and property that is received by the digital commodity exchange, or accrues to a customer as the result of trading in digital commodities, as belonging to the customer.

"(ii) COMMINGLING PROHIBITED.—Money, assets, and property of a customer described in clause (i) shall be separately accounted for and shall not be commingled with the funds of the digital commodity exchange or be used to margin, secure, or guarantee any trades or accounts of any customer or person other than the person for whom the same are held.

"(B) EXCEPTIONS.—

"(i) USE OF FUNDS.—

"(I) IN GENERAL.—Notwithstanding subparagraph (A), money, assets, and property of customers of a digital commodity exchange described in subparagraph (A) may, for convenience, be commingled and deposited in the same account or accounts with any bank, trust company, derivatives clearing organization, or qualified digital commodity custodian.

"(II) WITHDRAWAL.—Notwithstanding subparagraph (A), such share of the money, assets, and property described in item (aa) as in the normal course of business shall be necessary to margin, guarantee, secure, transfer, adjust, or settle a contract of sale of a digital commodity with a registered entity may be withdrawn and applied to such purposes, including the payment of commissions, brokerage, interest, taxes, storage, and other charges, lawfully ac-

cruing in connection with the contract of sale of a digital commodity.

"(ii) COMMISSION ACTION.—Notwithstanding subparagraph (A), in accordance with such terms and conditions as the Commission may prescribe by rule, regulation, or order, any money, assets, or property of the customers of a digital commodity exchange described in subparagraph (A) may be commingled and deposited in customer accounts with any other money, assets, or property received by the digital commodity exchange and required by the Commission to be separately accounted for and treated and dealt with as belonging to the customer of the digital commodity exchange.

"(2) PERMITTED INVESTMENTS.—Money described in subparagraph (A) may be invested in obligations of the United States, in general obligations of any State or of any political subdivision of a State, and in obligations fully guaranteed as to principal and interest by the United States, or in any other investment that the Commission may by rule or regulation prescribe, and such investments shall

be made in accordance with such rules and regulations and subject to such conditions as the Commission may prescribe.

''(3) CUSTOMER PROTECTION DURING BANKRUPTCY.—

''(A) CUSTOMER PROPERTY.—All assets held on behalf of a customer by a digital commodity exchange, and all money, assets, and property of any customer received by a digital commodity exchange for trading or custody, or to facilitate, margin, guarantee, or secure contracts of sale of a digital commodity (including money, assets, or property accruing to the customer as the result of the transactions), shall be considered customer property for purposes of section 761 of title 11, United States Code.

''(B) TRANSACTIONS.—A transaction involving a unit of a digital commodity occurring on or subject to the rules of a digital commodity exchange shall be considered a 'contract for the purchase or sale of a commodity for future delivery, on or subject to the rules of, a contract market or board of trade' for the purposes of the definition of a 'commodity con-

tract' in section 761 of title 11, United States Code.

"(C) EXCHANGES.—A digital commodity exchange shall be considered a futures commission merchant for purposes of section 761 of title 11, United States Code.

"(D) ASSETS REMOVED FROM SEGREGATION.—Assets removed from segregation due to a customer election under paragraph (5) shall not be considered customer property for purposes of section 761 of title 11, United States Code.

"(4) MISUSE OF CUSTOMER PROPERTY.—

"(A) IN GENERAL.—It shall be unlawful—

"(i) for any digital commodity exchange that has received any customer money, assets, or property for custody to dispose of, or use any such money, assets, or property as belonging to the digital commodity exchange or any person other than a customer of the digital commodity exchange; or

"(ii) for any other person, including any depository, other digital commodity exchange, or digital commodity custodian

that has received any customer money, assets, or property for deposit, to hold, dispose of, or use any such money, assets, or property, or property, as belonging to the depositing digital commodity exchange or any person other than the customers of the digital commodity exchange.

''(B) USE FURTHER DEFINED.—For purposes of this section, 'use' of a digital commodity includes utilizing any unit of a digital asset to participate in a blockchain service defined in paragraph (5) or a decentralized governance system associated with the digital commodity or the blockchain system to which the digital commodity relates in any manner other than that expressly directed by the customer from whom the unit of a digital commodity was received.

''(5) PARTICIPATION IN BLOCKCHAIN SERVICES.—

''(A) IN GENERAL.—A customer shall have the right to waive the restrictions in paragraph (1) for any unit of a digital commodity to be used under subparagraph (B), by affirmatively

electing, in writing to the digital commodity exchange, to waive the restrictions.

''(B) USE OF FUNDS.—Customer digital commodities removed from segregation under subparagraph (A) may be pooled and used by the digital commodity exchange or its designee to provide a blockchain service for a blockchain system to which the unit of the digital asset removed from segregation in subparagraph (A) relates.

''(C) LIMITATIONS.—

''(i) IN GENERAL.—The Commission may, by rule, establish notice and disclosure requirements, and any other limitations and rules related to the waiving of any restrictions under this paragraph that are reasonably necessary to protect customers, including eligible contract participants, non-eligible contract participants, or any other class of customers.

''(ii) CUSTOMER CHOICE.—A digital commodity exchange may not require a waiver from a customer described in subparagraph (A) as a condition of doing business on the exchange.

''(D) BLOCKCHAIN SERVICE DEFINED.—In this subparagraph, the term 'blockchain service' means any activity relating to validating transactions on a blockchain system, providing security for a blockchain system, or other similar activity required for the ongoing operation of a blockchain system.

''(e) MARKET ACCESS REQUIREMENTS.—

''(1) IN GENERAL.—A digital commodity exchange shall require any person who is not an eligible contract participant to access trading on the exchange through a digital commodity broker.

''(2) AFFILIATED COMMODITY BROKERS.—A registered digital commodity exchange may permit an affiliated digital commodity broker to facilitate access to the digital commodity exchange.

''(3) DIRECT ACCESS FOR ELIGIBLE CONTRACT PARTICIPANTS.—Nothing in this section shall prohibit a digital commodity exchange in compliance with this section from permitting direct access for eligible contract participants.

''(4) ADDITIONAL REQUIREMENTS.—The Commission may, by rule, impose any additional requirements related to the operations and activities of the digital commodity exchange and an affiliated digital

commodity broker necessary to protect market participants, promote fair and equitable trading on the digital commodity exchange, and promote responsible economic or financial innovation.

"(f) DESIGNATION OF CHIEF COMPLIANCE OFFICER.—

"(1) IN GENERAL.—A digital commodity exchange shall designate an individual to serve as a chief compliance officer.

"(2) DUTIES.—The chief compliance officer shall—

"(A) report directly to the board or to the senior officer of the exchange;

"(B) review compliance with the core principles in this subsection;

"(C) in consultation with the board of the exchange, a body performing a function similar to that of a board, or the senior officer of the exchange, resolve any conflicts of interest that may arise;

"(D) establish and administer the policies and procedures required to be established pursuant to this section;

"(E) ensure compliance with this Act and the rules and regulations issued under this Act,

including rules prescribed by the Commission pursuant to this section; and

"(F) establish procedures for the remediation of noncompliance issues found during compliance office reviews, look backs, internal or external audit findings, self-reported errors, or through validated complaints.

"(3) REQUIREMENTS FOR PROCEDURES.—In establishing procedures under paragraph (2)(F), the chief compliance officer shall design the procedures to establish the handling, management response, remediation, retesting, and closing of noncompliance issues.

"(4) ANNUAL REPORTS.—

"(A) IN GENERAL.—In accordance with rules prescribed by the Commission, the chief compliance officer shall annually prepare and sign a report that contains a description of—

"(i) the compliance of the digital commodity exchange with this Act; and

"(ii) the policies and procedures, including the code of ethics and conflict of interest policies, of the digital commodity exchange.

''(B) REQUIREMENTS.—The chief compliance officer shall—

''(i) submit each report described in subparagraph (A) with the appropriate financial report of the digital commodity exchange that is required to be submitted to the Commission pursuant to this section; and

''(ii) include in the report a certification that, under penalty of law, the report is accurate and complete.

''(g) APPOINTMENT OF TRUSTEE.—

''(1) IN GENERAL.—If a proceeding under section 5e results in the suspension or revocation of the registration of a digital commodity exchange, or if a digital commodity exchange withdraws from registration, the Commission, on notice to the digital commodity exchange, may apply to the appropriate United States district court where the digital commodity exchange is located for the appointment of a trustee.

''(2) ASSUMPTION OF JURISDICTION.—If the Commission applies for appointment of a trustee under paragraph (1)—

"(A) the court may take exclusive jurisdiction over the digital commodity exchange and the records and assets of the digital commodity exchange, wherever located; and

"(B) if the court takes jurisdiction under subparagraph (A), the court shall appoint the Commission, or a person designated by the Commission, as trustee with power to take possession and continue to operate or terminate the operations of the digital commodity exchange in an orderly manner for the protection of customers subject to such terms and conditions as the court may prescribe.

"(h) QUALIFIED DIGITAL COMMODITY CUSTODIAN.—A digital commodity exchange shall hold in a qualified digital commodity custodian each unit of a digital commodity that is—

"(1) the property of a customer of the digital commodity exchange;

"(2) required to be held by the digital commodity exchange under subsection (c)(12) of this section; or

"(3) otherwise so required by the Commission to reasonably protect customers or promote the public interest.

''(i) EXEMPTIONS.—

''(1) In order to promote responsible economic or financial innovation and fair competition, or protect customers, the Commission may (on its own initiative or on application of the registered digital commodity exchange) exempt, either unconditionally or on stated terms or conditions or for stated periods and either retroactively or prospectively, or both, a registered digital commodity exchange from the requirements of this section, if the Commission determines that—

''(A) the exemption would be consistent with the public interest and the purposes of this Act; and

''(B) the exemption will not have a material adverse effect on the ability of the Commission or the digital commodity exchange to discharge regulatory or self-regulatory duties under this Act.

''(2) The Commission may exempt, conditionally or unconditionally, a digital commodity exchange from registration under this section if the Commission finds that the digital commodity exchange is subject to comparable, comprehensive supervision and regulation on a consolidated basis by

the appropriate governmental authorities in the home country of the facility.

''(j) CUSTOMER DEFINED.—In this section, the term 'customer' means any person that maintains an account for the trading of digital commodities directly with a digital commodity exchange (other than a person that is owned or controlled, directly or indirectly, by the digital commodity exchange) for its own behalf or on behalf of any other person.

''(k) FEDERAL PREEMPTION.—Notwithstanding any other provision of law, the Commission shall have exclusive jurisdiction over any digital commodity exchange registered under this section.

''(l) WITHDRAWAL OF CERTIFICATION OF A BLOCKCHAIN SYSTEM.—

''(1) IN GENERAL.—

''(A) DETERMINATION BY A DIGITAL COMMODITY EXCHANGE.—With respect to a certification of a blockchain system that becomes effective pursuant to section 44(f) of the Securities Exchange Act of 1934, if a digital commodity exchange determines that the blockchain system may not be a decentralized system, the digital commodity exchange shall notify the Commission of such determination.

"(B) WITHDRAWAL PROCESS.—With respect to each notification received under subparagraph (A), the Commission shall initiate a withdrawal process under which the Commission shall—

"(i) publish a notice announcing the proposed withdrawal;

"(ii) provide a 30 day comment period with respect to the proposed withdrawal; and

"(iii) after the end of the 30-day comment required under clause (ii), publish either—

"(I) a notification of withdrawal of the applicable certification; or

"(II) a notice that the Commission is not withdrawing the certification.

"(C) DETAILED ANALYSIS REQUIRED.—The Commission shall include, with each publication of a notification of withdrawal described under subparagraph (B)(iii)(I), a detailed analysis of the factors on which the decision was based.

''(2) RECERTIFICATION.—With respect to a blockchain system for which a certification has been withdrawn under this subsection, no person may make a certification under section 44(a) of the Securities Exchange Act of 1934 with respect to such blockchain system during the 90-day period beginning on the date of such withdrawal.

''(3) APPEAL OF WITHDRAWAL.—

''(A) IN GENERAL.—If a certification is withdrawn under this subsection, a person making may appeal the decision to the United States Court of Appeals for the District of Columbia, not later than 60 days after the notice of withdrawal is made.

''(B) REVIEW.—In an appeal under subparagraph (A), the court shall have de novo review of the determination to withdraw the certification.''.

SEC. 505. QUALIFIED DIGITAL COMMODITY CUSTODIANS.

The Commodity Exchange Act (7 U.S.C. 1 et seq.), as amended by the preceding provisions of this Act, is amended by inserting after section 5i the following:

''SEC. 5j. QUALIFIED DIGITAL COMMODITY CUSTODIANS.

''(a) IN GENERAL.—A digital commodity custodian is a qualified digital commodity custodian if the digital

commodity custodian complies with the requirements of this section.

''(b) SUPERVISION REQUIREMENT.—A digital commodity custodian that is not subject to supervision and examination by an appropriate Federal banking agency, the National Credit Union Administration, the Commission, or the Securities and Exchange Commission shall be subject to adequate supervision and appropriate regulation by—

''(1) a State bank supervisor (within the meaning of section 3 of the Federal Deposit Insurance Act);

''(2) a State credit union supervisor, as defined under section 6003 of the Anti-Money Laundering Act of 2020; or

''(3) an appropriate foreign governmental authority in the home country of the digital commodity custodian.

''(c) OTHER REQUIREMENTS.—

''(1) NOT OTHERWISE PROHIBITED.—The digital commodity custodian has not been prohibited by a supervisor of the digital commodity custodian from engaging in an activity with respect to the custody and safekeeping of digital commodities.

''(2) INFORMATION SHARING.—

"(A) IN GENERAL.—A digital commodity custodian shall share information with the Commission on request and comply with such requirements for periodic sharing of information regarding customer accounts that the digital commodity custodian holds on behalf of an entity registered with the Commission as the Commission determines by rule are reasonably necessary to effectuate any of the provisions, or to accomplish any of the purposes, of this Act.

"(B) PROVISION OF INFORMATION.—Any entity that is subject to regulation and examination by an appropriate Federal banking agency may satisfy any information request described in subparagraph (A) by providing the Commission with a detailed listing, in writing, of the digital commodities of a customer within the custody or use of the entity.

"(d) ADEQUATE SUPERVISION AND APPROPRIATE REGULATION.—

"(1) IN GENERAL.—For purposes of subsection (b), the terms 'adequate supervision' and 'appropriate regulation' mean such minimum standards for supervision and regulation as are reasonably necessary to protect the digital commodities of cus-

tomers of an entity registered with the Commission, including standards relating to the licensing, examination, and supervisory processes that require the digital commodity custodian to, at a minimum—

"(A) receive a review and evaluation of ownership, character and fitness, conflicts of interest, business model, financial statements, funding resources, and policies and procedures of the digital commodity custodian;

"(B) hold capital sufficient for the financial integrity of the digital commodity custodian;

"(C) protect customer assets;

"(D) establish and maintain books and records regarding the business of the digital commodity custodian;

"(E) submit financial statements and audited financial statements to the applicable supervisor described in subsection (b);

"(F) provide disclosures to the applicable supervisor described in subsection (b) regarding actions, proceedings, and other items as determined by the supervisor;

"(G) maintain and enforce policies and procedures for compliance with applicable State

and Federal laws, including those related to anti-money laundering and cybersecurity;

"(H) establish a business continuity plan to ensure functionality in cases of disruption; and

"(I) establish policies and procedures to resolve complaints.

"(2) RULEMAKING WITH RESPECT TO DEFINITIONS.—

"(A) IN GENERAL.—For purposes of this section, the Commission may, by rule, further define the terms 'adequate supervision' and 'appropriate regulation' as necessary in the public interest, as appropriate for the protection of investors, and consistent with the purposes of this Act.

"(B) CONDITIONAL TREATMENT OF CERTAIN CUSTODIANS BEFORE RULEMAKING.—Before the effective date of a rulemaking under subparagraph (A), a trust company is deemed subject to adequate supervision and appropriate regulation if—

"(i) the trust company is expressly permitted by a State bank supervisor to

engage in the custody and safekeeping of digital commodities;

"(ii) the State bank supervisor has established licensing, examination, and supervisory processes that require the trust company to, at a minimum, meet the conditions described in subparagraphs (A) through (I) of paragraph (1); and

"(iii) the trust company is in good standing with its State bank supervisor.

"(C) TRANSITION PERIOD FOR CERTAIN CUSTODIANS.—In implementing the rulemaking under subparagraph (A), the Commission shall provide a transition period of not less than 2 years for any trust company that is deemed subject to adequate supervision and appropriate regulation under subparagraph (B) on the effective date of the rulemaking.

"(e) AUTHORITY TO TEMPORARILY SUSPEND STANDARDS.—The Commission may, by rule or order, temporarily suspend, in whole or in part, any requirement imposed under, or any standard referred to in, this section if the Commission determines that the suspension would be consistent with the public interest and the purposes of this Act.".

SEC. 506. REGISTRATION AND REGULATION OF DIGITAL COMMODITY BROKERS AND DEALERS.

The Commodity Exchange Act (7 U.S.C. 1 et seq.), as amended by the preceding provisions of this Act, is amended by inserting after section 4t the following:

"SEC. 4u. REGISTRATION AND REGULATION OF DIGITAL COMMODITY BROKERS AND DEALERS.

''(a) REGISTRATION.—It shall be unlawful for any person to act as a digital commodity broker or digital commodity dealer unless the person is registered as such with the Commission.

''(b) REQUIREMENTS.—

''(1) IN GENERAL.—A person shall register as a digital commodity broker or digital commodity dealer by filing a registration application with the Commission.

''(2) CONTENTS.—

''(A) IN GENERAL.—The application shall be made in such form and manner as is prescribed by the Commission, and shall contain such information as the Commission considers necessary concerning the business in which the applicant is or will be engaged.

''(B) CONTINUAL REPORTING.—A person that is registered as a digital commodity broker or digital commodity dealer shall continue to

submit to the Commission reports that contain such information pertaining to the business of the person as the Commission may require.

''(3) STATUTORY DISQUALIFICATION.—Except to the extent otherwise specifically provided by rule, regulation, or order, it shall be unlawful for a digital commodity broker or digital commodity dealer to permit any person who is associated with a digital commodity broker or a digital commodity dealer and who is subject to a statutory disqualification to effect or be involved in effecting a contract of sale of a digital commodity on behalf of the digital commodity broker or the digital commodity dealer, respectively, if the digital commodity broker or digital commodity dealer, respectively, knew, or in the exercise of reasonable care should have known, of the statutory disqualification.

''(4) LIMITATIONS ON CERTAIN ASSETS.—A digital commodity broker or digital commodity dealer shall not offer, offer to enter into, enter into, or facilitate any contract of sale of a digital commodity that has not been certified under section 5c(d).

''(c) ADDITIONAL REGISTRATIONS.—

''(1) WITH THE COMMISSION.—Any person required to be registered as a digital commodity

broker or digital commodity dealer may also be registered as a futures commission merchant, introducing broker, or swap dealer.

''(2) WITH THE SECURITIES AND EXCHANGE COMMISSION.—Any person required to be registered as a digital commodity broker or digital commodity dealer under this section may register with the Securities and Exchange Commission as a digital asset broker or digital asset dealer, pursuant to section 15(b) of the Securities Exchange Act of 1934.

''(3) WITH MEMBERSHIP IN A REGISTERED FUTURES ASSOCIATION.—Any person required to be registered as a digital commodity broker or digital commodity dealer under this section shall be a member of a registered futures association.

''(4) REGISTRATION REQUIRED.—Any person required to be registered as a digital commodity broker or digital commodity dealer under this section shall register with the Commission as such regardless of whether the person is registered with another State or Federal regulator.

''(d) RULEMAKING.—

''(1) IN GENERAL.—The Commission shall prescribe such rules applicable to registered digital commodity brokers and registered digital commodity

dealers as are appropriate to carry out this section, including rules in the public interest that limit the activities of digital commodity brokers and digital commodity dealers.

"(2) MULTIPLE REGISTRANTS.—The Commission shall prescribe rules or regulations permitting, or may otherwise authorize, exemptions or additional requirements applicable to persons with multiple registrations under this Act, including as futures commission merchants, introducing brokers, digital commodity brokers, digital commodity dealers, or swap dealers, as may be in the public interest to reduce compliance costs and promote customer protection.

"(e) CAPITAL REQUIREMENTS.—

"(1) IN GENERAL.—Each digital commodity broker and digital commodity dealer shall meet such minimum capital requirements as the Commission may prescribe to address the risks associated with digital commodity trading and to ensure that the digital commodity broker or digital commodity dealer, respectively, is able to—

"(A) meet, and continue to meet, at all times, the obligations of such a registrant; and

"(B) in the case of a digital commodity dealer, fulfill the counterparty obligations of the

digital commodity dealer for any margined, leveraged, or financed transactions.

"(2) RULE OF CONSTRUCTION.—Nothing in this section shall limit, or be construed to limit, the authority of the Securities and Exchange Commission to set financial responsibility rules for a broker or dealer registered pursuant to section 15(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b)) (except for section 15(b)(11) of such Act (15 U.S.C. 78o(b)(11)) in accordance with section 15(c)(3) of such Act (15 U.S.C. 78o(c)(3)).

"(3) FUTURES COMMISSION MERCHANTS AND OTHER DEALERS.—Each futures commission merchant, introducing broker, digital commodity broker, digital commodity dealer, broker, and dealer shall maintain sufficient capital to comply with the stricter of any applicable capital requirements to which the futures commission merchant, introducing broker, digital commodity broker, digital commodity dealer, broker, or dealer, respectively, is subject under this Act or the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.).

"(f) REPORTING AND RECORDKEEPING.—Each digital commodity broker and digital commodity dealer—

''(1) shall make such reports as are required by the Commission by rule or regulation regarding the transactions, positions, and financial condition of the digital commodity broker or digital commodity dealer, respectively;

''(2) shall keep books and records in such form and manner and for such period as may be prescribed by the Commission by rule or regulation; and

''(3) shall keep the books and records open to inspection and examination by any representative of the Commission.

''(g) DAILY TRADING RECORDS.—

''(1) IN GENERAL.—Each digital commodity broker and digital commodity dealer shall maintain daily trading records of the transactions of the digital commodity broker or digital commodity dealer, respectively, and all related records (including related forward or derivatives transactions) and recorded communications, including electronic mail, instant messages, and recordings of telephone calls, for such period as the Commission may require by rule or regulation.

''(2) INFORMATION REQUIREMENTS.—The daily trading records shall include such information as the Commission shall require by rule or regulation.

''(3) COUNTERPARTY RECORDS.—Each digital commodity broker and digital commodity dealer shall maintain daily trading records for each customer or counterparty in a manner and form that is identifiable with each digital commodity transaction.

''(4) AUDIT TRAIL.—Each digital commodity broker and digital commodity dealer shall maintain a complete audit trail for conducting comprehensive and accurate trade reconstructions.

''(h) BUSINESS CONDUCT STANDARDS.—

''(1) IN GENERAL.—Each digital commodity broker and digital commodity dealer shall conform with such business conduct standards as the Commission, by rule or regulation, prescribes related to—

''(A) fraud, manipulation, and other abusive practices involving spot or margined, leveraged, or financed digital commodity transactions (including transactions that are offered but not entered into);

''(B) diligent supervision of the business of the registered digital commodity broker or digital commodity dealer, respectively; and

''(C) such other matters as the Commission deems appropriate.

''(2) BUSINESS CONDUCT REQUIREMENTS.—The Commission shall, by rule, prescribe business conduct requirements which—

''(A) require disclosure by a registered digital commodity broker and registered digital commodity dealer to any counterparty to the transaction (other than an eligible contract participant) of—

''(i) information about the material risks and characteristics of the digital commodity;

''(ii) information about the material risks and characteristics of the transaction;

''(B) establish a duty for such a digital commodity broker and such a digital commodity dealer to communicate in a fair and balanced manner based on principles of fair dealing and good faith;

''(C) establish standards governing digital commodity broker and digital commodity dealer marketing and advertising, including testimonials and endorsements; and

''(D) establish such other standards and requirements as the Commission may determine are—

"(i) in the public interest;

"(ii) appropriate for the protection of customers; or

"(iii) otherwise in furtherance of the purposes of this Act.

"(3) PROHIBITION ON FRAUDULENT PRACTICES.—It shall be unlawful for a digital commodity broker or digital commodity dealer to—

"(A) employ any device, scheme, or artifice to defraud any customer or counterparty;

"(B) engage in any transaction, practice, or course of business that operates as a fraud or deceit on any customer or counterparty; or

"(C) engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative.

"(i) DUTIES.—

"(1) RISK MANAGEMENT PROCEDURES.—Each digital commodity broker and digital commodity dealer shall establish robust and professional risk management systems adequate for managing the day-to-day business of the digital commodity broker or digital commodity dealer, respectively.

"(2) DISCLOSURE OF GENERAL INFORMATION.—Each digital commodity broker and digital

commodity dealer shall disclose to the Commission information concerning—

"(A) the terms and conditions of the transactions of the digital commodity broker or digital commodity dealer, respectively;

"(B) the trading operations, mechanisms, and practices of the digital commodity broker or digital commodity dealer, respectively;

"(C) financial integrity protections relating to the activities of the digital commodity broker or digital commodity dealer, respectively; and

"(D) other information relevant to trading in digital commodities by the digital commodity broker or digital commodity dealer, respectively.

"(3) ABILITY TO OBTAIN INFORMATION.—Each digital commodity broker and digital commodity dealer shall—

"(A) establish and enforce internal systems and procedures to obtain any necessary information to perform any of the functions described in this section; and

"(B) provide the information to the Commission, on request.

"(4) CONFLICTS OF INTEREST.—Each digital commodity broker and digital commodity dealer shall

implement conflict-of-interest systems and procedures that—

"(A) establish structural and institutional safeguards—

"(i) to minimize conflicts of interest that might potentially bias the judgment or supervision of the digital commodity broker or digital commodity dealer, respectively, and contravene the principles of fair and equitable trading and the business conduct standards described in this Act, including conflicts arising out of transactions or arrangements with affiliates (including affiliates acting as digital asset issuers, digital commodity dealers, or qualified digital commodity custodians), which may include information partitions and the legal separation of different persons involved in digital commodity activities; and

"(ii) to ensure that the activities of any person within the digital commodity broker or digital commodity dealer relating to research or analysis of the price or market for any digital commodity or acting in a role of providing exchange activities or

making determinations as to accepting exchange customers are separated by appropriate informational partitions within the digital commodity broker or digital commodity dealer from the review, pressure, or oversight of persons whose involvement in pricing, trading, exchange, or clearing activities might potentially bias their judgment or supervision and contravene the core principles of open access and the business conduct standards described in this Act; and

''(B) address such other issues as the Commission determines to be appropriate.

''(5) ANTITRUST CONSIDERATIONS.—Unless necessary or appropriate to achieve the purposes of this Act, a digital commodity broker or digital commodity dealer shall not—

''(A) adopt any process or take any action that results in any unreasonable restraint of trade; or

''(B) impose any material anticompetitive burden on trading or clearing.

''(j) DESIGNATION OF CHIEF COMPLIANCE OFFICER.—

"(1) IN GENERAL.—Each digital commodity broker and digital commodity dealer shall designate an individual to serve as a chief compliance officer.

"(2) DUTIES.—The chief compliance officer shall—

"(A) report directly to the board or to the senior officer of the registered digital commodity broker or registered digital commodity dealer;

"(B) review the compliance of the registered digital commodity broker or registered digital commodity dealer with respect to the registered digital commodity broker and registered digital commodity dealer requirements described in this section;

"(C) in consultation with the board of directors, a body performing a function similar to the board, or the senior officer of the organization, resolve any conflicts of interest that may arise;

"(D) be responsible for administering each policy and procedure that is required to be established pursuant to this section;

''(E) ensure compliance with this Act (including regulations), including each rule prescribed by the Commission under this section;

''(F) establish procedures for the remediation of noncompliance issues identified by the chief compliance officer through any—

''(i) compliance office review;

''(ii) look-back;

''(iii) internal or external audit finding;

''(iv) self-reported error; or

''(v) validated complaint; and

''(G) establish and follow appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues.

''(3) ANNUAL REPORTS.—

''(A) IN GENERAL.—In accordance with rules prescribed by the Commission, the chief compliance officer shall annually prepare and sign a report that contains a description of—

''(i) the compliance of the registered digital commodity broker or registered digital commodity dealer with respect to this Act (including regulations); and

''(ii) each policy and procedure of the registered digital commodity broker or registered digital commodity dealer of the chief compliance officer (including the code of ethics and conflict of interest policies).

''(B) REQUIREMENTS.—The chief compliance officer shall ensure that a compliance report under subparagraph (A)—

''(i) accompanies each appropriate financial report of the registered digital commodity broker or registered digital commodity dealer that is required to be furnished to the Commission pursuant to this section; and

''(ii) includes a certification that, under penalty of law, the compliance report is accurate and complete.

''(k) SEGREGATION OF DIGITAL COMMODITIES.—

''(1) HOLDING OF CUSTOMER ASSETS.—

''(A) IN GENERAL.—Each digital commodity broker and digital commodity dealer shall hold customer money, assets, and property in a manner to minimize the risk of loss to the customer or unreasonable delay in customer ac-

cess to the money, assets, and property of the customer.

''(B) QUALIFIED DIGITAL COMMODITY CUSTODIAN.—Each digital commodity broker and digital commodity dealer shall hold in a qualified digital commodity custodian each unit of a digital commodity that is—

''(i) the property of a customer or counterparty of the digital commodity broker or digital commodity dealer, respectively;

''(ii) required to be held by the digital commodity broker or digital commodity dealer under subsection (e); or

''(iii) otherwise so required by the Commission to reasonably protect customers or promote the public interest.

''(2) SEGREGATION OF FUNDS.—

''(A) IN GENERAL.—Each digital commodity broker and digital commodity dealer shall treat and deal with all money, assets, and property that is received by the digital commodity broker or digital commodity dealer, or accrues to a customer as the result of trading

in digital commodities, as belonging to the customer.

"(B) COMMINGLING PROHIBITED.—

"(i) IN GENERAL.—Except as provided in clause (ii), each digital commodity broker and digital commodity dealer shall separately account for money, assets, and property of a digital commodity customer, and shall not commingle any such money, assets, or property with the funds of the digital commodity broker or digital commodity dealer, respectively, or use any such money, assets, or property to margin, secure, or guarantee any trades or accounts of any customer or person other than the person for whom the money, assets, or property are held.

"(ii) EXCEPTIONS.—

"(I) USE OF FUNDS.—

"(aa) IN GENERAL.—A digital commodity broker or digital commodity dealer may, for convenience, commingle and deposit in the same account or accounts with any bank, trust company,

derivatives clearing organization, or qualified digital commodity custodian money, assets, and property of customers.

''(bb) WITHDRAWAL.—The share of the money, assets, and property described in item (aa) as in the normal course of business shall be necessary to margin, guarantee, secure, transfer, adjust, or settle a contract of sale of a digital commodity with a registered entity may be withdrawn and applied to such purposes, including the payment of commissions, brokerage, interest, taxes, storage, and other charges, lawfully accruing in connection with the contract.

''(II) COMMISSION ACTION.—In accordance with such terms and conditions as the Commission may prescribe by rule, regulation, or order, any money, assets, or property of the customers of a digital commodity

broker or digital commodity dealer may be commingled and deposited in customer accounts with any other money, assets, or property received by the digital commodity broker or digital commodity dealer, respectively, and required by the Commission to be separately accounted for and treated and dealt with as belonging to the customer of the digital commodity broker or digital commodity dealer, respectively.

''(3) PERMITTED INVESTMENTS.—Money described in paragraph (2) may be invested in obligations of the United States, in general obligations of any State or of any political subdivision of a State, in obligations fully guaranteed as to principal and interest by the United States, or in any other investment that the Commission may by rule or regulation allow.

''(4) CUSTOMER PROTECTION DURING BANKRUPTCY.—

''(A) CUSTOMER PROPERTY.—All money, assets, or property described in paragraph (2) shall be considered customer property for pur-

poses of section 761 of title 11, United States Code.

''(B) TRANSACTIONS.—A transaction involving a unit of a digital commodity occurring with a digital commodity dealer shall be considered a 'contract for the purchase or sale of a commodity for future delivery, on or subject to the rules of, a contract market or board of trade' for purposes of the definition of a 'commodity contract' in section 761 of title 11, United States Code.

''(C) BROKERS AND DEALERS.—A digital commodity dealer and a digital commodity broker shall be considered a futures commission merchant for purposes of section 761 of title 11, United States Code.

''(D) ASSETS REMOVED FROM SEGREGATION.—Assets removed from segregation due to a customer election under paragraph (6) shall not be considered customer property for purposes of section 761 of title 11, United States Code.

''(5) MISUSE OF CUSTOMER PROPERTY.—

''(A) IN GENERAL.—It shall be unlawful—

"(i) for any digital commodity broker or digital commodity dealer that has received any customer money, assets, or property for custody to dispose of, or use any such money, assets, or property as belonging to the digital commodity broker or digital commodity dealer, respectively, or any person other than a customer of the digital commodity broker or digital commodity dealer, respectively; or

"(ii) for any other person, including any depository, digital commodity exchange, other digital commodity broker, other digital commodity dealer, or digital commodity custodian that has received any customer money, assets, or property for deposit, to hold, dispose of, or use any such money, assets, or property, as belonging to the depositing digital commodity broker or digital commodity dealer or any person other than the customers of the digital commodity broker or digital commodity dealer, respectively.

"(B) USE FURTHER DEFINED.—For purposes of this section, 'use' of a digital com-

modity includes utilizing any unit of a digital asset to participate in a blockchain service defined in paragraph (6) or a decentralized governance system associated with the digital commodity or the blockchain system to which the digital commodity relates in any manner other than that expressly directed by the customer from whom the unit of a digital commodity was received.

"(6) PARTICIPATION IN BLOCKCHAIN SERVICES.—

"(A) IN GENERAL.—A customer shall have the right to waive the restrictions in paragraph (1) for any unit of a digital commodity to be used under subparagraph (B), by affirmatively electing, in writing to the digital commodity broker or digital commodity dealer, to waive the restrictions.

"(B) USE OF FUNDS.—Customer digital commodities removed from segregation under subparagraph (A) may be pooled and used by the digital commodity broker or digital commodity dealer, or one of their designees, to provide a blockchain service for a blockchain system to which the unit of the digital asset re-

moved from segregation in subparagraph (A) relates.

"(C) LIMITATIONS.—

"(i) IN GENERAL.—The Commission may, by rule, establish notice and disclosure requirements, and any other limitations and rules related to the waiving of any restrictions under this paragraph that are reasonably necessary to protect customers, including eligible contract participants, non-eligible contract participants, or any other class of customers.

"(ii) CUSTOMER CHOICE.—A digital commodity broker or digital commodity dealer may not require a waiver from a customer described in subparagraph (A) as a condition of doing business with the broker or dealer.

"(D) BLOCKCHAIN SERVICE DEFINED.—In this subparagraph, the term 'blockchain service' means any activity relating to validating transactions on a blockchain system, providing security for a blockchain system, or other similar activity required for the ongoing operation of a blockchain system.

''(l) FEDERAL PREEMPTION.—Notwithstanding any other provision of law, the Commission shall have exclusive jurisdiction over any digital commodity broker or digital commodity dealer registered under this section.

''(m) EXEMPTIONS.—In order to promote responsible economic or financial innovation and fair competition, or protect customers, the Commission may (on its own initiative or on application of the registered digital commodity broker or registered digital commodity dealer) exempt, unconditionally or on stated terms or conditions, or for stated periods, and retroactively or prospectively, or both, a registered digital commodity broker or registered digital commodity dealer from the requirements of this section, if the Commission determines that—

''(1)(A) the exemption would be consistent with the public interest and the purposes of this Act; and

''(B) the exemption will not have a material adverse effect on the ability of the Commission to discharge regulatory duties under this Act; or

''(2) the registered digital commodity broker or registered digital commodity dealer is subject to comparable, comprehensive supervision and regulation by the appropriate government authorities in the home country of the registered digital commodity

broker or registered digital commodity dealer, respectively.''.

SEC. 507. REGISTRATION OF ASSOCIATED PERSONS.

(a) IN GENERAL.—Section 4k of the Commodity Exchange Act (7 U.S.C. 6k) is amended—

(1) by redesignating subsections (4) through (6) as subsections (5) through (7), respectively; and

(2) by inserting after subsection (3) the following:

''(4) It shall be unlawful for any person to act as an associated person of a digital commodity broker or an associated person of a digital commodity dealer unless the person is registered with the Commission under this Act and such registration shall not have expired, been suspended (and the period of suspension has not expired), or been revoked. It shall be unlawful for a digital commodity broker or a digital commodity dealer to permit such a person to become or remain associated with the digital commodity broker or digital commodity dealer if the digital commodity broker or digital commodity dealer knew or should have known that the person was not so registered or that the registration had expired, been suspended (and the period of suspension has not expired), or been revoked.''; and

(3) in subsection (5) (as so redesignated), by striking ''or of a commodity trading advisor'' and inserting ''of a commodity trading advisor, of a digital commodity broker, or of a digital commodity dealer''.

(b) CONFORMING AMENDMENTS.—The Commodity Exchange Act (7 U.S.C. 1a et seq.) is amended by striking ''section 4k(6)'' each place it appears and inserting ''section 4k(7)''.

SEC. 508. REGISTRATION OF COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS.

(a) IN GENERAL.—Section 4m(3) of the Commodity Exchange Act (7 U.S.C. 6m(3)) is amended—

(1) in subparagraph (A)—

(A) by striking ''any commodity trading advisor'' and inserting ''a commodity pool operator or commodity trading advisor''; and

(B) by striking ''acting as a commodity trading advisor'' and inserting ''acting as a commodity pool operator or commodity trading advisor''; and

(2) in subparagraph (C), by inserting ''digital commodities,'' after ''physical commodities,''.

(b) EXEMPTIVE AUTHORITY.—Section 4m of such Act (7 U.S.C. 6m) is amended by adding at the end the following:

''(4) EXEMPTIVE AUTHORITY.—The Commission shall promulgate rules to provide appropriate exemptions for commodity pool operators and commodity trading advisors, to provide relief from duplicative, conflicting, or unduly burdensome requirements or to promote responsible innovation, to the extent the exemptions foster the development of fair and orderly cash or spot digital commodity markets, are necessary or appropriate in the public interest, and are consistent with the protection of customers.''.

SEC. 509. EXCLUSION FOR DECENTRALIZED FINANCE ACTIVITIES.

The Commodity Exchange Act (7 U.S.C. 1 et seq.), as amended by the preceding provisions of this Act, is amended by inserting after section 4u the following:

''SEC. 4v. DECENTRALIZED FINANCE ACTIVITIES NOT SUBJECT TO THIS ACT.

''(a) IN GENERAL.—Notwithstanding any other provision of this Act, a person shall not be subject to this Act and the regulations promulgated under this Act based on the person directly or indirectly engaging in any of the following activities, whether singly or in combination, in relation to the operation of a blockchain system or in rela-

tion to decentralized finance (as defined in section 605(d) of the Financial Innovation and Technology for the 21st Century Act):

''(1) Compiling network transactions, operating or participating in a liquidity pool, relaying, searching, sequencing, validating, or acting in a similar capacity with respect to contract of sale of a digital asset.

''(2) Providing computational work, operating a node, or procuring, offering, or utilizing network bandwidth, or other similar incidental services with respect to a contract of sale of a digital asset.

''(3) Providing a user-interface that enables a user to read, and access data about a blockchain system, send messages, or otherwise interact with a blockchain system.

''(4) Developing, publishing, constituting, administering, maintaining, or otherwise distributing a blockchain system.

''(5) Developing, publishing, constituting, administering, maintaining, or otherwise distributing software or systems that create or deploy hardware or software, including wallets or other systems, facilitating an individual user's own personal ability to

keep, safeguard, or custody the user's digital commodities or related private keys.

''(b) EXCEPTIONS.—Subsection (a) shall not be interpreted to apply to the anti-fraud, anti-manipulation, or false reporting enforcement authorities of the Commission.''.

SEC. 510. FUNDING FOR IMPLEMENTATION AND ENFORCEMENT.

(a) COLLECTION OF FEES.—

(1) IN GENERAL.—The Commodity Futures Trading Commission (in this section referred to as the ''Commission'') shall charge and collect a filing fee from each person who files with the Commission a notice of intent to register as a digital commodity exchange, digital commodity broker, or digital commodity dealer pursuant to section 106.

(2) AMOUNT.—The fees authorized under paragraph (1) may be collected and available for obligation only in the amounts provided in advance in an appropriation Act.

(3) AUTHORITY TO ADJUST FEES.—Notwithstanding the preceding provisions of this subsection, to promote fair competition or innovation, the Commission, in its sole discretion, may reduce or elimi-

nate any fee otherwise required to be paid by a small or medium filer under this subsection.

(b) FEE SCHEDULE.—

(1) IN GENERAL.—The Commission shall publish in the Federal Register a schedule of the fees to be charged and collected under this section.

(2) CONTENT.—The fee schedule for a fiscal year shall include a written analysis of the estimate of the Commission of the total costs of carrying out the functions of the Commission under this Act during the fiscal year.

(3) SUBMISSION TO CONGRESS.—Before publishing the fee schedule for a fiscal year, the Commission shall submit a copy of the fee schedule to the Congress.

(4) TIMING.—

(A) 1ST FISCAL YEAR.—The Commission shall publish the fee schedule for the fiscal year in which this Act is enacted, within 30 days after the date of the enactment of this Act.

(B) SUBSEQUENT FISCAL YEARS.—The Commission shall publish the fee schedule for each subsequent fiscal year, not less than 90 days before the due date prescribed by the

Commission for payment of the annual fee for the fiscal year.

(c) LATE PAYMENT PENALTY.—

(1) IN GENERAL.—The Commission may impose a penalty against a person that fails to pay an annual fee charged under this section, within 30 days after the due date prescribed by the Commission for payment of the fee.

(2) AMOUNT.—The amount of the penalty shall be—

(A) 5 percent of the amount of the fee due; multiplied by

(B) the whole number of consecutive 30-day periods that have elapsed since the due date.

(d) REIMBURSEMENT OF EXCESS FEES.—To the extent that the total amount of fees collected under this section during a fiscal year that begins after the date of the enactment of this Act exceeds the amount provided under subsection (a)(2) with respect to the fiscal year, the Commission shall reimburse the excess amount to the persons who have timely paid their annual fees, on a pro-rata basis that excludes penalties, and shall do so within 60 days after the end of the fiscal year.

(e) DEPOSIT OF FEES INTO THE TREASURY.—All amounts collected under this section shall be credited to the currently applicable appropriation, account, or fund of the Commission as discretionary offsetting collections, and shall be available for the purposes authorized in subsection (f) only to the extent and in the amounts provided in advance in appropriations Acts.

(f) AUTHORIZATION OF APPROPRIATIONS.—In addition to amounts otherwise authorized to be appropriated to the Commission, there is authorized to be appropriated to the Commission amounts collected under this section to cover the costs the costs of carrying out the functions of the Commission under this Act.

(g) SUNSET.—The authority to charge and collect fees under this section shall expire at the end of the 4th fiscal year that begins after the date of the enactment of this Act.

SEC. 511. EFFECTIVE DATE.

Unless otherwise provided in this title, this title and the amendments made by this title shall take effect 360 days after the date of enactment of this Act, except that, to the extent a provision of this title requires a rulemaking, the provision shall take effect on the later of—

(1) 360 days after the date of enactment of this Act; or

(2) 60 days after the publication in the Federal Register of the final rule implementing the provision.

SEC. 512. SENSE OF THE CONGRESS.

It is the sense of the Congress that nothing in this Act or any amendment made by this Act should be interpreted to authorize any entity to regulate any commodity, other than a digital commodity, on any spot market.

TITLE VI—INNOVATION AND TECHNOLOGY IMPROVEMENTS

SEC. 601. FINDINGS; SENSE OF CONGRESS.

(a) FINDINGS.—Congress finds the following:

(1) Entrepreneurs and innovators are building and deploying this next generation of the internet.

(2) Digital asset networks represent a new way for people to join together and cooperate with one another to undertake certain activities.

(3) Digital assets have the potential to be the foundational building blocks of these networks, aligning the economic incentive for individuals to cooperate with one another to achieve a common purpose.

(4) The digital asset ecosystem has the potential to grow our economy and improve everyday lives of Americans by facilitating collaboration through

the use of technology to manage activities, allocate resources, and facilitate decision making.

(5) Blockchain networks and the digital assets they empower provide creator control, enhance transparency, reduce transaction costs, and increase efficiency if proper protections are put in place for investors, consumers, our financial system, and our national security.

(6) Blockchain technology facilitates new types of network participation which businesses in the United States may utilize in innovative ways.

(7) Other digital asset companies are setting up their operations outside of the United States, where countries are establishing frameworks to embrace the potential of blockchain technology and digital assets and provide safeguards for consumers.

(8) Digital assets, despite the purported anonymity, provide law enforcement with an exceptional tracing tool to identify illicit activity and bring criminals to justice.

(9) The Financial Services Committee of the House of Representatives has held multiple hearings highlighting various risks that digital assets can pose to the financial markets, consumers, and inves-

tors that must be addressed as we seek to harness the benefits of these innovations.

(b) SENSE OF CONGRESS.—It is the sense of Congress that—

(1) the United States should seek to prioritize understanding the potential opportunities of the next generation of the internet;

(2) the United States should seek to foster advances in technology that have robust evidence indicating they can improve our financial system and create more fair and equitable access to financial services for everyday Americans while protecting our financial system, investors, and consumers;

(3) the United States must support the responsible development of digital assets and the underlying technology in the United States or risk the shifting of the development of such assets and technology outside of the United States, to less regulated countries;

(4) Congress should consult with public and private sector stakeholders to understand how to enact a functional framework tailored to the specific risks and unique benefits of different digital asset-related activities, distributed ledger technology, distributed networks, and decentralized systems; and

(5) Congress should enact a functional framework tailored to the specific risks of different digital asset-related activities and unique benefits of distributed ledger technology, distributed networks, and decentralized systems; and

(6) consumers and market participants will benefit from a framework for digital assets consistent with longstanding investor protections in securities and commodities markets, yet tailored to the unique benefits and risks of the digital asset ecosystem.

SEC. 602. CODIFICATION OF THE SEC STRATEGIC HUB FOR INNOVATION AND FINANCIAL TECHNOLOGY.

Section 4 of the Securities Exchange Act of 1934 (15 U.S.C. 78d) is amended by adding at the end the following:

''(l) STRATEGIC HUB FOR INNOVATION AND FINANCIAL TECHNOLOGY.—

''(1) OFFICE ESTABLISHED.—There is established within the Commission the Strategic Hub for Innovation and Financial Technology (referred to in this section as the 'FinHub').

''(2) PURPOSES.—The purposes of FinHub are as follows:

''(A) To assist in shaping the approach of the Commission to technological advancements.

"(B) To examine financial technology innovations among market participants.

"(C) To coordinate the response of the Commission to emerging technologies in financial, regulatory, and supervisory systems.

"(3) DIRECTOR OF FINHUB.—FinHub shall have a Director who shall be appointed by the Commission, from among individuals having experience in both emerging technologies and Federal securities laws and serve at the pleasure of the Commission. The Director shall report directly to the Commission and perform such functions and duties as the Commission may prescribe.

"(4) RESPONSIBILITIES.—FinHub shall—

"(A) foster responsible technological innovation and fair competition within the Commission, including around financial technology, regulatory technology, and supervisory technology;

"(B) provide internal education and training to the Commission regarding financial technology;

"(C) advise the Commission regarding financial technology that would serve the Commission's functions;

"(D) analyze technological advancements and the impact of regulatory requirements on financial technology companies;

"(E) advise the Commission with respect to rulemakings or other agency or staff action regarding financial technology;

"(F) provide businesses working in emerging financial technology fields with information on the Commission, its rules and regulations; and

"(G) encourage firms working in emerging technology fields to engage with the Commission and obtain feedback from the Commission on potential regulatory issues.

"(5) ACCESS TO DOCUMENTS.—The Commission shall ensure that FinHub has full access to the documents and information of the Commission and any self-regulatory organization, as necessary to carry out the functions of FinHub.

"(6) REPORT TO CONGRESS.—

"(A) IN GENERAL.—Not later than October 31 of each year after 2024, FinHub shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of

Representatives a report on the activities of FinHub during the immediately preceding fiscal year.

"(B) CONTENTS.—Each report required under subparagraph (A) shall include—

"(i) the total number of persons that met with FinHub;

"(ii) the total number of market participants FinHub met with, including the classification of those participants;

"(iii) a summary of general issues discussed during meetings with persons;

"(iv) information on steps FinHub has taken to improve Commission services, including responsiveness to the concerns of persons;

"(v) recommendations—

"(I) with respect to the regulations of the Commission and the guidance and orders of the Commission; and

"(II) for such legislative actions as FinHub determines appropriate; and

"(vi) any other information, as determined appropriate by the Director of FinHub.

"(C) CONFIDENTIALITY.—A report under subparagraph (A) may not contain confidential information.

"(7) SYSTEMS OF RECORDS.—

"(A) IN GENERAL.—The Commission shall establish a detailed system of records (as defined under section 552a of title 5, United States Code) to assist FinHub in communicating with interested parties.

"(B) ENTITIES COVERED BY THE SYSTEM.—Entities covered by the system required under subparagraph (A) include entities or persons submitting requests or inquiries and other information to Commission through FinHub.

"(C) SECURITY AND STORAGE OF RECORDS.—FinHub shall store—

"(i) electronic records—

"(I) in the system required under subparagraph (A); or

"(II) on the secure network or other electronic medium, such as

encrypted hard drives or back-up media, of the Commission; and

''(ii) paper records in secure facilities.

''(8) EFFECTIVE DATE.—This subsection shall take effect on the date that is 180 days after the date of the enactment of this subsection.''.

SEC. 603. CODIFICATION OF LABCFTC.

(a) IN GENERAL.—Section 18 of the Commodity Exchange Act (7 U.S.C. 22) is amended by adding at the end the following:

''(e) LABCFTC.—

''(1) ESTABLISHMENT.—There is established in the Commission LabCFTC.

''(2) PURPOSE.—The purposes of LabCFTC are to—

''(A) promote responsible financial technology innovation and fair competition for the benefit of the American public;

''(B) serve as an information platform to inform the Commission about new financial technology innovation; and

''(C) provide outreach to financial technology innovators to discuss their innovations and the regulatory framework established by

this Act and the regulations promulgated thereunder.

''(3) DIRECTOR.—LabCFTC shall have a Director, who shall be appointed by the Commission and serve at the pleasure of the Commission. Notwithstanding section 2(a)(6)(A), the Director shall report directly to the Commission and perform such functions and duties as the Commission may prescribe.

''(4) DUTIES.—LabCFTC shall—

''(A) advise the Commission with respect to rulemakings or other agency or staff action regarding financial technology;

''(B) provide internal education and training to the Commission regarding financial technology;

''(C) advise the Commission regarding financial technology that would bolster the Commission's oversight functions;

''(D) engage with academia, students, and professionals on financial technology issues, ideas, and technology relevant to activities under this Act;

''(E) provide persons working in emerging technology fields with information on the Com-

mission, its rules and regulations, and the role of a registered futures association; and

"(F) encourage persons working in emerging technology fields to engage with the Commission and obtain feedback from the Commission on potential regulatory issues.

"(5) ACCESS TO DOCUMENTS.—The Commission shall ensure that LabCFTC has full access to the documents and information of the Commission and any self-regulatory organization or registered futures association, as necessary to carry out the functions of LabCFTC.

"(6) REPORT TO CONGRESS.—

"(A) IN GENERAL.—Not later than October 31 of each year after 2024, LabCFTC shall submit to the Committee on Agriculture of the House of Representatives and the Committee on Agriculture, Nutrition, and Forestry of the Senate a report on its activities.

"(B) CONTENTS.—Each report required under paragraph (1) shall include—

"(i) the total number of persons that met with LabCFTC;

"(ii) a summary of general issues discussed during meetings with the person;

"(iii) information on steps LabCFTC has taken to improve Commission services, including responsiveness to the concerns of persons;

"(iv) recommendations made to the Commission with respect to the regulations, guidance, and orders of the Commission and such legislative actions as may be appropriate; and

"(v) any other information determined appropriate by the Director of LabCFTC.

"(C) CONFIDENTIALITY.—A report under paragraph (A) shall abide by the confidentiality requirements in section 8.

"(7) SYSTEMS OF RECORDS.—

"(A) IN GENERAL.—The Commission shall establish a detailed system of records (as defined in section 552a of title 5, United States Code) to assist LabCFTC in communicating with interested parties.

"(B) PERSONS COVERED BY THE SYSTEM.—The persons covered by the system of records shall include persons submitting requests or inquiries and other information to the Commission through LabCFTC.

''(C) SECURITY AND STORAGE OF RECORDS.—The system of records shall store records electronically or on paper in secure facilities, and shall store electronic records on the secure network of the Commission and on other electronic media, such as encrypted hard drives and back-up media, as needed.''.

(b) CONFORMING AMENDMENTS.—Section 2(a)(6)(A) of such Act (7 U.S.C. 2(a)(6)(A)) is amended—

(1) by striking ''paragraph and in'' and inserting ''paragraph,''; and

(2) by inserting ''and section 18(c)(3),'' before ''the executive''.

(c) EFFECTIVE DATE.—The Commodity Futures Trading Commission shall implement the amendments made by this section (including complying with section 18(c)(7) of the Commodity Exchange Act) within 180 days after the date of the enactment of this Act.

SEC. 604. CFTC-SEC JOINT ADVISORY COMMITTEE ON DIGITAL ASSETS.

(a) ESTABLISHMENT.—The Commodity Futures Trading Commission and the Securities and Exchange Commission (in this section referred to as the ''Commissions'') shall jointly establish the Joint Advisory Com-

mittee on Digital Assets (in this section referred to as the ''Committee'').

(b) PURPOSE.—

(1) IN GENERAL.—The Committee shall—

(A) provide the Commissions with advice on the rules, regulations, and policies of the Commissions related to digital assets;

(B) further the regulatory harmonization of digital asset policy between the Commissions;

(C) examine and disseminate methods for describing, measuring, and quantifying digital asset—

(i) decentralization;

(ii) functionality;

(iii) information asymmetries; and

(iv) transaction and network security;

(D) examine the potential for digital assets, blockchain systems, and distributed ledger technology to improve efficiency in the operation of financial market infrastructure and better protect financial market participants, including services and systems which provide—

(i) improved customer protections;

(ii) public availability of information;

(iii) greater transparency regarding customer funds;

(iv) reduced transaction cost; and

(v) increased access to financial market services; and

(E) discuss the implementation by the Commissions of this Act and the amendments made by this Act.

(2) REVIEW BY AGENCIES.—Each Commission shall—

(A) review the findings and recommendations of the Committee;

(B) promptly issue a public statement each time the Committee submits a finding or recommendation to a Commission—

(i) assessing the finding or recommendation of the Committee;

(ii) disclosing the action or decision not to take action made by the Commission in response to a finding or recommendation; and

(iii) explaining the reasons for the action or decision not to take action; and

(C) each time the Committee submits a finding or recommendation to a Commission,

provide the Committee with a formal response to the finding or recommendation not later than 3 months after the date of the submission of the finding or recommendation.

(c) MEMBERSHIP AND LEADERSHIP.—

(1) NON-FEDERAL MEMBERS.—

(A) IN GENERAL.—The Commissions shall appoint at least 20 nongovernmental stakeholders who represent a broad spectrum of interests, equally divided between the Commissions, to serve as members of the Committee. The appointees shall include—

(i) digital asset issuers;

(ii) persons registered with the Commissions and engaged in digital asset related activities;

(iii) individuals engaged in academic research relating to digital assets; and

(iv) digital asset users.

(B) MEMBERS NOT COMMISSION EMPLOYEES.—Members appointed under subparagraph (A) shall not be deemed to be employees or agents of a Commission solely by reason of membership on the Committee.

(2) CO-DESIGNATED FEDERAL OFFICERS.—

(A) NUMBER; APPOINTMENT.—There shall be 2 co-designated Federal officers of the Committee, as follows:

(i) The Director of LabCFTC of the Commodity Futures Trading Commission.

(ii) The Director of the Strategic Hub for Innovation and Financial Technology of the Securities and Exchange Commission.

(B) DUTIES.—The duties required by chapter 10 of title 5, United States Code, to be carried out by a designated Federal officer with respect to the Committee shall be shared by the co-designated Federal officers of the Committee.

(3) COMMITTEE LEADERSHIP.—

(A) COMPOSITION; ELECTION.—The Committee members shall elect, from among the Committee members—

(i) a chair;

(ii) a vice chair;

(iii) a secretary; and

(iv) an assistant secretary.

(B) TERM OF OFFICE.—Each member elected under subparagraph (A) in a 2-year pe-

riod referred to in section 1013(b)(2) of title 5, United States Code, shall serve in the capacity for which the member was so elected, until the end of the 2-year period.

(d) NO COMPENSATION FOR COMMITTEE MEMBERS.—

(1) NON-FEDERAL MEMBERS.—All Committee members appointed under subsection (c)(1) shall—

(A) serve without compensation; and

(B) while away from the home or regular place of business of the member in the performance of services for the Committee, be allowed travel expenses, including per diem in lieu of subsistence, in the same manner as persons employed intermittently in the Government service are allowed expenses under section 5703(b) of title 5, United States Code.

(2) NO COMPENSATION FOR CO-DESIGNATED FEDERAL OFFICERS.—The co-designated Federal officers shall serve without compensation in addition to that received for their services as officers or employees of the United States.

(e) FREQUENCY OF MEETINGS.—The Committee shall meet—

(1) not less frequently than twice annually; and

(2) at such other times as either Commission may request.

(f) DURATION.—Section 1013(a)(2) of title 5, United States Code, shall not apply to the Committee.

(g) TIME LIMITS.—The Commissions shall—

(1) adopt a joint charter for the Committee within 90 days after the date of the enactment of this section;

(2) appoint members to the Committee within 120 days after such date of enactment; and

(3) hold the initial meeting of the Committee within 180 days after such date of enactment.

(h) FUNDING.—Subject to the availability of funds, the Commissions shall jointly fund the Committee.

SEC. 605. STUDY ON DECENTRALIZED FINANCE.

(a) IN GENERAL.—The Commodity Futures Trading Commission and the Securities and Exchange Commission shall jointly carry out a study on decentralized finance that analyzes—

(1) the nature, size, role, and use of decentralized finance blockchain protocols;

(2) the operation of blockchain protocols that comprise decentralized finance;

(3) the interoperability of blockchain protocols and blockchain systems;

(4) the interoperability of blockchain protocols and software-based systems, including websites and wallets;

(5) the decentralized governance systems through which blockchain protocols may be developed, published, constituted, administered, maintained, or otherwise distributed, including—

(A) whether the systems enhance or detract from—

(i) the decentralization of the decentralized finance; and

(ii) the inherent benefits and risks of the decentralized governance system; and

(B) any procedures, requirements, or best practices that would mitigate the risks identified in subparagraph (A)(ii);

(6) the benefits of decentralized finance, including—

(A) operational resilience and availability of blockchain systems;

(B) interoperability of blockchain systems;

(C) market competition and innovation;

(D) transaction efficiency;

(E) transparency and traceability of transactions; and

(F) disintermediation;

(7) the risks of decentralized finance, including—

(A) pseudonymity of users and transactions;

(B) disintermediation; and

(C) cybersecurity vulnerabilities;

(8) the extent to which decentralized finance has integrated with the traditional financial markets and any potential risks or improvements to the stability of the markets;

(9) how the levels of illicit activity in decentralized finance compare with the levels of illicit activity in traditional financial markets;

(10) methods for addressing illicit activity in decentralized finance and traditional markets that are tailored to the unique attributes of each;

(11) how decentralized finance may increase the accessibility of cross-border transactions; and

(12) the feasibility of embedding self-executing compliance and risk controls into decentralized finance.

(b) CONSULTATION.—In carrying out the study required under subsection (a), the Commodity Futures Trading Commission and the Securities and Exchange

Commission shall consult with the Secretary of the Treasury on the factors described under paragraphs (7) through (10) of subsection (a).

(c) REPORT.—Not later than 1 year after the date of enactment of this Act, the Commodity Futures Trading Commission and the Securities and Exchange Commission shall jointly submit to the relevant congressional committees a report that includes the results of the study required by subsection (a).

(d) GAO STUDY.—The Comptroller General of the United States shall—

(1) carry out a study on decentralized finance that analyzes the information described under paragraphs (1) through (12) of subsection (a); and

(2) not later than 1 year after the date of enactment of this Act, submit to the relevant congressional committees a report that includes the results of the study required by paragraph (1).

(e) DEFINITIONS.—In this section:

(1) DECENTRALIZED FINANCE.—

(A) IN GENERAL.—The term ''decentralized finance'' means blockchain protocols that allow users to engage in financial transactions in a self-directed manner so that a third-party intermediary does not effectuate the trans-

actions or take custody of digital assets of a user during any part of the transactions.

(B) RELATIONSHIP TO EXCLUDED ACTIVITIES.—The term ''decentralized finance'' shall not be interpreted to limit or exclude any activity from the activities described in section 15I(a) of the Securities Exchange Act of 1934 or section 4v(a) of the Commodity Exchange Act.

(2) RELEVANT CONGRESSIONAL COMMITTEES.—The term ''relevant congressional committees'' means—

(A) the Committees on Financial Services and Agriculture of the House of Representatives; and

(B) the Committees on Banking, Housing, and Urban Affairs and Agriculture, Nutrition, and Forestry of the Senate.

SEC. 606. STUDY ON NON-FUNGIBLE DIGITAL ASSETS.

(a) IN GENERAL.—The Comptroller General of the United States shall carry out a study of non-fungible digital assets that analyzes—

(1) the nature, size, role, purpose, and use of non-fungible digital assets;

(2) the similarities and differences between non-fungible digital assets and other digital assets, including digital commodities and payment stablecoins, and how the markets for those digital assets intersect with each other;

(3) how non-fungible digital assets are minted by issuers and subsequently administered to purchasers;

(4) how non-fungible digital assets are stored after being purchased by a consumer;

(5) the interoperability of non-fungible digital assets between different blockchain systems;

(6) the scalability of different non-fungible digital asset marketplaces;

(7) the benefits of non-fungible digital assets, including verifiable digital ownership;

(8) the risks of non-fungible tokens, including—

(A) intellectual property rights;

(B) cybersecurity risks; and

(C) market risks;

(9) whether and how non-fungible digital assets have integrated with traditional marketplaces, including those for music, real estate, gaming, events, and travel;

(10) whether non-fungible tokens can be used to facilitate commerce or other activities through the representation of documents, identification, contracts, licenses, and other commercial, government, or personal records;

(11) any potential risks to traditional markets from such integration; and

(12) the levels and types of illicit activity in non-fungible digital asset markets.

(b) REPORT.—Not later than 1 year after the date of the enactment of this Act, the Comptroller General, shall make publicly available a report that includes the results of the study required by subsection (a).

SEC. 607. STUDY ON EXPANDING FINANCIAL LITERACY AMONGST DIGITAL ASSET HOLDERS.

(a) IN GENERAL.— The Commodity Futures Trading Commission with the Securities and Exchange Commission shall jointly conduct a study to identify—

(1) the existing level of financial literacy among retail digital asset holders, including subgroups of investors identified by the Commodity Futures Trading Commission with the Securities and Exchange Commission;

(2) methods to improve the timing, content, and format of financial literacy materials regarding dig-

ital assets provided by the Commodity Futures Trading Commission and the Securities and Exchange Commission;

(3) methods to improve coordination between the Securities and Exchange Commission and the Commodity Futures Trading Commission with other agencies, including the Financial Literacy and Education Commission as well as nonprofit organizations and State and local jurisdictions, to better disseminate financial literacy materials;

(4) the efficacy of current financial literacy efforts with a focus on rural communities and communities with majority minority populations;

(5) the most useful and understandable relevant information that retail digital asset holders need to make informed financial decisions before engaging with or purchasing a digital asset or service that is typically sold to retail investors of digital assets;

(6) the most effective public-private partnerships in providing financial literacy regarding digital assets to consumers;

(7) the most relevant metrics to measure successful improvement of the financial literacy of an individual after engaging with financial literacy efforts; and

(8) in consultation with the Financial Literacy and Education Commission, a strategy (including to the extent practicable, measurable goals and objectives) to increase financial literacy of investors regarding digital assets.

(b) REPORT.—Not later than 1 year after the date of the enactment of this Act, the Commodity Futures Trading Commission and the Securities and Exchange Commission shall jointly submit a written report on the study required by subsection (a) to the Committees on Financial Services and on Agriculture of the House of Representatives and the Committees on Banking, Housing, and Urban Affairs and on Agriculture, Nutrition, and Forestry of the Senate.

SEC. 608. STUDY ON FINANCIAL MARKET INFRASTRUCTURE IMPROVEMENTS.

(a) IN GENERAL.—The Commodity Futures Trading Commission and the Securities and Exchange Commission shall jointly conduct a study to assess whether additional guidance or rules are necessary to facilitate the development of tokenized securities and derivatives products, and to the extent such guidance or rules would foster the development of fair and orderly financial markets, be necessary or appropriate in the public interest, and be consistent with the protection of investors and customers.

(b) REPORT.—

(1) TIME LIMIT.—Not later than 1 year after the date of enactment of this Act, the Commodity Futures Trading Commission and the Securities and Exchange Commission shall jointly submit to the relevant congressional committees a report that includes the results of the study required by subsection (a).

(2) RELEVANT CONGRESSIONAL COMMITTEES DEFINED.—In this section, the term ''relevant congressional committees'' means—

(A) the Committees on Financial Services and on Agriculture of the House of Representatives; and

(B) the Committees on Banking, Housing, and Urban Affairs and on Agriculture, Nutrition, and Forestry of the Senate.

Passed the House of Representatives May 22, 2024.

Attest:

Clerk.

118TH CONGRESS
2D SESSION

H. R. 4763

AN ACT

To provide for a system of regulation of digital assets by the Commodity Futures Trading Commission and the Securities and Exchange Commission, and for other purposes.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

-against-

RIPPLE LABS, INC., BRADLEY GARLINGHOUSE, and CHRISTIAN A. LARSEN,

Defendants.

20 Civ. 10832 (AT)

ORDER

ANALISA TORRES, District Judge:

Plaintiff, the Securities and Exchange Commission (the "SEC"), brings this action against Defendants Ripple Labs, Inc. ("Ripple") and two of its senior leaders, Bradley Garlinghouse and Christian A. Larsen, alleging that Defendants engaged in the unlawful offer and sale of securities in violation of Section 5 of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. §§ 77e(a) and (c). Am. Compl. ¶¶ 9, 430–35, ECF No. 46. The SEC also alleges that Garlinghouse and Larsen aided and abetted Ripple's Section 5 violations. *Id.* ¶¶ 9, 436–40.

Before the Court are the parties' cross-motions for summary judgment. ECF Nos. 824, 836; *see also* ECF Nos. 621, 625, 639, 642.[1] For the reasons stated below, the SEC's motion is GRANTED in part and DENIED in part, and Defendants' motion is GRANTED in part and DENIED in part.

[1] Portions of the briefs, Rule 56.1 statements, and other documents discussed in this order were filed under seal or redacted. *See* ECF No. 819 (granting in part and denying in part the parties' and third parties' motions to seal). These materials are "judicial documents" because they are "relevant to the performance of the judicial function and useful in the judicial process." *Lugosch v. Pyramid Co. of Onondaga*, 435 F.3d 110, 119 (2d Cir. 2006); *see also Bernstein v. Bernstein Litowitz Berger & Grossmann LLP*, 814 F.3d 132, 139 (2d Cir. 2016). To the extent that information in these documents is disclosed in this order, the privacy and business interests that justified their sealing or redaction are outweighed by "the public's right of access to [information] necessary to understand the basis for court rulings." *Spinelli v. Nat'l Football League*, 903 F.3d 185, 193 n.2 (2d Cir. 2018); *see also Dodona I, LLC v. Goldman, Sachs & Co.*, 119 F. Supp. 3d 152, 155 (S.D.N.Y. 2015).

BACKGROUND[2]

I. Factual Background

A. Development of the XRP Ledger and the Founding of Ripple

In 2011 and early 2012, Arthur Britto, Jed McCaleb, and David Schwartz developed the source code for a cryptographically secured ledger, or a "blockchain,"[3] which is now known as the XRP Ledger. SEC 56.1 Resp. ¶ 11, ECF No. 842; *see also* ECF No. 668. They aimed to create a faster, cheaper, and more energy-efficient alternative to the bitcoin blockchain, the first blockchain ledger which was introduced in 2009. *Id.* ¶¶ 4, 12. When the XRP Ledger launched in 2012, its source code generated a fixed supply of 100 billion XRP. *Id.* ¶¶ 17–18. XRP is the native digital token of the XRP Ledger, and the XRP Ledger requires XRP to operate. *Id.* ¶¶ 13–14. Each unit of XRP is divisible into one million "drops," and each unit or drop of XRP is fungible with any other unit or drop. Defs. 56.1 Resp. ¶¶ 17–18, ECF No. 835; *see also* ECF No. 663.

In 2012, Britto, Defendant Larsen, and McCaleb founded Ripple.[4] *Id.* ¶ 41; SEC 56.1 Resp. ¶ 32. Larsen became Ripple's CEO, a position he held until December 2016. Defs. 56.1 Resp. ¶ 41. Of the 100 billion XRP generated by the XRP Ledger's code, the three founders

[2] The facts in this section are taken from the parties' Rule 56.1 statements, counterstatements, and responses, unless otherwise noted. Disputed facts are so noted. Citations to a paragraph in a Rule 56.1 statement also include the opposing party's response. "[W]here there are no citations[,] or where the cited materials do not support the factual assertions in the [s]tatements, the Court is free to disregard the assertion." *Holtz v. Rockefeller & Co.*, 258 F.3d 62, 73 (2d Cir. 2001) (alteration omitted).

[3] A blockchain is an electronically distributed database or ledger "shared among a computer network's nodes." *See* Adam Hayes, *Blockchain Facts: What Is It, How It Works, and How It Can Be Used*, Investopedia (updated Apr. 23, 2023), https://www.investopedia.com/terms/b/blockchain.asp/. A blockchain is a system for recording information. Each transaction is recorded as a "block" of data on the digital ledger, which is connected to the blocks before and after it. SEC 56.1 Resp. ¶ 1, ECF No. 842. Blockchains are typically recorded across a distributed network of computers. *Id.* ¶ 2.

[4] Ripple was originally named NewCoin, Inc. and incorporated under California law. SEC 56.1 Resp. ¶ 33. It was then renamed OpenCoin, Inc. in October 2012. *Id.* In 2013, the company was renamed Ripple Labs, Inc., and in 2014, it was incorporated under Delaware law. *Id.* In this order, the Court shall refer to the company as Ripple, even when referring to its forerunners, NewCoin and OpenCoin.

retained 20 billion for themselves (including 9 billion for Larsen) and provided 80 billion XRP to Ripple. *Id.* ¶ 15; SEC 56.1 Resp. ¶ 21. The founders did not sell any XRP before the launch of the XRP Ledger, and Ripple never owned the 20 billion XRP retained by the three founders. SEC 56.1 Resp. ¶¶ 20, 22.

Since its founding, Ripple's mission has been to realize an "Internet of Value" by using technology to facilitate the transfer of value across the internet. *Id.* ¶ 35. Specifically, Ripple "seeks to modernize international payments by developing a global payments network for international currency transfers." *Id.* For instance, Ripple developed a software product called RippleNet, which allows customers to clear and settle cross-border financial transactions on mutually agreed upon terms. *Id.* ¶ 41. One feature of RippleNet is known as "on demand liquidity" ("ODL"). *Id.* ¶ 45. ODL facilitates cross-border transactions by allowing customers to exchange fiat currency (for example, U.S. dollars) for XRP and then the XRP for another fiat currency (for example, Mexican pesos). *Id.* ¶ 46; Defs. 56.1 Resp. ¶ 740.

Like ODL, some, but not all, of Ripple's products and services rely on the XRP Ledger and XRP. SEC 56.1 Resp. ¶ 44. The XRP Ledger is based on open-source software; anyone can use the ledger, submit transactions, host a node to contribute to the validation of transactions, propose changes to the source code, or develop applications that run on the ledger. *Id.* ¶¶ 52, 54. Other developers have built software products that use the XRP Ledger, such as payment-processing applications. *Id.* ¶ 59. Ripple has also funded companies as part of its "Xpring" initiative to incentivize the development of other use "cases" on the XRP Ledger. *Id.* ¶¶ 58–59.

B. Defendants' Sales and Distributions of XRP

At all times before the end of 2020, Ripple owned between 50 and 80 billion XRP. *See* Defs. 56.1 Resp. ¶¶ 15, 35; *see also id.* ¶ 256. Although the parties dispute the specific dollar amounts and details, they agree that from 2013 through the end of 2020, Ripple engaged in various sales and distributions of XRP. *See id.* ¶¶ 647, 716; *see generally* SEC 56.1 Resp. ¶¶ 92–123.

First, Ripple, through wholly owned subsidiaries, sold XRP directly to certain counterparties (primarily institutional buyers, hedge funds, and ODL customers) pursuant to written contracts (the "Institutional Sales"). SEC 56.1 Resp. ¶ 105; Defs. 56.1 Resp. ¶¶ 5–6, 619–20, 716. The SEC alleges that Ripple sold approximately $728.9 million of XRP in these Institutional Sales. Defs. 56.1 Resp. ¶ 716.

Second, Ripple sold XRP on digital asset exchanges "programmatically," or through the use of trading algorithms (the "Programmatic Sales"). SEC 56.1 Resp. ¶ 95; Defs. 56.1 Resp. ¶ 647. Ripple's XRP sales on these digital asset exchanges were blind bid/ask transactions: Ripple did not know who was buying the XRP, and the purchasers did not know who was selling it. SEC 56.1 Resp. ¶ 96; Defs. 56.1 Resp. ¶¶ 652–54. The SEC alleges that Ripple sold approximately $757.6 million of XRP in Programmatic Sales. Defs. 56.1 Resp. ¶ 647. Ripple used the proceeds from the Institutional and Programmatic Sales to fund its operations. Defs. 56.1 Resp. ¶¶ 156–70.[5]

Ripple also distributed XRP as a form of payment for services ("Other Distributions"). Defs. 56.1 Resp. ¶¶ 827–30. For instance, Ripple distributed XRP to its employees as a form of

[5] Since 2012, Ripple has also raised investment capital through multiple funding rounds in which it sold stock to investors. SEC 56.1 Resp. ¶ 34. Ripple has issued millions of shares of common stock, as well as convertible notes, preferred stock, and a stock warrant. SEC Add. 56.1 Resp. ¶¶ 1607, 1609, ECF No. 844.

employee compensation. SEC 56.1 Resp. ¶ 110; Defs. 56.1 Resp. ¶¶ 217–18. Ripple also distributed XRP in conjunction with its Xpring initiative to fund third parties that would develop new applications for XRP and the XRP Ledger. Defs. 56.1 Resp. ¶¶ 831–32. In sum, the SEC alleges that Ripple recognized revenue of $609 million from its distributions of XRP to individuals and entities in exchange for services. *Id.* ¶¶ 829–30.[6]

In addition to Ripple's sales and distributions, Larsen and Garlinghouse offered and sold XRP in their individual capacities. After stepping down as CEO of Ripple in December 2016, Larsen became the Executive Chairman of Ripple's Board of Directors, a position he currently holds. SEC 56.1 Resp. ¶¶ 128–29. From at least 2013 through 2020, Larsen sold XRP on digital asset exchanges programmatically and made at least $450 million from his sales. Defs. 56.1 Resp. ¶ 868.

Garlinghouse was hired as Ripple's COO in April 2015. SEC 56.1 Resp. ¶ 140. After Larsen stepped down as CEO, Garlinghouse became CEO effective January 1, 2017, a position he currently holds. *Id.* ¶ 143. From April 2017 through 2020, Garlinghouse sold XRP on digital asset exchanges, *id.* ¶¶ 303, 310; the SEC alleges that Garlinghouse sold approximately $150 million in XRP during this period, Defs. 56.1 Resp. ¶ 870. Garlinghouse has also received XRP as part of his overall compensation from Ripple. SEC 56.1 Resp. ¶ 145.

Defendants did not file a registration statement as to any offers or sales of XRP. Defs. 56.1 Resp. ¶ 928. Ripple did not publicly file any financial statements or other periodic reports,

[6] Ripple also distributed XRP for free to "early adopters and developers" and to charities and grant recipients. SEC 56.1 Resp. ¶¶ 92–94. The SEC does not include these transactions in its complaint. *See* SEC Opp. at 26 n.15, ECF No. 841.

nor did it make any EDGAR filings[7] with the SEC for Ripple or XRP, such as a Form 10-Q, Form 10-K, or Form 8-K relating to XRP. *Id.* ¶¶ 930–32.

C. Defendants' XRP Marketing Campaign

The SEC alleges that "in 2013 Defendants began extensive, years-long marketing efforts representing they would search for purported 'use' and 'value' for XRP—and casting XRP as an opportunity to invest in those efforts." SEC Opp. at 4, ECF No. 841. The SEC points to a wide range of statements, including informational brochures, internal talking points, public blog posts, statements on social media, videos, interviews with various Ripple employees, and more. Defendants dispute the SEC's factual narrative and argue that the SEC "cherry-picks excerpts from documents with many authors and from public statements of many speakers, made at many points across an eight-year period of time to many audiences." Defs. Opp. at 10, ECF No. 828.[8]

Since at least 2013, Ripple has prepared and distributed documents that describe the company's operations, the XRP trading market, and the XRP Ledger. For example, in 2013 and 2014, Ripple created three brochures: a "Ripple for Gateways" brochure, a "Ripple Primer," and a "Deep Dive for Finance Professionals." Defs. 56.1 Resp. ¶¶ 59–60, 171. These documents were distributed publicly to prospective and existing XRP investors and outline, among other things, the relationship between XRP and Ripple's business model. *Id.* Ripple circulated versions of the "Gateways" brochure to more than one hundred third parties, *id.* ¶ 172; the "Primer" had "widespread distribution," *id.* ¶ 178; and the "Deep Dive" was posted on Ripple's website and sent to over one hundred people, *id.* ¶¶ 185–86. Later, starting at the end of 2016,

[7] EDGAR, or "Electronic Data Gathering, Analysis, and Retrieval," is an electronic filing system developed by the SEC "to increase the efficiency and accessibility of corporate filings." James Chen, *Electronic Data Gathering Analysis and Retrieval: Overview, FAQ*, Investopedia (updated Feb. 13, 2022), https://www.investopedia.com/terms/e/edgar.asp/.

[8] The SEC's Rule 56.1 statement contains over 1,600 purported facts—many of which are disputed by Defendants—and cites over 900 exhibits. *See generally* Defs. 56.1 Resp. The Court highlights below only those documents and statements directly relevant to this order.

Ripple began to publish on its website quarterly "XRP Market Reports," which were intended to provide "clarity and visibility" about Ripple's market activities. *Id.* ¶¶ 500–01.

Ripple and its senior leaders used a variety of social media platforms—including Twitter, Facebook, Reddit, and XRP Chat, an online forum described as "The Largest XRP Crypto Community Forum"—to communicate about XRP and Ripple. Defs. 56.1 Resp. ¶¶ 77, 192; *see, e.g.*, *id.* ¶¶ 391–96, 401–08, 425, 437–40. Ripple officials also spoke in interviews about the company and its relationship to XRP. For instance, Larsen gave interviews in which he discussed XRP, *e.g.*, *id.* ¶¶ 371, 377, and Garlinghouse was interviewed by media outlets such as the Financial Times, Bloomberg, and CNBC, spoke with organizations like the Economic Club of New York, and participated at conferences such as DC Fintech, in which he described Ripple's operations and the XRP market, *e.g.*, *id.* ¶¶ 252, 263, 269, 387, 444, 446.

D. Defendants' Receipt of Legal Advice About XRP Offers and Sales

In February 2012, before the XRP Ledger was publicly launched, Ripple's founders, including Larsen, received from the Perkins Coie LLP law firm a memorandum, which sought to "review the proposed product and business structure, analyze the legal risks associated with [Ripple], and recommend steps to mitigate these risks." Defs. 56.1 Resp. ¶ 986; *see* ECF No. 846-29 at 4. The memorandum analyzes, among other things, the legal risks associated with selling XRP. Defs. 56.1 Resp. ¶ 986. Specifically, it states that "[i]f sold to [i]nvestors, [XRP tokens] are likely to be securities," and "[t]o the extent that [the founders'] issuance of [XRP] does not involve an investment of money, there is a low risk that [XRP] will be considered an investment contract." *Id.* ¶¶ 986, 989; *see* ECF No. 846-29 at 5, 12.

In October 2012, Ripple, Larsen, and others received another memorandum from Perkins Coie which sought to "review the proposed features of the Ripple [n]etwork and [XRP] and to

provide recommendations for mitigating relevant legal risks." Defs. 56.1 Resp. ¶ 987; *see* ECF No. 846-30 at 3. That memorandum states that "[a]lthough we believe that a compelling argument can be made that [XRP tokens] do not constitute 'securities' under federal securities laws, given the lack of applicable case law, we believe that there is some risk, albeit small, that the [SEC] disagrees with our analysis." Defs. 56.1 Resp. ¶ 993; *see* ECF No. 846-30 at 6. The memorandum further states that, "[t]he more that [the founders and Ripple] promote [XRP] as an investment opportunity, the more likely it is that the SEC will take action and argue that [XRP tokens] are 'investment contracts.'" Defs. 56.1 Resp. ¶ 993; *see* ECF No. 846-30 at 6.

Larsen reviewed both the February and the October 2012 memoranda and discussed them with Perkins Coie attorneys. Defs. 56.1 Resp. ¶ 998. Both memoranda analyze XRP under the Supreme Court's holding in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), which outlines the standard for an investment contract. *Id.* ¶ 988.

II. Procedural Background

On December 22, 2020, the SEC commenced this action. ECF No. 1. An amended complaint was filed on February 18, 2021. Am. Compl. Fact discovery closed on August 31, 2021, *see* ECF No. 313, and expert discovery concluded on February 28, 2022, *see* ECF No. 411. On March 11, 2022, the Court denied the SEC's motion to strike Ripple's affirmative defense that it "lacked . . . 'notice that its conduct was in violation of law, in contravention of Ripple's due process rights,'" ECF No. 128. ECF No. 440. That same day, the Court also denied Garlinghouse's and Larsen's separate motions to dismiss, ECF Nos. 105, 110. MTD Order, ECF No. 441. On March 6, 2023, the Court granted in part and denied in part the parties' motions to preclude expert testimony. ECF No. 814.

Before the Court are the parties' cross-motions for summary judgment filed on September 13, 2022. ECF Nos. 621, 625; *see also* ECF Nos. 639, 642, 824, 836. The Court has also reviewed amicus briefs from Accredify, Inc. d/b/a/ InvestReady, ECF No. 698[9]; the Blockchain Association, ECF No. 706; the Chamber of Digital Commerce, ECF No. 649; Coinbase, Inc., ECF No. 705; Cryptillian Payment Systems, LLC, ECF No. 716; the Crypto Council for Innovation, ECF No. 711; I-Remit, Inc., ECF No. 660; the New Sports Economy Institute, ECF No. 717; Paradigm Operations LP, ECF No. 707; Phillip Goldstein and the Investor Choice Advocates Network, ECF No. 683; Reaper Financial, LLC, ECF No. 710; SpendTheBits, Inc., ECF No. 684; TapJets, Inc., ECF No. 661; Valhil Capital, LLC, ECF No. 722; Veri DAO, LLC, ECF No. 709; and XRP holders Jordan Deaton, James LaMonte, Mya LaMonte, Tyler LaMonte, Mitchell McKenna, and Kristiana Warner, ECF No. 708.[10]

DISCUSSION

I. Legal Standard

A. Summary Judgment

Summary judgment is appropriate where the record shows that there is no genuine dispute as to any material fact and that the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(a); *see Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247–48 (1986); *Celotex Corp. v. Catrett*, 477 U.S. 317, 322–26 (1986). A genuine dispute exists "if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Anderson*, 477 U.S. at 248.

[9] Accredify, Inc. did not formally file an amicus brief after the Court granted leave to do so, *see* ECF No. 704, but included its brief as an attachment to its original request, *see* ECF No. 698.

[10] On November 4, 2022, the Court directed that any requests to file amicus briefs be filed by November 11, 2022. ECF No. 695. William M. Cunningham and Anoop Bungay, both *pro se* litigants, each separately requested leave to file an amicus brief on November 16, 2022, and January 20, 2023, respectively. ECF Nos. 712, 807. Cunningham's and Bungay's requests are DENIED as untimely.

The moving party initially bears the burden of demonstrating the absence of a genuine dispute of material fact by citing evidence in the record. *See Celotex*, 477 U.S. at 323–24; *Koch v. Town of Brattleboro, Vt.*, 287 F.3d 162, 165 (2d Cir. 2002). If the moving party meets its initial burden, the burden then shifts to the opposing party to establish a genuine dispute of material fact. Fed. R. Civ. P. 56(c)(1); *Beard v. Banks*, 548 U.S. 521, 529 (2006); *PepsiCo, Inc. v. Coca-Cola Co.*, 315 F.3d 101, 105 (2d Cir. 2002) (per curiam). In doing so, the non-moving party "may not rely on conclusory allegations or unsubstantiated speculation," *Scotto v. Almenas*, 143 F.3d 105, 114 (2d Cir. 1998), as "unsupported allegations do not create a material issue of fact," *Weinstock v. Columbia Univ.*, 224 F.3d 33, 41 (2d Cir. 2000).

B. Section 5 Liability and the *Howey* Test

Under Section 5 of the Securities Act, it is "unlawful for any person, directly or indirectly, . . . to offer to sell, offer to buy or purchase[,] or sell" a "security" unless a registration statement is in effect or has been filed with the SEC as to the offer and sale of such security to the public. 15 U.S.C. §§ 77e(a), (c), (e). To prove a violation of Section 5, the SEC must show: (1) that no registration statement was filed or in effect as to the transaction, and (2) that the defendant directly or indirectly offered to sell or sold the securities (3) through interstate commerce. *See SEC v. Cavanagh*, 445 F.3d 105, 111 n.13 (2d Cir. 2006).

Defendants do not dispute that they offered to sell and sold XRP through interstate commerce. *See, e.g.*, Defs. 56.1 Resp. ¶¶ 647, 716, 868, 870. They also do not dispute that they did not file a registration statement with the SEC for any offer or sale of XRP. *Id.* ¶ 928. The question before the Court is whether Defendants offered to sell or sold XRP as a security. Specifically, the SEC alleges that Defendants sold XRP as an "investment contract," which is a type of security as defined by the Securities Act, 15 U.S.C. § 77b(a)(1). *See, e.g.*, SEC Mem. at

2, 5, 49, ECF No. 837; Am. Compl. ¶¶ 3, 9, 60. Defendants argue that they did not sell XRP as an investment contract, and, therefore, no registration statement was required. *See, e.g.*, Defs. Mem. at 3, 36, ECF No. 825; Defs. 56.1 Resp. ¶ 928.

In *SEC v. W.J. Howey Co.*, the Supreme Court held that under the Securities Act, an investment contract is "a contract, transaction[,] or scheme whereby a person [(1)] invests his money [(2)] in a common enterprise and [(3)] is led to expect profits solely from the efforts of the promoter or a third party." 328 U.S. at 298–99; *see also SEC v. Edwards*, 540 U.S. 389, 393 (2004). In analyzing whether a contract, transaction, or scheme is an investment contract, "form should be disregarded for substance and the emphasis should be on economic reality" and the "totality of circumstances." *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967); *Glen-Arden Commodities, Inc. v. Constantino*, 493 F.2d 1027, 1034 (2d Cir. 1974).

C. Defendants' "Essential Ingredients" Test

In their summary judgment briefing, Defendants advance a novel "essential ingredients" test, arguing that, in addition to the *Howey* test, all investment contracts must contain three "essential ingredients": (1) "a contract between a promoter and an investor that establishe[s] the investor's rights as to an investment," which contract (2) "impose[s] post-sale obligations on the promoter to take specific actions for the investor's benefit" and (3) "grant[s] the investor a right to share in profits from the promoter's efforts to generate a return on the use of investor funds." Defs. Mem. at 2; *see id.* at 13–28.

The Court declines to adopt Defendants' "essential ingredients" test, which would call for the Court to read beyond the plain words of *Howey* and impose additional requirements not mandated by the Supreme Court. The Court sees no reason to do so. Neither *Howey*, nor its progeny, hold that an investment contract requires the existence of Defendants' "essential

ingredients." To the contrary, these cases make clear that the relevant test reflects a focus on an investor's expectation of "profits . . . from the efforts of others," rather than the formal imposition of post-sale obligations on the promoter or the grant to an investor of a right to share in profits. *Howey*, 328 U.S. at 301. The Supreme Court's use of the word "profits" in *Howey* was intended to refer to "income or return," *Edwards*, 540 U.S. at 394, and financial returns on investments are not equivalent to post-sale obligations or profit sharing. Thus, the Court is not persuaded that precedent supports the consideration of these "ingredients" in determining whether a contract, transaction, or scheme constitutes an investment contract under *Howey*.

Defendants do not cite a single case that has applied their test. *See generally* Defs. Mem. at 13–28. Rather, Defendants contend that the Court should look to the pre-1933 state "blue sky" law cases on which the *Howey* Court relied. *Id.* at 16–17. According to Defendants, every pre-1933 blue sky investment contract case involved a contract, post-sale obligations on the promoter, and the investor's right to receive a profit. *Id.* at 18–21. That may be so, but the *Howey* Court relied on the state courts' definition of an investment contract as "a contract or scheme for the placing of capital or laying out of money in a way intended to secure income or profit from its employment" when fashioning the relevant test. 328 U.S. at 298 (quotation marks and citation omitted). Had the Supreme Court intended to incorporate these ingredients as essential requirements, it would have done so. In any event, even accepting Defendants' survey and analysis of the caselaw as accurate, the fact that pre-1933 investment contract cases shared some common features does not convert those common features into requirements necessary for finding an investment contract under *Howey*. Rather, the Supreme Court was guided by the "fundamental purpose undergirding the Securities Acts," in which Congress "painted with a

broad brush" in recognition of the "virtually limitless scope of human ingenuity." *Reves v. Ernst & Young*, 494 U.S. 56, 60–61 (1990). So, too, must this Court be guided.

Indeed, in the more than seventy-five years of securities law jurisprudence after *Howey*, courts have found the existence of an investment contract even in the absence of Defendants' "essential ingredients," including in recent digital asset cases in this District. *See, e.g.*, *SEC v. Kik Interactive Inc.*, 492 F. Supp. 3d 169, 175–80 (S.D.N.Y. 2020); *Balestra v. ATBCOIN LLC*, 380 F. Supp. 3d 340, 354 (S.D.N.Y. 2019) ("ATB Coins did not entitle purchasers to a pro rata share of the profits derived from any ATB-managed transaction . . . . However, such a formalized profit-sharing mechanism is not required."). And this makes sense, given that the *Howey* test was intended to "embod[y] a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." 328 U.S. at 299. Put differently, the *Howey* test was intended to effectuate "[t]he statutory policy of affording broad protection to investors," protection that is "not to be thwarted by unrealistic and irrelevant formulae." *Id.* at 301. Accordingly, the Court rejects Defendants' argument that all investment contracts must include post-sale obligations on the promoter and grant the investor a right to share in profits from the promoter's efforts.

The Court does not reach Defendants' first "essential ingredient": that a contract must exist for an investment contract to exist.[11] As discussed in greater detail below, in each instance where Defendants offered or sold XRP as an investment contract, a contract existed.

[11] The SEC's opposition papers misconstrue Defendants' "essential ingredients" test. The SEC dedicates several pages to refuting the argument that a *written* contract must exist, *see* SEC Opp. at 19–24, but Defendants' proposed test does not turn on the need for a written contract as opposed to an oral or implied contract, *see* Defs. Mem. at 2, 18–19; Defs. Reply at 9, ECF No. 832. Therefore, the Court does not address the SEC's arguments that *Howey* does not require the existence of a written contract. *See* SEC Opp. at 19–24.

II. Analysis

A. The XRP Token

The plain words of *Howey* make clear that "an investment contract for purposes of the Securities Act means a *contract, transaction*[,] *or scheme*." 328 U.S. at 298–99 (emphasis added). But the subject of a contract, transaction, or scheme is not necessarily a security on its face. Under *Howey*, the Court analyzes the economic reality and totality of circumstances surrounding the offers and sales of the underlying asset. *See Tcherepnin*, 389 U.S. at 336; *Glen-Arden*, 493 F.2d at 1034.

Howey and its progeny have held that a variety of tangible and intangible assets can serve as the subject of an investment contract. *See, e.g.*, *Howey*, 328 U.S. 293 (orange groves); *Glen-Arden*, 493 F.2d 1027 (whiskey casks); *Edwards*, 540 U.S. 389 (payphones); *Hocking v. Dubois*, 885 F.2d 1449 (9th Cir. 1989) (condominiums), *cert. denied*, 494 U.S. 1078 (1990); *Cont'l Mktg. Corp. v. SEC*, 387 F.2d 466 (10th Cir. 1967) (beavers); *SEC v. Telegram Grp. Inc.*, 448 F. Supp. 3d 352 (S.D.N.Y. 2020) (digital tokens). In each of these cases, the subject of the investment contract was a standalone commodity, which was not itself inherently an investment contract. For instance, if the original citrus groves in *Howey* were later resold, those resales may or may not constitute investment contracts, depending on the totality of circumstances surrounding the later transaction.

Here, Defendants argue that XRP does not have the "character in commerce" of a security and is akin to other "ordinary assets" like gold, silver, and sugar. *See* Defs. Mem. at 3–4, 42–44 (citation omitted). This argument misses the point because ordinary assets—like gold, silver, and sugar—may be sold as investment contracts, depending on the circumstances of those sales. *See Glen-Arden*, 493 F.2d at 1033, 1035; *Fedance v. Harris*, 1 F.4th 1278, 1288–89

(11th Cir. 2021) ("Plenty of items that can be consumed or used . . . have been the subject of transactions determined to be securities because they had the attributes of an investment." (citation omitted)). Even if XRP exhibits certain characteristics of a commodity or a currency, it may nonetheless be offered or sold as an investment contract.

As another court in this District recently held:

> While helpful as a shorthand reference, the security in this case is not simply the [digital token, the] Gram, which is little more than alphanumeric cryptographic sequence . . . . This case presents a "scheme" to be evaluated under *Howey* that consists of the full set of contracts, expectations, and understandings centered on the sales and distribution of the Gram. *Howey* requires an examination of the entirety of the parties' understandings and expectations.

Telegram, 448 F. Supp. 3d at 379. XRP, as a digital token, is not in and of itself a "contract, transaction[,] or scheme" that embodies the *Howey* requirements of an investment contract. Rather, the Court examines the totality of circumstances surrounding Defendants' different transactions and schemes involving the sale and distribution of XRP. *See Marine Bank v. Weaver*, 455 U.S. 551, 560 n.11 (1982) ("Each transaction must be analyzed and evaluated on the basis of the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole.").

B. Defendants' Offers and Sales of XRP

The parties cross-move for summary judgment on the SEC's claim under Section 5 of the Securities Act. Whether Defendants offered or sold "investment contracts" is a legal question that the Court resolves based on the undisputed record. *See SEC v. Thompson*, 732 F.3d 1151, 1160–61 (10th Cir. 2013) (collecting cases). The SEC alleges that Ripple engaged in three categories of unregistered XRP offers and sales:

> (1) Institutional Sales under written contracts for which it received $728 million; (2) Programmatic Sales on digital asset exchanges for which it received $757 million; and

> (3) Other Distributions under written contracts for which it recorded $609 million in "consideration other than cash."

See SEC Reply at 4–5, ECF No. 843. The SEC also alleges that Larsen and Garlinghouse engaged in unregistered individual XRP sales, from which they received at least $450 million and $150 million, respectively. *See id.* at 5. The Court shall separately analyze and evaluate each category of transaction. *See Marine Bank*, 455 U.S. at 560 n.11.

1. Institutional Sales

The Court first addresses Ripple's Institutional Sales of XRP to sophisticated individuals and entities (the "Institutional Buyers") pursuant to written contracts. *See* SEC Mem. at 28–31; Defs. Mem. at 11. The SEC alleges that these Institutional Sales were distributions of XRP into public markets through conduits, and that "some Institutional [Buyers] were buying XRP as brokers, while others simply resold it as part of their trading strategies." SEC Mem. at 28–29.

The first prong of *Howey* examines whether an "investment of money" was part of the relevant transaction. 328 U.S. at 301. Here, the Institutional Buyers invested money by providing fiat or other currency in exchange for XRP. Defs. 56.1 Resp. ¶ 607. Defendants do not dispute that Ripple received money for XRP through its Institutional Sales. *See* Defs. Mem. at 11; Defs. Opp. at 17 n.7. However, Defendants argue that an "investment of money" is different from "merely payment of money"—that is, *Howey* requires not just payment of money but an intent to invest that money. *See* Defs. Opp. at 18–19.

Not so. Defendants' purported distinction is not supported by caselaw. The proper inquiry is whether the Institutional Buyers "provide[d] the capital," *Howey*, 328 U.S. at 300, "put up their money," *Glen-Arden*, 493 F.2d at 1034, or "provide[d]" cash, *Telegram*, 448 F. Supp. 3d at 368–69. Defendants do not dispute that there was a payment of money; the Court finds, therefore, that this element has been established.

The second prong of *Howey*, the existence of a "common enterprise," 328 U.S. at 301, may be demonstrated through a showing of "horizontal commonality," *Revak v. SEC Realty Corp.*, 18 F.3d 81, 87 (2d Cir. 1994). Horizontal commonality exists where the investors' assets are pooled and the fortunes of each investor are tied to the fortunes of other investors, as well as to the success of the overall enterprise. *See id.* at 88; *see also SEC v. SG Ltd.*, 265 F.3d 42, 49 (1st Cir. 2001) ("[H]orizontal commonality [is] a type of commonality that involves the pooling of assets from multiple investors so that all share in the profits and risks of the enterprise."); *ATBCOIN LLC*, 380 F. Supp. 3d at 353.[12]

Here, the undisputed record shows the existence of horizontal commonality. Ripple pooled the proceeds of its Institutional Sales into a network of bank accounts under the names of its various subsidiaries. *See, e.g.*, ECF No. 831-29 ¶¶ 3–4; Defs. 56.1 Resp. ¶¶ 795–98; *see also id.* ¶ 1004. Although Ripple maintained separate bank accounts for each subsidiary, Ripple controlled all of the accounts and used the funds raised from the Institutional Sales to finance its operations. *See* Defs. 56.1 Resp. ¶¶ 255–56; SEC Reply at 8; *cf.* Defs. Opp. at 22–23; Defs. Reply at 19–20, ECF No. 832. Defendants do not dispute that Ripple did not "segregate[] and separately manage[]" investor funds or "allow[] for profits to remain independent." *Kik*, 492 F. Supp. 3d at 179; *see* SEC Reply at 8. And, Ripple's accountants recorded all of its XRP-related proceeds together. *See* Defs. 56.1 Resp. ¶¶ 147–48.

Further, each Institutional Buyer's ability to profit was tied to Ripple's fortunes and the fortunes of other Institutional Buyers because all Institutional Buyers received the same fungible

[12] The SEC also argues that the record establishes strict vertical commonality. *See* SEC Mem. at 51–53. The Second Circuit has not addressed whether the strict vertical commonality theory can give rise to a common enterprise. *See Revak*, 18 F.3d at 88. In this case, because horizontal commonality establishes the existence of a common enterprise, the Court does not reach the issue of strict vertical commonality or its viability as a theory.

XRP.[13] *See id.* ¶¶ 206–07. Ripple used the funds it received from its Institutional Sales to promote and increase the value of XRP by developing uses for XRP and protecting the XRP trading market. *See id.* ¶¶ 156–57, 161–68, 255–56. When the value of XRP rose, all Institutional Buyers profited in proportion to their XRP holdings. *See Kik*, 492 F. Supp. 3d at 178 ("The success of the ecosystem drove demand for [the digital token] Kin and thus dictated investors' profits."); *Telegram*, 448 F. Supp. 3d at 369–70 (finding horizontal commonality where the digital token purchasers "possess an identical instrument, the value of which is entirely dependent on the success or failure of the TON Blockchain" and "[t]he investors' fortunes are directly tied to the success of the TON Blockchain as a whole"). The Court finds the existence of a common enterprise because the record demonstrates that there was a pooling of assets and that the fortunes of the Institutional Buyers were tied to the success of the enterprise as well as to the success of other Institutional Buyers.

The third prong of *Howey* examines whether the economic reality surrounding Ripple's Institutional Sales led the Institutional Buyers to have "a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." *See United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 852 (1975).[14] In this context, profit means an "income or return, to include, for example, dividends, other periodic payments, or *the increased value of the investment*." *Edwards*, 540 U.S. at 394 (emphasis added). The reasonable expectation of profits from the efforts of others need not be the sole reason a purchaser buys an investment; an asset

[13] The Court holds only that a common enterprise existed between Ripple and the Institutional Buyers. The Court does not reach the question of whether the common enterprise extends to encompass "other XRP holders," Defendants Garlinghouse and Larsen, the "XRP ecosystem," or any other entities. *Cf.* Defs. Opp. at 20–21.

[14] *Howey* contemplates that an investor is "led to expect profits solely from the efforts of the promoter or a third party." 328 U.S. at 298–99. However, the Second Circuit "ha[s] held that the word 'solely' should not be construed as a literal limitation; rather, [courts] 'consider whether, under all the circumstances, the scheme was being promoted primarily as an investment or as a means whereby participants could pool their own activities, their money and the promoter's contribution in a meaningful way.'" *United States v. Leonard*, 529 F.3d 83, 88 (2d Cir. 2008) (quoting *SEC v. Aqua-Sonic Prods. Corp.*, 687 F.2d 577, 582 (2d Cir. 1982)).

may be sold for both consumptive and speculative uses. *See SEC v. LBRY, Inc.*, No. 21 Civ. 260, 2022 WL 16744741, at *7 (D.N.H. Nov. 7, 2022). Moreover, "[t]he inquiry is an objective one focusing on the promises and offers made to investors; it is not a search for the precise motivation of each individual participant." *Telegram*, 448 F. Supp. 3d at 371 (citing *Warfield v. Alaniz*, 569 F.3d 1015, 1021 (9th Cir. 2009)).

Based on the totality of circumstances, the Court finds that reasonable investors, situated in the position of the Institutional Buyers, would have purchased XRP with the expectation that they would derive profits from Ripple's efforts. From Ripple's communications, marketing campaign, and the nature of the Institutional Sales, reasonable investors would understand that Ripple would use the capital received from its Institutional Sales to improve the market for XRP and develop uses for the XRP Ledger, thereby increasing the value of XRP. *Cf. Kik*, 492 F. Supp. 3d at 179–80; *Telegram*, 448 F. Supp. 3d at 371–78.

Starting in 2013, Ripple marketed XRP to potential investors, including the Institutional Buyers, by distributing promotional brochures that touted XRP as an investment tied to the company's success. For instance, in the "Deep Dive" brochure, which was circulated to prospective investors, Ripple explains that its "business model is predicated on a belief that demand for XRP will increase . . . if the Ripple protocol becomes widely adopted," and "[i]f the Ripple protocol becomes the backbone of global value transfer, Ripple . . . expects the demand for XRP to be considerable." Defs. 56.1 Resp. ¶ 187; ECF No. 855-14 at 23, 29, 31. Similarly, the "Ripple Primer" states that Ripple "hopes to make money from XRP if the world finds the Ripple network useful." Defs. 56.1 Resp. ¶ 180; ECF No. 861-26 at 20. The "Gateways" brochure also explains that "Ripple's business model is based on the success of [XRP,]" and includes a graphical representation of bitcoin's price change below the text: "Can a virtual

currency really create and hold value? *Bitcoin proves it can*." Defs. 56.1 Resp. ¶¶ 173, 175; ECF No. 861-25 at 21.

Later, through its XRP Market Reports, Ripple continued to connect XRP's price and trading to its own efforts. Ripple's Q1 2017 XRP Markets Report states that the company's efforts—including its "vocal . . . commitment to XRP," the announcement of a new business relationship, and "continu[ing] to sign up banks to commercially deploy its enterprise blockchain solution and join its global payments network"—may have had an impact on XRP's price increase and "impressive" trading volume. Defs. 56.1 Resp. ¶ 421; ECF No. 839-4 at 9. The Q2 2017 XRP Markets Report highlights XRP's "dramatic" and "stunning" price increase and notes that "[t]he market responded favorably to [Ripple's] escrow and decentralization announcements." Defs. 56.1 Resp. ¶ 422; ECF No. 839-4 at 16. Similarly, Ripple's Q1 2020 XRP Markets Report states that XRP's liquidity was "bolstered through new use cases for XRP outside of cross-border payments." Defs. 56.1 Resp. ¶ 366; ECF No. 839-4 at 98.

During this time, Ripple's senior leaders echoed similar statements on various public channels. In a February 2014 interview, Larsen said, "for Ripple . . . to do well, we have to do a very good job in protecting the value of XRP and the value of the network," and asked potential investors to "[g]ive [Ripple] time" to "add[] the most value to the protocol." Defs. 56.1 Resp. ¶ 461. In July 2017, David Schwartz, who was then chief cryptographer at Ripple, *see id.* ¶ 40, wrote on Reddit that "Ripple's interest[s] closely (but, yes, not perfectly) align with those of other XRP holders," *id.* ¶ 462. In February 2018, Schwartz posted on Reddit that what "really set[s] XRP apart from any other digital asset" is the "amazing team of dedicated professionals that Ripple has managed to amass to develop an ecosystem around XRP." *Id.* ¶¶ 345, 349, 360. In a December 2017 interview, Garlinghouse stated that XRP gave Ripple "a huge strategic asset

to go invest in and accelerate the vision [it] see[s] for an internet of value." *Id.* ¶ 468. And, in March 2018, Garlinghouse said at a press conference that "Ripple is very, very interested in the success and the health of the ecosystem and will continue to invest in the ecosystem." *Id.* ¶ 469.

Ripple and its senior leaders publicly emphasized the complexity of creating an "internet of value" and the need for extensive capital to solve this "trillion dollar" problem. Defs. 56.1 Resp. ¶ 101. For instance, in October 2017, Garlinghouse declared in a YouTube video: "I have no qualms saying definitively if we continue to drive the success we're driving, we're going to drive a massive amount of demand for XRP because we're solving a multitrillion dollar problem." *Id.* ¶ 98; *see also id.* ¶¶ 99–101. In July 2017, Schwartz wrote on Reddit that, "Ripple can justify spending $100 million on a project if it could reasonably be expected to increase the price of XRP by one penny over the long term." *Id.* ¶ 462. In November 2017, Schwartz posted on XRP Chat that Ripple would use its "war chest" to put upward pressure on XRP's price. *Id.* ¶ 445.

These statements, and many more, are representative of Ripple's overall messaging to the Institutional Buyers about the investment potential of XRP and its relationship to Defendants' efforts. Clearly, the Institutional Buyers would have understood that Ripple was pitching a speculative value proposition for XRP with potential profits to be derived from Ripple's entrepreneurial and managerial efforts. *See LBRY*, 2022 WL 16744741, at *5–6.

Further, the nature of the Institutional Sales also supports the conclusion that Ripple sold XRP as an investment rather than for consumptive use. In their sales contracts, some Institutional Buyers agreed to lockup provisions or resale restrictions based on XRP's trading volume. *See, e.g.*, Defs. 56.1 Resp. ¶¶ 575, 800–01. These restrictions are inconsistent with the notion that XRP was used as a currency or for some other consumptive use. "Simply put, a

rational economic actor would not agree to freeze millions of dollars . . . if the purchaser's intent was to obtain a substitute for fiat currency." *Telegram*, 448 F. Supp. 3d at 373. Certain Institutional Sales contracts required the Institutional Buyer to indemnify Ripple for claims arising out of the sale or distribution of XRP, *see* Defs. 56.1 Resp. ¶ 792, and other contracts expressly stated that the Institutional Buyer was purchasing XRP "solely to resell or otherwise distribute . . . and not to use [XRP] as an [e]nd [u]ser or for any other purpose." *Id.* ¶ 793. These various provisions in the Institutional Sales contracts support the conclusion that the parties did not view the XRP sale as a sale of a commodity or a currency—they understood the sale of XRP to be an investment in Ripple's efforts.

Therefore, having considered the economic reality and totality of circumstances surrounding the Institutional Sales, the Court concludes that Ripple's Institutional Sales of XRP constituted the unregistered offer and sale of investment contracts in violation of Section 5 of the Securities Act.[15]

2. Programmatic Sales

The Court next addresses Ripple's Programmatic Sales, which occurred under different circumstances from the Institutional Sales. *See* SEC Mem. at 28; Defs. Mem. at 10–11. The SEC alleges that in the Programmatic Sales to public buyers ("Programmatic Buyers") on digital asset exchanges, "Ripple understood that people were speculating on XRP as an investment," "explicitly targeted speculators[,] and made increased speculative volume a 'target goal.'" SEC Mem. at 28.

[15] The Court holds only that Ripple's sales of XRP to the Institutional Buyers were offers and sales of investment contracts. To the extent the SEC instead argues that Ripple actually sold investment contracts to the public and used the Institutional Buyers as underwriters, the Court rejects that argument. *Cf.* SEC Mem. at 63–65.

Having considered the economic reality of the Programmatic Sales, the Court concludes that the undisputed record does not establish the third *Howey* prong. Whereas the Institutional Buyers reasonably expected that Ripple would use the capital it received from its sales to improve the XRP ecosystem and thereby increase the price of XRP, *see Kik*, 492 F. Supp. 3d at 180; *cf. supra* § II.B.1, Programmatic Buyers could not reasonably expect the same. Indeed, Ripple's Programmatic Sales were blind bid/ask transactions, and Programmatic Buyers could not have known if their payments of money went to Ripple, or any other seller of XRP. SEC 56.1 Resp. ¶ 96; Defs. 56.1 Resp. ¶¶ 652–54. Since 2017, Ripple's Programmatic Sales represented less than 1% of the global XRP trading volume. SEC 56.1 Resp. ¶¶ 77, 82. Therefore, the vast majority of individuals who purchased XRP from digital asset exchanges did not invest their money in Ripple at all. An Institutional Buyer knowingly purchased XRP directly from Ripple pursuant to a contract, but the economic reality is that a Programmatic Buyer stood in the same shoes as a secondary market purchaser who did not know to whom or what it was paying its money.[16]

Further, it is not enough for the SEC to argue that Ripple "explicitly targeted speculators" or that "Ripple understood that people were speculating on XRP as an investment," SEC Mem. at 28, because a speculative motive "on the part of the purchaser or seller does not evidence the existence of an 'investment contract' within the meaning of the [Securities Act]," *Sinva, Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 253 F. Supp. 359, 367 (S.D.N.Y. 1966). "[A]nyone who buys or sells[, for example,] a horse or an automobile hopes to realize a

[16] The Court does not address whether secondary market sales of XRP constitute offers and sales of investment contracts because that question is not properly before the Court. Whether a secondary market sale constitutes an offer or sale of an investment contract would depend on the totality of circumstances and the economic reality of that specific contract, transaction, or scheme. *See Marine Bank*, 455 U.S. at 560 n.11; *Telegram*, 448 F. Supp. 3d at 379; *see also* ECF No. 105 at 34:14-16, *LBRY*, No. 21 Civ. 260 (D.N.H. Jan. 30, 2023) (declining to extend holding to include secondary sales).

profitable 'investment.' But the expected return is not contingent upon the continuing efforts of another." *Id.* (citing *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 348 (1943)). The relevant inquiry is whether this speculative motive "derived from the entrepreneurial or managerial efforts of others." *Forman*, 421 U.S. at 852. It may certainly be the case that many Programmatic Buyers purchased XRP with an expectation of profit, but they did not derive that expectation from Ripple's efforts (as opposed to other factors, such as general cryptocurrency market trends)—particularly because none of the Programmatic Buyers were aware that they were buying XRP from Ripple.

Of course, some Programmatic Buyers may have purchased XRP with the expectation of profits to be derived from Ripple's efforts. However, "[t]he inquiry is an objective one focusing on the promises and offers made to investors; it is not a search for the precise motivation of each individual participant." *Telegram*, 448 F. Supp. 3d at 371 (citation omitted). Here, the record establishes that with respect to Programmatic Sales, Ripple did not make any promises or offers because Ripple did not know who was buying the XRP, and the purchasers did not know who was selling it. SEC 56.1 Resp. ¶ 96; Defs. 56.1 Resp. ¶¶ 652–54. In fact, many Programmatic Buyers were entirely unaware of Ripple's existence. SEC Add. 56.1 Resp. ¶ 1606, ECF No. 844; ECF Nos. 831-1–831-26.

The Programmatic Sales also lacked other factors present in the economic reality of the Institutional Sales which cut in favor of finding "a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." *Forman*, 421 U.S. at 852; *cf. supra* § II.B.1. For instance, the Programmatic Sales were not made pursuant to contracts that contained lockup provisions, resale restrictions, indemnification clauses, or statements of purpose. *Cf. Telegram*, 448 F. Supp. 3d at 373. Similarly, Ripple's promotional materials, such

as the "Ripple Primer" and the "Gateways" brochure, were widely circulated amongst potential investors like the Institutional Buyers. But, there is no evidence that these documents were distributed more broadly to the general public, such as XRP purchasers on digital asset exchanges. Nor is there evidence that Programmatic Buyers understood that statements made by Larsen, Schwartz, Garlinghouse, and others were representations of Ripple and its efforts.

Lastly, the Institutional Buyers were sophisticated entities, including institutional investors and hedge funds. SEC 56.1 Resp. ¶ 105. An "examination of the entirety of the parties' understandings and expectations," including the "full set of contracts, expectations, and understandings centered on the sales and distribution of" XRP supports the conclusion that a reasonable investor, situated in the position of the Institutional Buyers, would have been aware of Ripple's marketing campaign and public statements connecting XRP's price to its own efforts. *Telegram*, 448 F. Supp. 3d at 379. There is no evidence that a reasonable Programmatic Buyer, who was generally less sophisticated as an investor, shared similar "understandings and expectations" and could parse through the multiple documents and statements that the SEC highlights, which include statements (sometimes inconsistent) across many social media platforms and news sites from a variety of Ripple speakers (with different levels of authority) over an extended eight-year period.

Therefore, having considered the economic reality and totality of circumstances, the Court concludes that Ripple's Programmatic Sales of XRP did not constitute the offer and sale of investment contracts.[17]

[17] Because the Court finds that the record does not establish the third *Howey* prong as to the Programmatic Sales, the Court does not reach whether the first or second *Howey* prongs have been satisfied.

3. Other Distributions

The SEC's last category of XRP offers and sales are "Other Distributions under written contracts for which [Ripple] recorded $609 million in 'consideration other than cash' in its audited financial statements." SEC Reply at 5. These Other Distributions include distributions to employees as compensation and to third parties as part of Ripple's Xpring initiative to develop new applications for XRP and the XRP Ledger. SEC Mem. at 31–32. The SEC alleges that "Ripple funded its projects by transferring XRP to third parties and then having them sell the XRP into public markets." *Id.* at 31.

The Other Distributions do not satisfy *Howey*'s first prong that there be an "investment of money" as part of the transaction or scheme. 328 U.S. at 301. *Howey* requires a showing that the investors "provide[d] the capital," *id.* at 300, "put up their money," *Glen-Arden*, 493 F.2d at 1034, or "provide[d]" cash, *Telegram*, 448 F. Supp. 3d at 368–69. "In every case [finding an investment contract] the purchaser gave up some tangible and definable consideration in return for an interest that had substantially the characteristics of a security." *Int'l Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 560 (1979). Here, the record shows that recipients of the Other Distributions did not pay money or "some tangible and definable consideration" to Ripple. To the contrary, Ripple paid XRP to these employees and companies. And, as a factual matter, there is no evidence that "Ripple funded its projects by transferring XRP to third parties and then having them sell the XRP," SEC Mem. at 31, because Ripple never received the payments from these XRP distributions.

In its opposition papers, the SEC pivots and argues instead that the Other Distributions were an indirect public offering because "the parties that received XRP from Ripple, such as an '[Xpring] recipient,' could 'transfer their XRP (in exchange for units of another currency, goods,

or services) to another holder.'" SEC Opp. at 26 (citation omitted). But the SEC does not elsewhere allege that the recipients of these Other Distributions, like Ripple employees and Xpring third-party companies, were Ripple's underwriters. In any event, the SEC does not develop the argument that these secondary market sales were offers or sales of investment contracts, particularly where the payment of money for these XRP sales never traced back to Ripple, and the Court cannot make such a finding.

Therefore, having considered the economic reality and totality of circumstances, the Court concludes that Ripple's Other Distributions did not constitute the offer and sale of investment contracts.[18]

4. Larsen's and Garlinghouse's Offers and Sales

Lastly, the Court addresses Larsen's and Garlinghouse's offers and sales of XRP. Section 4(a)(1) of the Securities Act exempts "transactions by any person other than an issuer, underwriter, or dealer." 15 U.S.C. § 77d(a)(1). The SEC argues that this exemption does not apply to Larsen and Garlinghouse because they are "affiliates" of Ripple and "an affiliate of the issuer—such as an officer, director, or controlling shareholder—ordinarily may not rely upon the Section 4(1) exemption." *Cavanagh*, 445 F.3d at 111 (cleaned up).

The Court need not reach this issue. Like Ripple's Programmatic Sales, Larsen's and Garlinghouse's XRP sales were programmatic sales on various digital asset exchanges through blind bid/ask transactions. *See* SEC 56.1 Resp. ¶¶ 280–84, 306–09. Larsen and Garlinghouse did not know to whom they sold XRP, and the buyers did not know the identity of the seller. Thus, as a matter of law, the record cannot establish the third *Howey* prong as to these transactions. For substantially the same reasons discussed above, *supra* § II.B.2, Larsen's and

[18] Because the Court determines that the record does not establish the first *Howey* prong as to the Other Distributions, the Court does not reach whether the second or third *Howey* prongs have been satisfied.

Garlinghouse's offer and sale of XRP on digital asset exchanges did not amount to offers and sales of investment contracts.[19]

5. Defendants' Due Process Defenses

Defendants each assert a "fair notice" defense, claiming that the SEC violated their due process rights; Larsen and Garlinghouse also assert an as-applied vagueness defense based on the same due process principles. *See* Defs. Opp. at 43 & n.28; *see also* ECF No. 51 at 97–99; ECF No. 462 at 97–99; ECF No. 463 at 103–05.

"A fundamental principle in our legal system is that laws which regulate persons or entities must give fair notice of conduct that is forbidden or required." *FCC v. Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012). This clarity requirement is "essential to the protections provided by the Due Process Clause of the Fifth Amendment," and "requires the invalidation of laws that are impermissibly vague." *Id.* Laws fail to comport with due process when they (1) "fail[] to provide a person of ordinary intelligence fair notice of what is prohibited," or (2) are so standardless that they authorize or encourage "seriously discriminatory enforcement." *Id.* (citation omitted).

This "assessment cannot be conducted in the abstract; rather . . . the party claiming a lack of notice [must] show[] 'that the statute in question provided insufficient notice that his or her behavior at issue was prohibited.'" ECF No. 440 at 8 (quoting *Copeland v. Vance*, 893 F.3d 101, 110 (2d Cir. 2018)). "[T]he evaluation of any fair notice defense is objective—it does not require inquiry into 'whether a particular [party] actually received a warning that alerted him or her to the danger of being held to account for the behavior in question.'" *Id.* at 10 n.5 (quoting

[19] For the reasons stated, the Court need not address Defendants' argument that Larsen and Garlinghouse are entitled to summary judgment on offers and sales on "foreign exchanges." *See* Defs. Mem. at 58–74.

United States v. Smith, 985 F. Supp. 2d 547, 587 (S.D.N.Y. 2014), *aff'd sub nom. United States v. Halloran*, 664 F. App'x 23 (2d Cir. 2016)).

The Court rejects Defendants' fair notice and vagueness defenses as to the Institutional Sales. First, the caselaw that defines an investment contract provides a person of ordinary intelligence a reasonable opportunity to understand what conduct it covers. *See Copeland*, 893 F.3d at 114. *Howey* sets forth a clear test for determining what constitutes an investment contract, and *Howey*'s progeny provides guidance on how to apply that test to a variety of factual scenarios. *See Smith*, 985 F. Supp. 2d at 588 ("[I]t is not only the language of a statute that can provide the requisite fair notice; judicial decisions interpreting that statute can do so as well."). That is constitutionally sufficient to satisfy due process. *See United States v. Zaslavskiy*, No. 17 Cr. 647, 2018 WL 4346339, at *9 (E.D.N.Y. Sept. 11, 2018) ("[T]he abundance of caselaw interpreting and applying *Howey* at all levels of the judiciary, as well as related guidance issued by the SEC as to the scope of its regulatory authority and enforcement power, provide all the notice that is constitutionally required.").

Second, the caselaw articulates sufficiently clear standards to eliminate the risk of arbitrary enforcement. *Howey* is an objective test that provides the flexibility necessary for the assessment of a wide range of contracts, transactions, and schemes. Defendants focus on the SEC's failure to issue guidance on digital assets and its inconsistent statements and approaches to regulating the sale of digital assets as investment contracts. *See* Defs. Opp. at 45–52. But the SEC's approach to enforcement, at least as to the Institutional Sales,[20] is consistent with the

[20] Because the Court finds that only the Institutional Sales constituted the offer and sale of investment contracts, the Court does not address Defendants' asserted fair notice defense as to the other transactions and schemes. The Court's holding is limited to the Institutional Sales because the SEC's theories as to the other sales in this case are potentially inconsistent with its enforcement in prior digital asset cases. *See Upton v. SEC*, 75 F.3d 92, 98 (2d Cir. 1996).

enforcement actions that the agency has brought relating to the sale of other digital assets to buyers pursuant to written contracts and for the purpose of fundraising. *See, e.g.*, *Telegram*, 448 F. Supp. 3d 352; *Kik*, 492 F. Supp. 3d 169. Moreover, the law does not require the SEC to warn all potential violators on an individual or industry level. *See Dickerson v. Napolitano*, 604 F.3d 732, 745–46 (2d Cir. 2010) ("Courts ask whether the law presents an ordinary person with sufficient notice of or the opportunity to understand what conduct is prohibited or proscribed, not whether a particular [party] actually received a warning that alerted him or her to the danger of being held to account for the behavior in question." (cleaned up)).

Accordingly, the SEC's motion for summary judgment is GRANTED as to the Institutional Sales and otherwise DENIED, and Defendants' motion for summary judgment is GRANTED as to the Programmatic Sales, the Other Distributions, and Larsen's and Garlinghouse's sales, and DENIED as to the Institutional Sales.

C. Larsen's and Garlinghouse's Aiding and Abetting of Ripple's Violations

The SEC also moves for summary judgment on its aiding and abetting claim against Larsen and Garlinghouse. *See* SEC Mem. at 66. To establish liability for aiding and abetting a securities violation, the SEC must show:

> (1) the existence of a securities law violation by the primary (as opposed to the aiding and abetting) party;
> (2) knowledge of this violation on the part of the aider and abettor; and
> (3) substantial assistance by the aider and abettor in the achievement of the primary violation.

SEC v. Apuzzo, 689 F.3d 204, 206 (2d Cir. 2012) (cleaned up). Courts cannot consider the three requirements in isolation from one another because "[s]atisfaction of the knowledge requirement will depend on the theory of primary liability, and there may be a nexus between the degree of knowledge and the requirement that the alleged aider and abettor render substantial assistance."

SEC v. Espuelas, 905 F. Supp. 2d 507, 517 (S.D.N.Y. 2012) (quoting *SEC v. DiBella*, 587 F.3d 553, 566 (2d Cir. 2009)). Indeed, courts have found that "'[a] high degree of substantial assistance may lessen the SEC's burden in proving scienter' and vice versa." *SEC v. Wey*, 246 F. Supp. 3d 894, 928 (S.D.N.Y. 2017) (quoting *Apuzzo*, 689 F.3d at 215).

As to the first requirement, the Court has already held that Ripple's Institutional Sales constituted the unregistered offer and sale of investment contracts in violation of Section 5 of the Securities Act. *See supra* § II.B.1.

With respect to the second requirement, to show knowledge of Ripple's violations, the SEC must demonstrate Larsen's and Garlinghouse's "general awareness of their overall role in Ripple's illegal scheme." MTD Order at 15; *see SEC v. Yorkville Advisors, LLC*, 305 F. Supp. 3d 486, 511 (S.D.N.Y. 2018); Dodd-Frank Wall St. Reform & Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376, § 929O (2010) (codified at 15 U.S.C. § 78t(e)). The SEC need not demonstrate that Larsen and Garlinghouse were aware that Ripple's transactions and schemes were illegal. *See SEC v. Mattessich*, 407 F. Supp. 3d 264, 272–73 (S.D.N.Y. 2019). Rather, the SEC must show that Larsen and Garlinghouse knew, or recklessly disregarded, the facts that made Ripple's transactions and schemes illegal under statutory and caselaw. *See id.*

Based on the record, Defendants have raised a genuine dispute of material fact as to whether Larsen and Garlinghouse knew or recklessly disregarded the facts that made Ripple's scheme illegal. *See* MTD Order at 15. It is not clear whether Larsen and Garlinghouse knew or recklessly disregarded that securities laws, rather than laws under other regulatory regimes, applied to XRP. For instance, Larsen and Garlinghouse testified that they did not believe XRP was a security because multiple foreign regulators, including regulators in Japan, Singapore, Switzerland, the United Arab Emirates, and the United Kingdom, had determined that XRP was

not a security. SEC Add. 56.1 Resp. ¶¶ 1744, 1782. Larsen and Garlinghouse also stated that when the U.S. Department of Justice and the U.S. Treasury Department's Financial Crimes Enforcement Network labeled XRP a "virtual currency" in 2015, they understood this as an "official United States government declaration that XRP [was] a currency" and "exempt from [U.S.] securities laws." *Id.* ¶¶ 1734, 1759–60. Larsen further testified that he understood the 2018 speech by the then-Director of the SEC Division of Corporate Finance, Bill Hinman—in which he stated that neither bitcoin nor ether (another digital asset) were securities—to further reinforce the SEC's position that XRP was not a security. *See id.* ¶¶ 1742–43.

The October 2012 Perkins Coie memorandum, which Larsen reviewed, advises, "[a]lthough we believe that a compelling argument can be made that [XRP tokens] do not constitute 'securities' under the federal securities laws, given the lack of applicable [caselaw], we believe that there is some risk, albeit small, that the [SEC] disagrees with our analysis." Defs. 56.1 Resp. ¶ 993; *see* ECF No. 846-30 at 6. Larsen testified that after receiving the memorandum, Ripple took specific steps to ensure compliance with the advice contained within the memorandum. Defs. 56.1 Resp. ¶ 1730.

Likewise, Defendants have raised a genuine issue of material fact as to whether Larsen and Garlinghouse knew or recklessly disregarded facts about each of the *Howey* elements. For example, Defendants have adduced evidence that Larsen and Garlinghouse did not know that Ripple's Institutional Sales of XRP satisfied the *Howey* "common enterprise" element because they did not believe that the proceeds from the sales were pooled and understood that Ripple did not manage, operate, or control the XRP Ledger or the broader "XRP ecosystem." *See id.* ¶¶ 1748–50. Based on the disputed facts in the record, therefore, a reasonable juror could find

that Larsen and Garlinghouse did not know or recklessly disregard Ripple's Section 5 violations. *See Apuzzo*, 689 F.3d at 206.

As to the third requirement, Defendants concede that Larsen, as Ripple's CEO prior to 2017, provided substantial assistance, and Garlinghouse, after becoming Ripple's CEO in January 2017, provided substantial assistance. *See* Defs. Opp. at 71. However, Larsen claims that he did not provide substantial assistance during his time as Executive Chairman of Ripple's Board, starting in 2017. *See id.*

To satisfy the substantial assistance component of aiding and abetting, the "SEC must show that the defendant in some sort associated himself with the venture, that he participated in it as in something that he wished to bring about, and that he sought by his action to make it succeed." *Apuzzo*, 689 F.3d at 206 (cleaned up). In other words, the defendant must "consciously assist the commission of the specific crime in some active way." *SEC v. Mudd*, 885 F. Supp. 2d 654, 670–71 (S.D.N.Y. 2012) (cleaned up).

Here, Larsen has raised a triable issue of material fact as to whether he provided "substantial assistance" beginning in 2017. *See Anderson*, 477 U.S. at 248. The record establishes that, starting in 2017, Larsen moved away from a day-to-day operational role at Ripple. *See* SEC Add. 56.1 Resp. ¶¶ 1722–29. But after he stepped down as CEO, Larsen also continued his role on the XRP Sales Committee, which approved Ripple's sales of XRP. *See* Defs. 56.1 Resp. Part 2 ¶ 1099, ECF No. 835-1. The Court concludes, therefore, that a reasonable jury could find that, starting in 2017, Larsen did not "consciously assist [Ripple's Section 5 violations] in some active way." *Mudd*, 885 F. Supp. 2d at 670–71 (cleaned up).

Accordingly, the SEC's motion for summary judgment on the aiding and abetting claim against Larsen and Garlinghouse is DENIED.

CONCLUSION

For the foregoing reasons, the SEC's motion for summary judgment is GRANTED as to the Institutional Sales, and otherwise DENIED. Defendants' motion for summary judgment is GRANTED as to the Programmatic Sales, the Other Distributions, and Larsen's and Garlinghouse's sales, and DENIED as to the Institutional Sales.

The Court shall issue a separate order setting a trial date and related pre-trial deadlines in due course.

The Clerk of Court is directed to terminate the motions at ECF Nos. 621, 625, 639, 642, 807, 824, and 836.

SO ORDERED.

Dated: July 13, 2023
New York, New York

ANALISA TORRES
United States District Judge

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United States District Court, S.D. New York.

SECURITIES AND EXCHANGE COMMISSION, Plaintiff,
v.
TERRAFORM LABS PTE. LTD.
and Do Hyeong Kwon, Defendants.

23-cv-1346 (JSR)
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Signed July 31, 2023

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OPINION AND ORDER

JED S. RAKOFF, United States District Judge:

***1** In this case, the Securities and Exchange Commission ("SEC") alleges that the defendants -- Terraform Labs Pte Ltd., a "crypto-assets" company, and its Founder, Chief Executive Officer and majority shareholder, Do Hyeong Kwon -- orchestrated a multi-billion-dollar fraud involving the development, marketing, and sale of various cryptocurrencies. The defendants have moved to dismiss the SEC's Amended Complaint. After full briefing, the Court, on June 14, 2023, heard oral argument on the motion. Having now carefully considered the parties' arguments, the Court concludes that because, according to the well-pleaded allegations of the complaint, the defendants used false and materially misleading statements to entice U.S. investors to purchase and hold on to defendants' products, and because those products were unregistered investment-contract securities that enabled investors to profit from the supposed investment activities of defendants and others, the motion to dismiss must be denied.

I. Factual Allegations

Unless otherwise noted, the following factual allegations are taken from the SEC's Amended Complaint, Dkt. No. 25. For purposes of this motion, all well-plead allegations must be taken as true, and all reasonable inferences therefrom must be drawn in the SEC's favor. *See Buon v. Spindler*, 65 F.4th 64, 76 (2d Cir. 2023).

A. The Defendants and the "Crypto-Assets" at Issue

Defendant Terraform Labs, Pte Ltd. ("Terraform") is a Singapore-based company that develops, markets, and sells "crypto-assets," including cryptocurrencies, and co-defendant Do Keyong Kwon is the company's Founder, Chief Executive Officer, and majority shareholder, holding 92 percent of the company's shares. *See* Dkt. No. 25, ("Amended Complaint") ¶ 1, 16. Terraform and Kwon are best known for developing and selling the Terra USD cryptocurrency (the "UST coin") and a "companion" cryptocurrency called the "LUNA" coin. *Id.* ¶ 4.

The first of these -- the UST coin -- is a "stablecoin," a kind of cryptocurrency whose price is algorithmically pegged to another asset, such as a fiat currency or exchange-traded commodity. *Id.* ¶ 7. Theoretically, stablecoins like the UST coin can serve as useful mediums of exchange, since the coin's stable value -- assuming it maintains its peg -- may assure buyers and sellers that the coin will retain purchasing power over time. *See New to the Crypto World? Here Are Terms to Know*, N.Y. Times (June 8, 2022).

In the case of the UST coin, each coin was pegged to the U.S. dollar and, for a time, could be purchased and sold for exactly $1.00. *Amended Complaint* ¶ 33. At any point, an owner of a UST coin could swap their coin for $1.00 worth of the companion coin, LUNA. Likewise, any holder of a LUNA coin could exchange that coin for $1.00 in UST coin. This

fixed relationship theoretically ensured that the value of coins stayed fixed at $1.00. *Id.*

The defendants also marketed and sold three other types of "crypto-assets." The first of these was a version of the LUNA coin called "wLUNA." *Id.* ¶ 39. Where LUNA coins were available only for use on the Terraform blockchain (described below), the wLUNA version allowed holders of LUNA to use LUNA coins in transactions on other, non-Terraform blockchains. *Id.* ¶¶ 59-61. A second offering, mAssets, functioned as "security-based swaps" whose value "mirrored" the price of securities exchanged on stock exchanges. *Id.* ¶ 37. By rising or falling in parallel to the price of a given security, the mAsset allowed traders to gauge the risk of investing in that security without "the burdens of owning or transacting real assets." *Id.* The third additional crypto-asset was a "MIR" token that allowed its holders to share in the fees generated by the "Mirror Protocol" (also described below).

B. The Defendants Create the Terraform Blockchain and Related Crypto-Assets

***2** In April 2019, Terraform, Kwon, and another co-founder officially launched a blockchain to house transactions using the UST and LUNA coins, which they called the Terraform blockchain. [1] On the same day, the defendants created one billion LUNA tokens and, a few months later, began producing the first of the UST coins. *See id.* ¶¶ 34, 36. Demand for the UST coins, however, was slow to grow. *Id.* ¶ 36. In the first two months of 2021, the total amount of UST coins in circulation hovered just under 300 million, indicating that many holders of LUNA coins had not exchanged their coins for UST coins. *Id.*

In response, Terraform and Kwon began in September 2020 marketing UST coins as profitable investment opportunities -- as opposed to just stable stores of value -- in meetings with U.S. investors, investment conferences in major U.S. cities, and on social media platforms. *Id.* ¶¶ 35, 43. Beginning in December 2020, for instance, the defendants unveiled the "Mirror Protocol," a program under which the defendants would, for a fee, issue "mAssets" to investors that -- as noted above -- were designed to help investors maximize their profits and minimize their risk from trading traditional stocks. *Id.* ¶ 37. Then, in March 2021, the defendants launched a mechanism that would transform the UST coins into "yield-bearing" stablecoins, a program known as the "Anchor Protocol." *Id.* ¶ 35.

At bottom, the "Anchor Protocol" was an investment pool into which owners of UST coins could deposit their coins and earn a share of whatever profits the pool generated. *Id.* ¶ 36. By advertising rates of returns of 19-20% on the coin owners' initial investment and touting the "deep relevant experience" of the Terraform team, the defendants generated enormous demand for the UST coins. *Id.* ¶¶ 36, 40. By May 2022, there were about 19 billion UST coins in circulation, with 14 billion deposited in the Anchor Protocol. *Id.* Indeed, at that time, UST had a total market value of over $17 billion, making it among the world's most popular cryptocurrency products. *Id.* ¶ 4.

Terraform and Kwon represented to investors that the continued profitability of the UST coins and the Anchor Protocol depended on the development of the broader Terraform "ecosystem," which, they said, would grow in proportion to the volume of transactions on the blockchain. *Id.* ¶¶ 39, 51-52. To encourage more transactions, Kwon and others at Terraform promised investors that they would devote much of the company's earnings to expanding and improving the Terraform ecosystem and its crypto-asset products. *Id.* ¶ 47. For instance, at various points when revenues from the "Anchor Protocol" investments did not cover the advertised returns to UST depositors, Terraform injected millions of dollars from its reserves -- which included a $50 million dollar fund named the "LUNA Foundation Guard" -- to ensure depositors received the money they were promised. *Id.* ¶ 78.

Not only did the defendants develop and market these crypto-assets, but they offered and sold them in unregistered transactions. *Id.* ¶ 105. Indeed, from April through September 2018, the defendants contracted to sell close to 200 million LUNA coins to institutional investors in the United States and elsewhere, with Kwon signing the purchase agreements. *Id.* ¶ 107. Then, in November 2019 and September 2020 -- seeking to reverse "the lackluster performance of LUNA" in that year by "improving liquidity" -- the defendants loaned nearly 100 million LUNA coins to a U.S. trading firm. *Id.* ¶ 108.

***3** These transactions, in the SEC's view, amounted to unlawful public distributions of securities because the defendants imposed no restrictions on the resale of the LUNA tokens by their new possessors and, indeed, made the sales with the understanding that the tokens *would* be resold to the public. *Id.* ¶ 105-109. The SEC alleges, moreover, that

the defendants violated laws prohibiting the unregistered offering and sale of securities and security-based swaps in a more straightforward way: by directly offering and selling MIR tokens, mAssets, and LUNA tokens on crypto-asset marketplaces. *Id.* ¶¶ 111-113.

According to the SEC, the defendants also defrauded investors through the development, promotion, and sale of these crypto-assets. Although Terraform and Kwon represented that the coins were stable investments and would always retain their value, this was not the case. And in May 2021, the UST coin's value dropped below $1.00. At that point, realizing that investors harbored serious doubts about the UST coins and that the coin would not return to a value of $1.00 by itself, Terraform and Kwon persuaded a third-party trading firm based in the United States to buy a large number of UST coins in an effort to artificially restore the coin's $1.00 peg. *Id.* ¶ 166. While UST returned to $1.00 through this agreement, Kwon and Terraform concealed the true reason the calamity had been adverted, instead touting the restoration of the peg as a triumph of the "automatically self-heal[ing]" UST/LUNA algorithm. *Id.* ¶ 7.

This artificial secret arrangement restored confidence among investors, who poured billions of dollars into the Terraform ecosystem. *Id.* ¶ 8. Exactly one year later, however, the market for UST coins crashed. In April 2022, the market price of LUNA reached a high point of $119.18 per coin. *Id.* ¶ 56. The next month, the UST coin's value declined below $1.00 after many investors converted their tokens into LUNA coins or sold them altogether. *Id.* ¶ 9. Because, this time, there was no external intervention to prop up the price of the coins, the value of both UST and LUNA plummeted to under a penny, wiping out over $40 billion of total market value for investors. *Id.* ¶ 1.

Terraform also fraudulently misstated the real-world utility of its coins. In particular, they told investors that users of "Chai" – a Korean phone application used by consumers and merchants to send and receive payments – were using Terraform's stablecoins and blockchain to execute transactions on the platform. *Id.* ¶¶ 121-134. The defendants told investors that this partnership would generate enormous fees for the company that would redound to investors. *See, e.g., id.* at 130. These claims, however, were false. In essence, the defendants fabricated transactions to make it appear as if Chai users were using Terraform's products when, in reality, all transactions on Chai took place exclusively on the Chai platform and involved only Korean currency. *Id.* ¶ 142.

On these allegations, the SEC asserts five claims for relief in its Amended Complaint. *First*, they allege that the defendants committed fraud in the sale of their crypto-assets in violation of Section 17(a) of the Securities Act. *Second*, and similarly, they allege that the same fraudulently-induced sales violated Section 10(b) of the Exchange Act and SEC Rule 10b-5 promulgated thereunder. *Third*, they allege that Kwon, as Terraform's CEO and co-founder, is jointly and severally liable with Terraform for any securities' law violations committed by Terraform. *Fourth*, they allege that the defendants failed to register the offer and sale of Terraform's crypto-assets as required by the securities laws. *Fifth*, they allege that the defendants offered, sold and effected transactions of security-based swaps -- namely, its "mAssets" product -- to individuals who were not "eligible contract participants," as that term is defined by statute and regulation.

II. Legal Standards

***4** Terraform and Kwon move to dismiss the SEC's Amended Complaint both for lack of personal jurisdiction under Federal Rule of Civil Procedure Rule 12(b)(2) and for failure to state a claim under Federal Rule of Civil Procedure Rule 12(b)(6).

To defeat a motion to dismiss for lack of personal jurisdiction under Rule 12(b)(2), a plaintiff must, through its factual allegations, make a prima facie showing that the Court has jurisdiction over the defendants. This burden is satisfied if the factual allegations contained in the complaint, taken as true, demonstrate two things:

First, the allegations must show that the defendants "purposefully directed" their activities at the forum state (in this case, the United States), thereby "avail[ing] [themselves] of the privilege[s] of conducting activities" in that state, including "the protections of its laws." *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 472, 105 S.Ct. 2174, 85 L.Ed.2d 528 (1985). The touchstone, here, is whether the defendants could reasonably "foresee being haled into court" in the forum state because of their activities in that state. *Kernan v. Kurz-Hastings, Inc.*, 175 F.3d 236, 243 (2d Cir. 1999). [2]

Second, the plaintiff must also show that the alleged injuries "arise out of or relate to" the activities that the defendants directed at the forum state. *Burger King*, 471 U.S. at 472-73, 105 S.Ct. 2174. Precisely how related the alleged harms and the defendants' activities need be to establish

personal jurisdiction depends on the "substantiality of [the defendants'] contacts" with the forum. *SPV OSUS Ltd. v. UBS AG*, 114 F. Supp. 3d 161, 169 (S.D.N.Y. 2015). Where, for instance, the defendants have "only limited contacts with the state," the plaintiff must show that those contacts proximately caused the harm complained of. *Id.* The corollary is that proximate causation may not be strictly required if the defendants' contacts are extensive. *See Chew v. Dietrich*, 143 F.3d 24, 29 (2d Cir. 1998).

As for the defendants' alternate ground for its motion to dismiss, a complaint survives a motion to dismiss brought under Rule 12(b)(6) if it contains "enough facts to state a claim to relief that is plausible on its face." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007). A claim, in turn, bears facial plausibility where it is supported by "factual content that allows the court to draw the reasonable Inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009). In other words, a complaint that offers only "labels and conclusions," bereft of factual support, or one that alleges facts evincing a "sheer possibility that a defendant has acted unlawfully" will not do. *Id.* If the plaintiff has not "nudged [its] claims across the line from conceivable to plausible, [the claims] must be dismissed." *Twombly*, 550 U.S. at 570, 127 S.Ct. 1955.

Finally, at all times for purposes of this motion, the Court must "construe the pleadings and affidavits in the light most favorable to [the] plaintiff[ ]" and resolve all factual "doubts in [the plaintiff's] favor." *Dorchester Fin. Sec., Inc. v. Banco BRJ, S.A.*, 722 F.3d 81, 85 (2d Cir. 2013).

III. Discussion

***5** With these standards in mind, the Court first assesses the defendants' motion to dismiss under Rule 12(b)(2) and then under Rule 12(b)(6).

A. The SEC has adequately pled that the Court may exercise personal jurisdiction over the defendants.

Terraform and Kwon argue that the Court lacks personal jurisdiction over them under the Due Process Clause. That Clause -- the fount of the personal jurisdiction requirement -- dictates that federal jurisdiction can be exercised only over defendants who direct their actions toward residents of a particular state, in this case, the United States.[3] *See Burger King*, 471 U.S. at 471, 105 S.Ct. 2174.

For over a century, this "minimum contacts" rule has struck a fair balance between, on the one hand, a state's interest in holding those who benefit from its laws accountable to those same laws and, on the other hand, an individual's right to "fair warning" about what sorts of activities will expose the individual to legal liability. *See Ford Motor Co. v. Mont. Eighth Jud. Dist. Ct.*, —— U.S. ——, 141 S. Ct. 1017, 1025, 209 L.Ed.2d 225 (2021). To that end, a defendant cannot be "haled into a jurisdiction solely as a result of random, fortuitous, or attenuated contacts," but must be carried there by actions that suggest a manifest intent to benefit from the forum's markets or laws, such as an offer to sell goods to residents of that forum. *Burger King*, 471 U.S. at 475, 105 S.Ct. 2174.

Here, the defendants argue that none of their actions reflects such an intent. On their telling, the activities that the SEC offers as the basis for specific jurisdiction -- namely, the company's efforts to offer and sell its crypto-assets -- were aimed generally at investors all over the world and thus not "purposefully directed" at potential investors in the United States. *Id.* at 472, 105 S.Ct. 2174. In the defendants' view, subjecting them to federal jurisdiction based on such incidental contacts with the United States would vitiate the protections afforded them by the Due Process Clause. *See id.* at 471, 105 S.Ct. 2174.

For its part, the SEC maintains that its allegations of direct sales of the company's crypto-products to United States firms -- carried out, they claim, through the United States banking system -- and the defendants' efforts to market their products at meetings in the United States suffice to show an intent to conduct business in the United States. Moreover, the SEC insists the Second Circuit has already ruled in a related, earlier action that courts in this district have jurisdiction over the defendants. *See U.S. Sec. & Exchange Comm. v. Terraform Labs Pte Ltd.*, 2022 WL 2066414 (2d Cir. June 8, 2022).

The SEC has the better of the argument and, this Court concludes, has satisfied its jurisdictional burden. For starters, the Second Circuit has already opined on this very issue and concluded, in no uncertain terms, that the defendants "purposefully availed themselves of the [United States] by promoting the digital assets at issue" -- namely, those related to the Mirror Protocol -- "to U.S.-based consumers and investors." *Id.* at *3. The panel's conclusion, in essence, rested

on the defendants' "extensive U.S. contacts," "including marketing and promotion to U.S. consumers, retention of U.S. based employees, contracts with U.S.-based entities, and business trips to the U.S., all of which relate to ... the digital assets at issue." *Id. at* *4. And all the contacts identified by the Second Circuit as bases for their decision are re-alleged by the SEC in its Amended Complaint here.

***6** Defendants offer two reasons why the Second Circuit's decision is "not dispositive here," *see* Defs.' Reply Br. at 1, but neither reason is persuasive. *First*, they argue that the Second Circuit "considered whether there was personal jurisdiction to enforce an investigative subpoena directed to a non-party" and did not determine, generally, that there was personal jurisdiction over the defendants. *Id.* But the panel's decision contains no such qualification. Though the Second Circuit's ruling on personal jurisdiction was made in the context of a dispute over a subpoena, there is nothing that suggests its conclusions were limited to that context. Indeed, the word "subpoena" does not even appear in the section of the decision on personal jurisdiction. *See Terraform Labs*, 2022 WL 2066414, at *3-4.

Second, defendants argue that the Second Circuit's ruling, to the extent it is relevant at all, has no bearing on the issue of personal jurisdiction over the *main* crypto-assets at issue here: the LUNA and UST tokens. Personal jurisdiction, they point out, exists only where alleged harms "arise out of or relate to" the defendants' contacts. Defs.' Reply Br. at 2. Because the prior Second Circuit case involved only the MIR tokens and mAssets, the panel had no basis to consider whether defendants' activities as to the LUNA or UST tokens "gave rise" to any cognizable injury. It follows, in their view, that the Second Circuit's ruling says nothing about whether jurisdiction can be exercised based on the defendants' offer and sale of its LUNA and UST tokens.

Here, again, the defendants point to a distinction without a difference. Though the Second Circuit's decision applied only to the company's mAssets and MIR Tokens, the case for personal jurisdiction based on the defendants' LUNA- and UST-related activities is, if anything, even stronger. While in the prior case, for instance, the SEC carried its burden by alleging that the defendants sold $200,000 of the Mirror Protocol coins to one U.S.-based trading platform, here, the SEC's allegation is that the defendants sold and loaned several million dollars' worth of LUNA and UST to several U.S. firms. *See* Amended Complaint ¶¶ 7-8, 107-109; Exhs. PP, QQ, RR, SS. Also, it would defy logic to accept, as defendants argue the Court should, that contracts between the defendants and U.S. firms to sell the defendants' products are not enough to establish personal jurisdiction just because the marketing efforts that ended in these contracts were directed at global investors. At this stage, an allegation that a defendant "negotiat[ed] and form[ed] a contract with a [United States] corporation" is normally enough, by itself, to support jurisdiction. *U.S. Titan, Inc. v. Guangzhou Zhen Hua Shipping Co., Ltd.*, 241 F.3d 135, 152-53 (2d Cir. 2001).

Nor can the defendants evade federal jurisdiction by claiming that these transactions involved the offshore subsidiaries of the parties to the contract, and not the parties themselves. To begin with, this defense does not apply at all to one of the contracts, which can, by itself, support jurisdiction. Specifically, the defendants directly promised to lend 30 million LUNA coins to a company based in the United States, Jump Trading Co., and not through an offshore entity. *See* Dkt. 33, Exhs. RR, SS. Even one such contract, "negotia[ted] and form[ed] ... with a [United States] corporation," suffices for jurisdiction. *U.S. Titan, Inc.*, 241 F.3d at 152-53.

But even as to the contract between Terraform's subsidiary in the British Virgin Islands and a California-based trading firm, a plaintiff may still establish personal jurisdiction over a foreign corporation based on its subsidiary's purposeful contacts with the United States if that subsidiary is a "mere department" of the foreign parent corporation. *Jazini v. Nissan Motor Co., Ltd.*, 148 F.3d 181, 184 (2d Cir. 1998). A foreign corporation, in other words, cannot use a subsidiary that serves no other purpose than as a shield against legal liability to block federal jurisdiction. Otherwise, rather than serve the values of "fair notice" and individual liberty, the Due Process Clause would be reduced to facilitating pure gamesmanship.

***7** Here, the SEC, if we assume the Amended Complaint's allegations to be true, have adequately pled that the defendants' BVI subsidiary is a "mere department" of Terraform itself. As the Amended Complaint points out, the BVI entity that executed the contract was named "Terraform Labs" and the contract was signed on the BVI entity's behalf by two co-founders of Terraform -- Mr. Kwon and Daniel Hyunsung Shin. *See* Amended Complaint ¶ 107; Dkt 33, Exhs. PP, QQ. These facts, at a minimum, suggest that the two companies operate under "common ownership," that "the parent corporation interferes in the selection and assignment of the subsidiary's executive personnel," and that the parent company, Terraform, exercises a high "degree of control over the marketing and operation[ ]" of its BVI subsidiary. *Jazini*,

148 F.3d 181, 184-85 (identifying "common ownership," the involvement of the parent corporation in the appointment of executives, and the degree of control exercised by the parent company as factors "courts must consider" "in determining whether [a] subsidiary is a mere department of the parent").

To be sure, it is conceivable that the discovery in this case may show that the companies feature separate ownership structures or that they operate wholly or substantially apart from one another. At this stage, however, the plaintiffs have adequately pled that the contract executed in the BVI entity's name should be imputed to the defendants. This, in turn, means that they have established still another prima facie case for personal jurisdiction over the defendants.

Furthermore, the SEC's argument for personal jurisdiction rests on far more than two contracts allegedly drawn up between the defendants and several U.S. firms. In their Amended Complaint, the SEC also alleges that the defendants attended meetings and investor conferences with U.S. investors, and retained U.S.-based employees whose sole duty was to solicit investment in the United States. All this amounts, as the Second Circuit put it, to "extensive U.S. contacts" that, in the Court's view, can independently support personal jurisdiction. *Terraform Labs*, 2022 WL 2066414, at *4.

For the forgoing reasons, the portion of defendants' motion that seeks dismissal under Rule 12(b)(2) is hereby denied.

B. The SEC is not barred from asserting that the defendants' crypto-assets are securities.

"The Exchange Act," which established the SEC, "delegates to [the agency] broad authority to regulate ... securities," but securities only. *U.S. Sec. & Exch. Comm'n v. Alpine Sec. Corp.*, 308 F. Supp. 3d 775, 790 (S.D.N.Y. 2018). The statute, in other words, sets forth the bounds of the SEC's regulatory authority by defining what sorts of products can be considered "securities" and, therefore, are subject to SEC regulation and enforcement. *See* 15 U.S.C. § 77b. Here, the SEC asserts that each of the defendants' crypto-assets is an "investment contract," one of the categories of products that the statute recognizes as a "security." *See id.* (stating that "the term 'security' means any ... investment contract[.]").

Against this backdrop, the defendants argue that the "Major Questions Doctrine," the Due Process Clause, and the Administrative Procedure Act ("APA") each independently prevent the SEC from alleging the company's digital assets to be "investment contracts." The Court considers each argument in turn.

1. The Major Questions Doctrine

The so-called "Major Questions Doctrine" (which is, at bottom, a principle of statutory construction) requires that in the extraordinary case where an agency claims the "power to regulate a significant portion of the American economy" that has "vast economic and political significance," it must point to "clear congressional authorization" for that power. *Util. Air Regul. Grp. v. EPA*, 573 U.S. 302, 324, 134 S.Ct. 2427, 189 L.Ed.2d 372 (2014). The underlying assumption is that Congress would speak clearly -- and not through "modest words," "vague terms," or "subtle device[s]," -- had it intended to grant an agency the authority to make decisions that would have tremendous economic and political consequences. *West Virginia v. EPA*, —— U.S. ——, 142 S. Ct. 2587, 2609, 213 L.Ed.2d 896 (2022).

***8** Because the doctrine is reserved for the most extraordinary cases where the agency claims broad regulatory authority *and* the area to be regulated is one invested with particular economic and political significance, it has been rarely invoked. *See West Virginia*, 142 S. Ct. at 2608 (stating that the Major Questions Doctrine applies only in "extraordinary cases ... in which the history and breadth of the authority that the agency has asserted, and the economic and political significance of that assertion, provide a reason to hesitate before concluding that Congress meant to confer such authority"). Indeed, since its inception in *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 159, 120 S.Ct. 1291, 146 L.Ed.2d 121 (2000), the doctrine has served as a basis for only five Supreme Court decisions. *See* Natasha Brunstein & Richard L. Revesz, *Mangling the Major Questions Doctrine*, 74 Admin. L. Rev. 217, 224-35 (2021).

In all five, the Supreme Court justified the doctrine's application by highlighting, once again, the extraordinary nature of the agency's claims and the exceptional importance of the industries to be regulated. In *Brown & Williamson*, for instance, the Supreme Court struck down an FDA regulation that would have led to the complete prohibition of tobacco products in the United States, an industry which, in the Court's words, then "constitute[d] one of the greatest basic industries of the United States with ramifying activities which

directly affect interstate and foreign commerce at every point, and stable conditions therein are necessary to the general welfare." *Brown & Williamson*, 529 U.S. at 137, 120 S.Ct. 1291. More recently, the Court deemed that the EPA's efforts to "substantially restructure the American energy market" represented a "*transformative* expansion in its regulatory authority" that, absent "clear congressional authorization," "Congress could [not] reasonably be understood to have granted." *West Virginia*, 142 S. Ct. at 2610 (emphasis added).

Needless to say, there is little comparison between the instant case and the ones in which the Major Questions Doctrine was decisive. As the doctrine's name suggests and the Supreme Court has, in case after case, emphasized, the Major Questions Doctrine is intended to apply only in extraordinary circumstances involving industries of "vast economic and political significance." *Util. Air Regul. Grp.*, 573 U.S. at 324, 134 S.Ct. 2427. This question, moreover, of whether an industry subject to regulation is of "vast economic and political significance" should not be resolved in a vacuum. Rather, an industry can be considered to have "vast economic and political significance" only if it resembles, in these two qualities, the industries that the Supreme Court has previously said meet this definition.

With this standard in mind, the crypto-currency industry -- though certainly important -- falls far short of being a "portion of the American economy" bearing "vast economic and political significance." *Id.* Put simply, it would ignore reality to place the crypto-currency industry and the American energy and tobacco industries -- the subjects of *West Virginia* and *Brown & Williamson*, respectively -- on the same plane of importance. If one were to do so, almost every large industry would qualify as one of "vast economic and political significance" and the doctrine would frustrate the administrative state's ability to perform the function for which Congress established it: the regulation of the American economy.

Moreover, the SEC's role is not to exercise vast economic power over the securities markets, but simply to assure that they provide adequate disclosure to investors. Thus, the SEC's decision to require truthful marketing of certain crypto-assets based on its determination that certain of such assets are securities hardly amounts to a "transformative expansion in its regulatory authority." *West Virginia*, 142 S. Ct. at 2610. It aligns, in fact, with Congress's expectations that the SEC is to regulate "virtually any instrument that might be sold as an investment," "in whatever form they are made and by whatever name they are called," including novel devices like the digital assets at issue here. *SEC v. Edwards*, 540 U.S. 389, 393, 124 S.Ct. 892, 157 L.Ed.2d 813 (2004); *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351, 64 S.Ct. 120, 88 L.Ed. 88 (1943) (stating the term "security" was intended to capture "[n]ovel, uncommon, or irregular devices, whatever they appear to be"). Recognizing "the virtually limitless scope of human ingenuity ... in the creation of countless and variable schemes," Congress's decision to use general descriptive terms like investment contract in the statute was intended, not to limit the SEC's authority to enumerated categories, but, on the contrary, to empower the SEC to interpret the statue's terms to capture these new schemes. *Reves v. Ernst & Young*, 494 U.S. 56, 60–61, 110 S.Ct. 945, 108 L.Ed.2d 47 (1990); *see also Joiner*, 320 U.S. at 351, 64 S.Ct. 120.

***9** Indeed, if the SEC were restricted (as defendant argues) to regulating only those instruments that are specifically listed by their precise names in 15 U.S.C. § 77b, the statute would "embody a static" rather than "flexible" principle, the exact opposite of what Congress intended. *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946). Strictly limiting the SEC's authority to a few narrow categories of instruments would, moreover, contradict the Supreme Court's instruction that "the reach of the [Exchange] Act does not stop with the obvious and commonplace," but must extend to "[n]ovel, uncommon, or irregular devices, whatever they appear to be," that are "widely offered [and sold]" in a way that "established their character" as a security. *Joiner*, 320 U.S. at 351-52, 64 S.Ct. 120.

In sum, there is no indication that Congress intended to hamstring the SEC's ability to resolve new and difficult questions posed by emerging technologies where these technologies impact markets that on their face appear to resemble securities markets. Defendants cannot wield a doctrine intended to be applied in exceptional circumstances as a tool to disrupt the routine work that Congress expected the SEC and other administrative agencies to perform.

2. Due Process Clause and the APA

Next, defendants argue that the SEC violated their due process rights by bringing this enforcement action against them without first providing them "fair notice" that their crypto-assets would be treated as securities. *See FCC v. Fox Television Stations Inc.*, 567 U.S. 239, 253-54, 132 S.Ct. 2307, 183 L.Ed.2d 234 (2012) (ruling that the Due Process

Clause requires that agencies bringing an enforcement action "provide," through written guidance, regulations, or other activity, "a person of ordinary intelligence fair notice" that the regulated conduct was "prohibited").

According to the defendants, the SEC has long maintained that cryptocurrencies are *not* securities, but here, they claim it has for the first time taken the position that *all* cryptocurrencies are securities and enforced this understanding against the defendants without any prior indication that it had changed its view. This sudden about-face, the defendants say, deprived them of their constitutional right to "fair notice" and, by implication, the opportunity to conform their behavior to the SEC's regulations. In response, the SEC argues that it has never taken either of the black-and-white positions that the defendants ascribe to it. Indeed, rather than state that *all* crypto-currencies are securities or that *none* of them are, the SEC insists that it has broadcast the same position on this issue all along: that *some* crypto-currencies, depending on their particular characteristics, may qualify as securities.

Prior to its bringing this case, moreover, the SEC asserted the exact same position it has taken in this case in several enforcement actions brought against other crypto-currency companies for allegedly fraudulent conduct in the offer and sale of their crypto-assets. *See, e.g., SEC v. PlexCorps*, 2018 WL 4299983, at *2-3 (E.D.N.Y. Aug. 9, 2018); *United States v. Zaslavskiy*, 2018 WL 4346339, at *8-9 (E.D.N.Y. Sept. 11, 2018). These relatively high-profile lawsuits -- which involved substantially similar allegations and millions of dollars in allegedly fraudulent crypto-currency transactions -- would have apprised a reasonable person working in the crypto-currency industry that the SEC considered *some* crypto-currencies to be securities and that the agency would enforce perceived violations of the securities laws through the development, marketing, and sale of these crypto-currencies.

Following this prior litigation, moreover, a department of the SEC issued written guidance in April 2019 that admonished those "engaging in the offer, sale, or distribution of a digital asset" to consider "whether the digital asset is a security" that would trigger the application of "federal securities laws." Sec. & Exchange Comm., *Framework for "Investment Contract" Analysis of Digital Assets* (April 2019). Within this document, the SEC also provided "a framework for analyzing whether a digital asset is an investment contract" and a list of characteristics that, if present in a given digital asset, would make the SEC more likely to view the given crypto-asset as a "security." *Id.* The instant lawsuit, in sum, is just one example of the SEC's longstanding view that some cryptocurrencies may fall within the regulatory ambit of federal securities laws. [4]

***10** None of the statements cited by the defendant, moreover, suggests that the SEC ever operated under a contrary assumption. For instance, the statement of an SEC staff member that a "token ... *all by itself* is not a security, just as the orange groves in *Howey* were not," Defs.' Br. at 13, does not amount to a concession that all cryptocurrencies are not securities. It does not, in other words, preclude the SEC from asserting, as it has here, that a token constitutes an investment contract when it is joined with a promise of future profits or the like to be generated by the offerors. The SEC's most recent representation that digital assets "may or may not meet the definition of a 'security' under the [f]ederal securities laws" is even more obviously aligned with its position in this case. *Securities & Exchange Comm.*, Release No. IA-6240, at 16 n.25 (Feb. 15, 2023).

In short, defendants' attempt to manufacture a "fair notice" problem here comes down to asserting the SEC's position in this litigation is inconsistent with a position that the SEC never adopted. So long as the SEC has -- through its regulations, written guidance, litigation, or other actions -- provided a reasonable person operating within the defendant's industry fair notice that their conduct may prompt an enforcement action by the SEC, it has satisfied its obligations under the Due Process Clause. [5]

It follows from the foregoing that the APA also does not foreclose the SEC's interpretation of federal securities laws to encompass the regulation of the defendants' crypto-assets. While it may be true that, where an agency intends to promulgate "a new industry-wide policy," notice-and-comment rulemaking -- not case-by-case adjudication -- offers a "better, fairer, and more effective" method of doing so, *Cmty. Television v. Gottfried*, 459 U.S. 498, 511, 103 S.Ct. 885, 74 L.Ed.2d 705 (1983), here, as detailed above, the SEC is not announcing a new policy in this case, but merely enforcing its previously stated view that certain crypto-assets can be regulated as securities if they meet the characteristics of an "investment contract" under the *Howey* case (described below). Far from representing a "radical departure" from the SEC's stated views on the law, this enforcement action is simply a "fact-intensive application of a statutory standard," a category of agency action that has traditionally been exempt

from the procedural requirements of notice-and-comment rulemaking.

To conclude, no doctrine -- whether grounded in interpretive canons, statute, or the federal Constitution -- bars the SEC from, as a preliminary matter, asserting that the defendants' crypto-assets are "investment contracts" that are subject to federal securities laws.

C. The SEC has, through its factual allegations, asserted a plausible claim that the defendants' crypto-assets qualify as securities.

Putting aside the SEC's general authority to regulate certain crypto-assets as investment contracts, the Court must still resolve whether the defendants' *particular* crypto-assets can fairly be given this label at this stage. For the reasons below, the Court concludes that the SEC has alleged facts sufficient to claim that the defendants' crypto assets are securities. More specifically, the SEC has adequately pled that each of the defendants' products are either themselves "investment contracts" or confer a right to "subscribe or purchase" another such security. *See* 15 U.S.C. § 77b(a)(1).

1. The *Howey* Test and its Scope

***11** Before proceeding, a few words on *SEC v. W.J. Howey Co.*, 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946) ("*Howey*"), in which the Supreme Court set forth the standard for determining whether a particular economic arrangement can be classified as an "investment contract." The *Howey* case centered on a transaction between an "orange-grove" cultivator and investors, in which the cultivator sold investors various parcels of land along with a promise to share with them any profits that were generated from his cultivation of the parcels. *Id.* at 295-96, 299, 66 S.Ct. 1100. In the Supreme Court's view, the transaction – comprised of not just the sale of the underlying property but also the promise of any profits that attached to that property – amounted to a "investment contract" that the SEC could legally regulate. Put another way, it was the cultivator's promise to share in the profits generated by his cultivation of the parcels that transformed the transaction from a mere sale of property into a contract that promised a future return based on an initial investment – that is, an investment contract.

Out of these facts emerged the *Howey* standard for determining the existence of an "investment contract." Following *Howey*, an "investment contract" under federal securities law is any "contract, transaction, or scheme whereby a person [(1)] invests his money [(2)] in a common enterprise and [(3)] is led to expect profits solely from the efforts of the promotor or a third party." *Id.* at 298-99, 66 S.Ct. 1100. The question in the instant case, then, is whether each of the defendants' crypto-assets -- and the means by which they were offered and sold -- amounted to a transaction or scheme that exhibited these three qualities.

Two preliminary notes are necessary before applying the *Howey* standard to the defendants' crypto-assets. To begin with, there need not be -- contrary to defendants' assertions -- a formal common-law contract between transacting parties for an "investment contract" to exist. Basic principles of interpretation compel this conclusion. By stating that "transaction[s]" and "scheme[s]" -- and not just "contract[s]" -- qualify as investment contracts, the Supreme Court made clear in *Howey* that Congress did not intend the term to apply only where transacting parties had drawn up a technically valid written or oral contract under state law. *See id.* Instead, Congress intended the phrase to apply in much broader circumstances: wherever the "contracting" parties agree -- that is, "scheme" -- that the contractee will make an investment of money in the contractor's profit-seeking endeavor. So, the supposed absence of an enforceable written contract between the defendants and many of the defendants' customers in this case does not, as an initial matter, preclude the SEC from asserting that defendants' crypto-assets are nevertheless investment contracts.

Nor must the Court restrict its *Howey* analysis to whether the tokens themselves -- apart from any of the related various investment "protocols" -- constitute investment contracts. As the Supreme Court has long made clear, courts deciding whether a given transaction or scheme amounts to a "investment contract" under *Howey* must analyze the "substance" -- and not merely the "form" -- of the parties' economic arrangement and decide if, under the "totality of the circumstances," that transaction or scheme meets the three requirements of *Howey*. *Tcherepnin v. Knight*, 389 U.S. 332, 336, 88 S.Ct. 548, 19 L.Ed.2d 564 (1967); *Glen-Arden Commodities, Inc. v. Costantino*, 493 F.2d 1027, 1034 (2d Cir. 1974).

As reiterated by the Supreme Court in *Marine Bank v. Weaver*, to determine the applicability of the securities laws, a given

transaction needs to be "evaluated on the basis of the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole." 455 U.S. 551, 560 n.11, 102 S.Ct. 1220, 71 L.Ed.2d 409 (1982). The fact that, for example, the Anchor Protocol did not exist at the time UST and LUNA were first launched is therefore immaterial. A product that at one time is not a security may, as circumstances change, become an investment contract that is subject to SEC regulation. *See Edwards*, 540 U.S. at 390, 124 S.Ct. 892.

***12** To that end, the Court declines to erect an artificial barrier between the tokens and the investment protocols with which they are closely related for the purposes of its analysis. Instead, it will evaluate -- as the Supreme Court did in *Howey* -- whether the crypto-assets and the "full set of contracts, expectations, and understandings centered on the sales and distribution of [these tokens]" amounted to an "investment contract" under federal securities laws. *Sec. & Exch. Comm'n v. Telegram Grp. Inc.*, 448 F. Supp. 3d 352, 379 (S.D.N.Y. 2020) (setting forth that the putative subject of an investment contract must be considered alongside the full set of "contracts, expectations, and understandings" that attach to the subject); *Howey*, 328 U.S. at 297–98, 66 S.Ct. 1100 (declining to "treat[ ] the contracts and deeds as separate transactions").

To be sure, the original UST and LUNA coins, as originally created and when considered in isolation, might not then have been, by themselves, investment contracts. Much as the orange groves in *Howey* would not be considered securities if they were sold apart from the cultivator's promise to share any profits derived by their cultivation, the term "security" also cannot be used to describe any crypto-assets that were not somehow intermingled with one of the investment "protocols," did not confer a "right to ... purchase" another security, or were otherwise not tied to the growth of the Terraform blockchain ecosystem. *See Telegram*, 448 F. Supp. 3d at 379 (describing a crypto-asset as "little more than alphanumeric cryptographic sequence"); 15 U.S.C. § 77b(a)(1) (including in the definition of security any instrument that confers a "right to subscribe to or purchase another security"). And where a stablecoin is designed exclusively to maintain a one-to-one peg with another asset, there is no reasonable basis for expecting that the tokens -- if used as stable stores of value or mirrored shares traded on public stock exchanges -- would generate profits through a common enterprise. So, in theory, the tokens, if taken by themselves, might not qualify as investment contracts.

But this conclusion is only marginally of interest, because, to begin with the coins were never, according to the amended complaint, standalone tokens. Rather, they conferred a "right to ... purchase" another security, the LUNA tokens. 15 U.S.C. § 77b(a)(1); Amended Complaint ¶ 84. Furthermore, the Amended Complaint alleges that the vast majority -- nearly 75 percent -- of the defendants' UST tokens *were* deposited in the Anchor Protocol.

As to the first point, the SEC alleges that the LUNA coins were, from the outset, pitched to investors, not as stablecoins, but primarily as yield-bearing investments whose value would grow in line with the Terraform blockchain ecosystem. *See, e.g.*, Amended Complaint ¶¶ 34-35, 46-47, 74-83. On these allegations, then, the Amended Complaint asserts that purchasers of LUNA coins reasonably expected their tokens to generate profits. And because the fees generated from the Mirror Protocol were allegedly distributed among holders of the MIR tokens, the Amended Complaint plausibly asserts that its purchasers viewed these tokens as profitable investments. It follows, moreover, that the UST coins, because they could be converted to LUNA coins, were also investment contracts.

As to the second point, the fact that most of the UST coins were deposited in the Anchor Protocol independently rendered these tokens investment contracts, indeed investments that were touted as being capable of being able to generate future profits of as much as 20%

2. *Howey* Applied to the SEC's Claims

Against the background of these general observations, the Court turns to whether the SEC has adequately pled that each of the defendants' inter-related crypto-assets -- the UST coin, the LUNA coin, the wLUNA tokens, the MIR tokens, and the mAssets tokens -- qualify as "investment contracts" under the three-pronged *Howey* test.

***13** Because the defendants do not dispute that each purchaser of the defendants' crypto-assets made an "investment of money" in exchange for these crypto-assets, the Court's analysis focuses exclusively on the two remaining *Howey* prongs.

a) *Common Enterprise*

First, the Amended Complaint states a plausible claim that purchasers of the defendants' crypto-assets were investing in a common enterprise. *Howey*, 328 U.S. at 298-99, 66 S.Ct. 1100. A common enterprise exists wherever there is "horizontal commonality" between purchasers and a given defendant. Such commonality, moreover, is established if each investor's fortunes are "ti[ed] ... to the fortunes of the other investors by the pooling of assets," and there is a "pro-rata distribution of profits" earned from these combined assets. *Revak v. SEC Realty Corp.*, 18 F.3d 81, 87 (2d Cir. 1994).

Here, the defendants marketed the UST coins as an asset that, when deposited into the Anchor Protocol, could generate returns of up to 20%. *See* Amended Complaint ¶¶ 74-83. In essence, the UST tokens were allegedly "pooled" together in the Anchor Protocol and, through the managerial efforts of the defendants, were expected to generate profits that would then be re-distributed to all those who deposited their coins into the Anchor Protocol -- in other words, on a pro-rata basis. *Id.* ¶ 76. If the SEC's allegations are credited -- which, at this stage, they must be -- there was thus plainly horizontal commonality between the defendants and at least those large majority of UST investors who deposited their coins in the Anchor Protocol. [6]

To be sure, not all UST token-holders deposited their tokens into the Anchor Protocol. Moreover, neither the LUNA tokens nor the MIR tokens could be deposited into the Anchor Protocol. The SEC's theory for horizontal commonality as to these other coins, however, rests on a different but equally plausible theory. As to the LUNA tokens, for instance, the SEC has demonstrated horizontal commonality by alleging that the defendants' used proceeds from LUNA coin sales to develop the Terraform blockchain and represented that these improvements would increase the value of the LUNA tokens themselves. *See* Amended Complaint ¶¶ 46-47, 49-51. In other words, by alleging that the defendants "pooled" the proceeds of LUNA purchases together and promised that further investment through these purchases would benefit all LUNA holders, the SEC has adequately pled that the defendants and the investors were joined in a common, profit-seeking enterprise. *See, e.g., Balestra v. ATBCOIN LLC*, 380 F. Supp. 3d 340, 353 (S.D.N.Y. 2019) (finding horizontal commonality where assets "were pooled together to facilitate the launch of the [blockchain], the success of which, in turn, would increase the value" of purchasers' coins); *SEC v. Kik Interactive, Inc.*, 492 F. Supp. 3d 169, 178 (S.D.N.Y. 2020) (finding horizontal commonality where the issuer of the crypto-assets pooled funds and used the funds to construct and develop its digital ecosystem). And the wLUNA investors were just a variation on this theme since wLUNA tokens could be exchanged for LUNA tokens.

***14** The SEC asserts an equally plausible claim that a similar scheme established horizontal commonality between MIR token investors and the defendants. According to the SEC, the proceeds from sales of the MIR tokens were "pooled together" to improve the Mirror Protocol. *See* Amended Complaint ¶ 87. Profits derived from the use of the Mirror Protocol, moreover, were fed back to investors based on the size of their investment. Here, too, the defendants tied their fortunes with those of the crypto-asset purchasers and distributed any profits generated by their investments on a pro-rata basis. *See Revak*, 18 F.3d at 87.

Finally, the mAssets on their face were intended to reflect the fortunes of the existing securities they mirrored. (See also, further discussion of mAssets below).

b) *Reasonable Expectation of Profits*

Under *Howey*, the SEC must adequately also plead that the investors not only invested in a common enterprise providing the possibility of future profits, but also that they were led to believe that it was the efforts of the defendants or other third parties that could earn them a return on their investment. *Howey*, 328 U.S. at 298-99, 66 S.Ct. 1100 (defining an investment contract as one in which an investor is "led to expect profits solely from the efforts of the promotor or a third party."). The qualification that the investors' expectations be reasonable is an important one. The SEC need not prove that each and every investor was personally led to think that profits would follow from their investment in the defendants' products. If an objective investor would have perceived the defendants' statements and actions as promising the possibility of such returns, the SEC has satisfied *Howey*'s requirement.

Through the facts alleged in its Amended Complaint, the Court concludes that the SEC meets this requirement. Beginning with investors in UST coins, the complaint adequately alleges that the defendants -- through social media posts, at investor conferences, in monthly investor reports, and at one-on-one meetings with investors -- repeatedly touted the profitability of the Anchor Protocol and encouraged UST coin purchasers to unload their tokens

into that investment vehicle. *See* Amended Complaint ¶¶ 74-83. Those profits, the defendants allegedly stated, would come about through the defendants' unique combination of investing and engineering experience. *See id.* ¶¶ 40, 57, 76.

Similarly, as to LUNA coin investors, the defendants allegedly coaxed investors to continue purchasing LUNA coins (and indirectly wLUNA coins) by pointing out the possibility of future investment returns. In particular, they said that profits from the continued sale of LUNA coins would be fed back into further development of the Terraform ecosystem, which would, in turn, increase the value of the LUNA coins. *See id.* ¶¶ 3, 31-33, 42, 49-57 (alleging Kwon stated that "[i]n the long run, Luna['s] value is actionable -- it grows as the ecosystem grows"). And, as with the UST coins, the defendants premised their case for LUNA's profitability on the defendants' particular investment and technical acumen. *See id.* ¶¶ 31, 47, 57-58.

The scheme surrounding the MIR tokens was, according to the Amended Complaint, nearly identical to that involving LUNA, except that the defendants' linked the MIR tokens' worth to the growth and development of the Mirror Protocol, rather than to the Terraform blockchain network more generally. *See id.* ¶¶ 90-96. And much the same could be said of the mAssets (discussed further below).

In conclusion, the SEC's claim that the defendants held out to the coins' consumers the possibility of profiting from their purchases is supported by specific factual allegations in the Amended Complaint, including readouts of investor meetings, excerpts of investor materials, and screenshots of social media posts made by Mr. Kwon and other Terraform executives. Because these particularized allegations, if true, clearly "nudge the [SEC's] claims across the line from conceivable to plausible," the SEC's assertion that the crypto-assets at issue here are securities under *Howey* survives the defendants' motion to dismiss. *See Friel v. Dapper Labs, Inc.*, —— F.Supp.3d ——, ——, 2023 WL 2162747, at *8 (S.D.N.Y. Feb. 22, 2023).

***15** It may also be mentioned that the Court declines to draw a distinction between these coins based on their manner of sale, such that coins sold directly to institutional investors are considered securities and those sold through secondary market transactions to retail investors are not. In doing so, the Court rejects the approach recently adopted by another judge of this District in a similar case, *SEC v. Ripple Labs Inc.*, —— F.Supp.3d ——, 2023 WL 4507900 (S.D.N.Y. July 13, 2023). There, that court found that, "[w]hereas ... [i]nstitutional [b]uyers reasonably expected that [the defendant crypto-asset company] would use the capital it received from its sales to improve the [crypto-asset] ecosystem and thereby increase the price of [the crypto-asset]," those who purchased their coins through secondary transactions had no reasonable basis to expect the same. *Id.* at —— – ——, 2023 WL 4507900 at *11-12. According to that court, this was because the re-sale purchasers could not have known if their payments went to the defendant, as opposed to the third-party entity who sold them the coin. Whatever expectation of profit they had could not, according to that court, be ascribed to defendants' efforts.

But *Howey* makes no such distinction between purchasers. And it makes good sense that it did not. That a purchaser bought the coins directly from the defendants or, instead, in a secondary resale transaction has no impact on whether a reasonable individual would objectively view the defendants' actions and statements as evincing a promise of profits based on their efforts. Indeed, if the Amended Complaint's allegations are taken as true -- as, again, they must be at this stage -- the defendants' embarked on a public campaign to encourage *both* retail and institutional investors to buy their crypto-assets by touting the profitability of the crypto-assets and the managerial and technical skills that would allow the defendants to maximize returns on the investors' coins.

As part of this campaign, the defendants said that sales from purchases of *all* crypto-assets -- no matter where the coins were purchased -- would be fed back into the Terraform blockchain and would generate additional profits for *all* crypto-asset holders. These representations would presumably have reached individuals who purchased their crypto-assets on secondary markets -- and, indeed, motivated those purchases -- as much as it did institutional investors. Simply put, secondary-market purchasers had every bit as good a reason to believe that the defendants would take their capital contributions and use it to generate profits on their behalf.

D. The Court declines to dismiss the counts in the SEC's Amended Complaint that relate to securities registration requirements.

1. LUNA and MIR Counts (Counts Four and Five)

Assuming the defendants' crypto-assets are securities, the defendants nonetheless seek to dismiss the SEC's first set of

"registration counts" -- Counts Four and Five of the Amended Complaint -- as inadequately pled. In those counts, the SEC alleges that the defendants' offer and sale of its LUNA and MIR tokens amounted to unlawful public distributions of *unregistered* securities.

The defendants allegedly sold LUNA coins to institutional investors without any restrictions on their re-sale and loaned other LUNA coins to a U.S. institutional investor with the explicit purpose of "improving liquidity" in light of the then "lackluster performance ... of the LUNA token." Amended Complaint ¶ 108. Because these transactions were allegedly made with the expectation that the purchasers would re-sell the coins into public markets, the SEC claims that they "essentially" amounted to "large-scale unregistered public distributions of LUNA" prohibited under Section 5 of the of the Securities Act. Defs.' Br. at 21.

Contrary to defendants' arguments, the SEC has pled sufficient facts to support this theory of liability. "Liability for violations of Section 5 extends to those who have 'engaged in steps necessary to the distribution of [unregistered] security issues.' " *U.S Secs. & Exch. Comm. v. Universal Exp., Inc.*, 475 F. Supp. 2d 412, 422 (S.D.N.Y. 2007) (quoting *SEC v. Chinese Consol. Benev. Ass'n, Inc.*, 120 F.2d 738, 741 (2d Cir. 1941)).

***16** If the SEC's allegations are credited, the defendants loaned LUNA tokens to a U.S. institutional investor to "improve liquidity," a term that in this context could signify little else than the defendants' desire that the institutional investor redistribute the coins on the secondary market. Indeed, the SEC also claims that the U.S. institutional investors actually *sold* the loaned LUNA tokens on a U.S. crypto-asset trading platform. *See* Amended Complaint ¶ 109. The agency, thus, has made a prima facie case that the defendants were necessary participants to unregistered public distributions of the securities, in that these transactions "would not have taken place ... but for the defendants['] participation." *Cf. id.*; *see also SEC v. Murphy*, 626 F.2d 633, 650-51 (9th Cir. 1980). The scheme, as alleged, is the very disguised public distribution that Section 5 seeks to prohibit.

This conclusion, of course, does not end the matter. Once the plaintiff satisfies its prima facie burden under Section 5 of the Securities Act, the burden shifts to the defendants to affirmatively plead an entitlement to the exemption. *See SEC v. Cavanagh*, 445 F.3d 105, 111 n.13 (2d Cir. 2006). Defendants fail to make the necessary showing. Nor is an exemption clear from the face of the complaint. *SEC v. Sason*, 433 F. Supp. 3d 496, 514 (S.D.N.Y. 2020).

For one, their insistence that the loan was intended to "improve liquidity" by "provid[ing] market participants on non-U.S. markets who were already intent on buying and selling LUNA a ready counterparty to trade against and thereby reduce their cost to trade" is, at this stage, completely unsupported by factual allegations. Defs.' Br. at 22. Equally unpersuasive is their argument that they did not violate Section 5 because they "did not direct the firm to resell into the U.S. market." *Id.* Proof of scienter, it is well-established, is not needed to show Section 5 liability. *Cavanagh*, 445 F.3d at 111 n.13.

The defendants' argument as to its sale of the MIR tokens is even less availing. For one, the SEC alleges that the defendants sold 37 million MIR tokens to at least six U.S. purchasers. *See* Amended Complaint at § 112. Though the defendants point out that these sales were made through a subsidiary, this Court, as noted above, considers the parent Terraform Labs and its wholly owned subsidiaries to be one and the same for purposes of this motion.

The defendants, moreover, engaged in a "listing agreement with a U.S. crypto-asset trading platform for the listing of MIR tokens on the platform." Amended Complaint ¶ 114. Here, they cannot evade the securities laws' registration requirements through technological subterfuge. Even if, as the defendants say, the U.S. trading platform automatically generated the MIR tokens that were then sold, the defendants would still be required to register any distributions stemming from this platform because they allegedly pocketed the fees generated by the MIR token sales.

2. mAssets Counts (Counts Five and Six)

In its second set of "registration counts," the SEC claims that the defendants offered, sold, and effected security-based swaps -- that is, its mAssets -- to non-eligible participants, in violation of Sections 5(e) and 5(l) of the Security Act. Most fundamentally, the defendants argue that the mAssets are not security-based swaps. This is because, according to the defendants, the mAssets do not involve a payment from one party to their counterparty based on a change of value in an underlying security. *CFTC v. Wilson*, 2018 WL 6322024, at *2 (S.D.N.Y. Nov. 30, 2018) (defining a swap as a "contract

in which two parties agree to exchange cash payments at predetermined dates in the future").

The defendants, however, misunderstand the SEC's allegations. Though the underlying mAsset does not involve a "swap," offers and sales of such mAssets do, if the Amended Complaint's allegations are to be believed. When an individual purchases an mAsset, they receive, in return for 150% of the traditional stock or security's value, a token whose value rises and falls based on the value of that underlying stock or security. Thus, though the mAsset, after being purchased, thereafter involves no counterparty with which to "swap" and can be sold or "burned" at will, the original purchase does indeed involve a counterparty -- the defendants -- and a transfer of financial risk based on a stock or security's future value. 7 U.S.C. § 1a(47) (defining a *security-based* swap as an agreement to transfer "the financial risk associated with a future change" in a security's value "without also conveying a current or future direct or indirect ownership interest in [the] asset").

***17** And though, again, the defendants did not *technically* sell the mAssets through the Mirror Protocol, which programmatically generated the tokens, the defendants were allegedly responsible for the Protocol's creation, upkeep, and promotion to the general public, including institutional and retail investors alike. Thus, though not the final step in the mAssets distribution cycle, they were "necessary participants" in it and, for their efforts, allegedly pocketed the fees generated by the Mirror Protocol.

E. The fraud counts in the SEC's Amended Complaint also survive the defendants' motion to dismiss.

Finally, the defendants seek to dismiss Counts One and Two of the Amended Complaint -- otherwise known as the "fraud" counts – because, in their view, the SEC failed to satisfy any of the pleading requirements on those counts in two respects. *First*, the defendants contend, the SEC allegedly failed to demonstrate that the defendants' statements regarding the crypto-assets' utility on the "Chai" platform were false. *Second*, and relatedly, the defendants argue that the SEC did not assert particularized allegations of fraud in its Amended Complaint as to the May 2021 alleged de-pegging incident.

Defendants appear to misunderstand what is required for a fraud claim to be dismissed at this stage. On a motion to dismiss, the SEC must plead factual allegations that, if taken as true, would state a plausible claim for relief. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007). Under Rule 9(b)'s particularity requirement, moreover, the SEC must also allege "precisely what material misstatements were made, the time and place of each misstatement, the speaker, the content, the [way] the statement was misleading, and what the defendants obtained as a result of the fraud." *Joseph Victori Wines Inc. v. Vina Santa Carolina, S.A.*, 933 F. Supp. 347, 356 (S.D.N.Y. 1996).

The SEC has met this burden: first, by asserting that the "Chai transactions" were processed in Korean Won and not on the Terraform blockchain, as the defendants claimed they were, *see* Amended Complaint ¶¶ 121, 134; and also second, by alleging that the defendants benefited from this allegedly false or misleading statement in the form of a $57 million investment in their company. *Id.* at ¶ 150. The pleading requirements do not require that the SEC affirmatively *prove* its allegations at this stage. The defendants' contrary factual allegations about the relationship between Chai and the defendants' crypto-assets -- aimed at showing that their statements about the crypto-assets' utility on Chai were accurate -- are therefore unavailing for purposes of this motion.

Next, the defendants allege that the SEC did not plead a "misstatement or omission" with respect to the May 2021 de-pegging incident. This is because, in defendants' view, Kwon was under no duty to disclose to investors that a third-party was responsible for restoring the token's peg. However, on the Amended Complaint's allegations, such a "duty to disclose" *does* apply, because it "arises whenever secret information renders prior public statements materially misleading." *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 268 (2d Cir. 1993). Here, the SEC has plausibly alleged both that the defendants ascribed the "re-peg" to the "self-healing" effects of the UST/LUNA algorithm and that the defendants knew that it was, in reality, a third-party investor that had stabilized the UST tokens value. That is enough under Second Circuit law to give rise to a duty to disclose that, on the SEC's allegation, the defendants did not fulfill. *See id.* at 268-69.

***18** Finally, as to the defendants' arguments that the count should be dismissed for lack of a proof of scienter, the SEC has, again, met its burden. Under Exchange Act Section 10(b) and Securities Act Section 17(a)(1), scienter can be pled either by "alleg[ing] facts establishing a motive to commit fraud and an opportunity to do so" or by "alleg[ing] facts

constituting circumstantial evidence of either reckless or conscious behavior." *In re Time Warner*, 9 F. 3d at 269.

Here, the SEC alleges that the defendants had a motive to mislead investors about the utility of their crypto-assets on the Chai platform, as the truth would decrease the tokens' value. *See* Amended Complaint ¶¶ 121-122, 132. What is more, the Amended Complaint's factual allegations give rise to the reasonable inference that Kwon had direct access to the truth about Chai and the de-pegging incident. For one, Kwon was a founder and board member of Chai until at least May 2022. *Id.* ¶ 127.[7] According to the SEC, moreover, Kwon personally negotiated the arrangement with the U.S. Trading Firm to buy UST for the express purpose of restoring the peg. *See* Amended Complaint ¶¶ 166-167; *SEC v. Constantin*, 939 F. Supp. 2d 288, 308 (S.D.N.Y. 2013).

IV. Conclusion

For the foregoing reasons, the Court denies the defendants' motion to dismiss in its entirety.

SO ORDERED.

All Citations

--- F.Supp.3d ----, 2023 WL 4858299

Footnotes

1 A blockchain is a digital public ledger on which transactions between parties -- most often involving the exchange of cryptocurrencies -- are permanently recorded and viewable to anyone. Blockchains and cryptocurrencies are both understood to be "decentralized," in that no entity has power over who can view transactions on the blockchain and the cryptocurrencies themselves are not denominated or minted by any centralized entity, such as a reserve bank.

2 Unless otherwise indicated, in quoting cases all internal quotation marks, alterations, emphases, footnotes and citations are omitted.

3 Specifically, because jurisdiction in this case is predicated on federal statutes, the relevant inquiry -- as both parties agree -- is whether the defendants had sufficient contacts with the United States generally to give rise to personal jurisdiction. Thus, the SEC need not demonstrate that the defendants had purposefully directed their activities at any particular U.S. state to establish that the Court possesses personal jurisdiction.

4 In the defendants' view, even these actions would not be enough to satisfy the SEC's obligations under the Due Process Clause with respect to its allegations regarding UST. The agency, they press, needed to have "previously asserted that something is a security merely because it can be used to buy something else the SEC calls a security." This, however, misstates the SEC's position. While the SEC *did* claim that the UST tokens were securities because they could be exchanged for LUNA, it also alleged with respect to each of the defendants' crypto-assets in its Amended Complaint that the defendants' UST tokens qualify as securities not simply because they were used to buy LUNA, but because they satisfy *Howey*'s three-part test (see below) for identifying "investment contracts." *See* Amended Complaint ¶¶ 74-83. It cannot be that the Due Process Clause requires an agency to detail in advance, in the name of "fair notice," each and every argument it intends to make in an adjudication proceeding. That the SEC previously expressed its views that crypto-assets could be considered "investment contracts" under *Howey* suffices.

5 Here, the Court makes explicit what has long been implied in the "fair notice" inquiry, at least as applied to agencies like the SEC that are charged with regulating highly technical entities. The question whether "fair notice" has been provided should be assessed from the perspective of a reasonable person *in the defendant's industry* rather than from that of a member of the general public. It would make little sense to construe the

Due Process Clause to require that agencies like the SEC provide "fair notice" to everyday citizens, most of whom have no interaction with the industries that the SEC is tasked with regulating.

6 Considering the Court's determination that the SEC has adequately pled the existence of "horizontal" commonality between such investors and the SEC, it sees no need to decide whether the SEC also established that there was vertical commonality between such investors and the defendants.

7 At this stage, violations of the securities laws by Terraform Labs can be imputed to its founder, CEO, and co-defendant, Do Hyeong Kwon. As the alleged CEO, founder, and majority shareholder of Terraform Labs, Kwon retained "control" over the company. *See* Amended Complaint ¶¶ 128-129. Kwon was also, according to the Amended Complaint, intimately involved in the central events of this litigation -- including communications with investors over the use of the defendants' crypto-assets on Chai and the May 2021 de-pegging incident. *Id.* ¶¶ 134-142, 157-159. As such, violations of securities laws by Terraform Labs may be imputed to Mr. Kwon under Section 20(a) of the Exchange Act.

End of Document

2023 WL 8944860
United States District Court, S.D. New York.

SECURITIES AND EXCHANGE COMMISSION, Plaintiff,
v.
TERRAFORM LABS PTE. LTD.
and Do Hyeong Kwon, Defendants.

23-cv-1346 (JSR)
|
Signed December 28, 2023

Synopsis

Background: Securities and Exchange Commission (SEC) brought civil enforcement action against company that sold cryptocurrency and related assets and company's founder, alleging that defendants offered and sold unregistered securities, offered and effected transactions in unregistered security-based swaps, and engaged in securities fraud in violation of § 10(b), Rule 10b-5, and the comparable fraud provision in the Securities Act. After the District Court, Jed S. Rakoff, J., 2023 WL 4858299, denied defendants' motion to dismiss for lack of personal jurisdiction and failure to state a claim, each side moved to exclude certain expert testimony, and each side moved for summary judgment on various issues.

Holdings: The District Court, Jed S. Rakoff, J., held that:

[1] expert testimony offered by SEC from economics professor and from computer scientist was admissible;

[2] expert testimony from finance professor offered by defendants in rebuttal to SEC's expert testimony from economics professor was admissible;

[3] expert testimony offered by defendants from software developer and economist was not admissible;

[4] certain assets offered for sale by defendants were investment contracts, and therefore securities, for purposes of claim alleging the offer and sale of unregistered securities;

[5] SEC established a prima facie case that defendants offered and sold unregistered securities, and defendants did not defeat that prima facie case;

[6] certain assets sold by defendants did not meet the statutory definition of a security-based swap, and defendants thus did not violate laws related to unregistered security-based swaps;

[7] genuine issues of material fact over both scienter and materiality precluded summary judgment for either party on securities-fraud claims;

[8] certain statements made to an SEC confidential informant by executives of nonparty trading company were admissible as statements against interest, and as statements of then-existing state of mind, despite being hearsay;

[9] founder was a control person for purposes of securities-fraud claims; and

[10] founder's due-process rights were not violated by his inability to submit a declaration.

SEC's motions to exclude and for summary judgment granted in part and denied in part; defendants' motion to exclude denied and their motion for summary judgment granted in part and denied in part.

Procedural Posture(s): Motion to Exclude Expert Report or Testimony; Motion for Summary Judgment.

West Headnotes (33)

[1] **Evidence** Relevance and materiality
Evidence Methodology and reasoning; scientific validity

When deciding whether to admit expert testimony, a court must make a preliminary assessment of whether the reasoning or methodology underlying the testimony is scientifically valid and of whether that reasoning or methodology properly can be applied to the facts in issue. Fed. R. Evid. 702.

[2] **Evidence** Finance and banking

Evidence As to Particular Subjects

Expert testimony offered by SEC from economics professor about trading history of cryptocurrency-related asset was admissible in enforcement action against company that sold cryptocurrency and related assets and company's founder alleging claims for, among other things, securities fraud in violation of § 10(b) and Rule 10b-5 and the offer and sale of unregistered securities, where professor specialized in the trading mechanisms of financial markets, his testimony, which related to a third-party trading firm's role in restoring a crypto-asset's price to company's stated target value, was based on a variant of a highly influential economic model, and defendants' criticisms of his testimony were either immaterial or were legitimate differences of expert opinion. Securities Act of 1933 § 5, 15 U.S.C.A. §§ 77e(a), 77e(c); Securities Exchange Act of 1934 § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5; Fed. R. Evid. 702.

[3] **Evidence** Finance and banking

Expert testimony offered by SEC from computer scientist whose firm specialized in cryptocurrency, cybersecurity, and digital forensic investigations about functionality of certain server and blockchain operated by company that sold cryptocurrency and related assets was admissible in enforcement action alleging claims against company and its founder for, among other things, securities fraud in violation of § 10(b) and Rule 10b-5 and the offer and sale of unregistered securities, even if computer scientist was not an expert in financial payment systems, where his analysis of server and blockchain was based on source-code analysis, an area in which he was an expert, and he was able to reach his conclusions from server source code and public blockchain data. Securities Act of 1933 § 5, 15 U.S.C.A. §§ 77e(a), 77e(c); Securities Exchange Act of 1934 § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5; Fed. R. Evid. 702.

[4] **Evidence** As to Particular Subjects

Expert testimony by finance professor offered in rebuttal to testimony of SEC's expert by defendants, company that sold cryptocurrency and related assets and company's founder, was admissible in SEC enforcement action alleging claims against company and its founder for, among other things, securities fraud in violation of § 10(b) and Rule 10b-5 and the offer and sale of unregistered securities, where defendants' expert considered the evidence necessary to critique SEC's expert's model, and SEC could cross-examine defendants' expert about other aspects of his report or otherwise rebut them. Securities Act of 1933 § 5, 15 U.S.C.A. §§ 77e(a), 77e(c); Securities Exchange Act of 1934 § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5; Fed. R. Evid. 702.

[5] **Evidence** Finance and banking

Evidence As to Particular Subjects

Expert testimony by software developer offered in rebuttal to testimony of SEC's expert by defendants, company that sold cryptocurrency and related assets and company's founder, was not admissible in SEC enforcement action alleging claims against defendants for, among other things, securities fraud in violation of § 10(b) and Rule 10b-5 and the offer and sale of unregistered securities, where SEC's expert's testimony related to blockchain transactions recorded on defendants' servers, but defendants' expert did not demonstrate sufficient expertise in blockchain analysis to opine on SEC's expert's conclusions, and defendants' expert did not personally analyze the blockchain data at issue in the case. Securities Act of 1933 § 5, 15 U.S.C.A. §§ 77e(a), 77e(c); Securities Exchange Act of 1934 § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5; Fed. R. Evid. 702.

[6] **Evidence** Speculation, guess, or conjecture; probability or possibility

A trial judge should exclude expert testimony if it is speculative or conjectural. Fed. R. Evid. 702.

[7] **Evidence** Finance and banking

Expert testimony by economist, whose field was market microstructure and cryptocurrency, offered by defendants, company that sold cryptocurrency and related assets and company's founder, was not admissible in SEC enforcement action alleging claims against defendants for, among other things, securities fraud in violation of § 10(b) and Rule 10b-5 and the offer and sale of unregistered securities, where a jury would not be aided by economist's proposed testimony, which consisted of a factual narrative addressing, based on defendants' marketing materials, how defendants' cryptocurrency-related assets were designed to work, not how they did work, and addressing whether regulators and market participants had discussed risks associated with defendants' cryptocurrency. Securities Act of 1933 § 5, 15 U.S.C.A. §§ 77e(a), 77e(c); Securities Exchange Act of 1934 § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5; Fed. R. Evid. 702.

[8] **Courts** Supreme Court decisions

When a Supreme Court precedent has direct application in a case, a district court must follow it, even if it appears to rest on reasons rejected in some other line of decisions.

[9] **Securities Regulation** Particular interests

Certain cryptocurrency-related assets offered for sale by company were "investment contracts," and therefore "securities," for purposes of the federal securities laws in SEC's enforcement action against company and its founder alleging claims for, among other things, the offer and sale of unregistered securities, because each asset involved the investment of money in a common enterprise with profits to be derived solely from the efforts of others; one asset, a type of token, could be deposited in a way that defendants said would generate a rate of return, another asset was described as providing holders a profit based on defendants' development of their blockchain, and another asset was described as a token that would generate fees for holders based on trades on defendants' blockchain. Securities Act of 1933 §§ 2, 5, 15 U.S.C.A. §§ 77b(a)(1), 77e(a), 77e(c).

1 Case that cites this headnote

[10] **Evidence** Matters of Opinion or Fact

A witness who provides a summary of relevant financial records is not supplying expert testimony. Fed. R. Evid. 702.

[11] **Securities Regulation** Offer and sale; delivery

SEC established a prima facie case that company that sold cryptocurrency and related assets and company's founder, by selling and offering for sale certain cryptocurrency-related assets, offered and sold unregistered securities, in violation of the Securities Act, where certain tokens were sold to investors through sales agreements that expressly contemplated defendants' development of a secondary market, other tokens were sold to purchasers through agreements that did not restrict purchases from reselling the tokens in secondary markets, and those tokens were also loaned to a party in an agreement that required the party to trade tokens on platforms that were not shown to be unavailable to United States investors. Securities Act of 1933 § 5, 15 U.S.C.A. §§ 77e(a), 77e(c).

1 Case that cites this headnote

[12] **Securities Regulation** Offer and sale; delivery

To prove liability for the offer or sale of unregistered securities, the SEC must show (1) lack of a registration statement as to the subject securities, (2) the offer or sale of the securities,

and (3) the use of interstate transportation or communication and the mails in connection with the offer or sale. Securities Act of 1933 § 5, 15 U.S.C.A. §§ 77e(a), 77e(c).

[13] **Securities Regulation** Evidence

Securities Regulation Evidence

Once the SEC has made a prima facie case of a defendant's liability for the offer or sale of an unregistered security, the defendant bears the burden of proving the applicability of an exemption. Securities Act of 1933 § 5, 15 U.S.C.A. §§ 77e(a), 77e(c).

[14] **Securities Regulation** Offerees' knowledge or sophistication; access to or need for information

Company that sold cryptocurrency and related assets and company's founder failed to establish that they sold certain cryptocurrency-related assets only to sophisticated investors, not to the public, such that defendants would be relieved of liability for having offered and sold unregistered securities, and defendants thus did not defeat SEC's prima facie showing of defendants' liability, where defendants' repeated statements about developing a liquid secondary market for certain assets, and their requirement that a third party trade certain other of their assets on exchanges, showed that defendants did not intend that the assets at issue would come to rest with the institutional investors who first purchased them. Securities Act of 1933 § 5, 15 U.S.C.A. §§ 77e(a), 77e(c).

[15] **Securities Regulation** Foreign Transactions or Securities

Company that sold cryptocurrency and related assets and company's founder failed to establish that sales agreements for certain assets occurred outside the United States and were thus exempt from registration requirements, such that defendants would be relieved of liability for having offered and sold unregistered securities, and defendants thus did not defeat SEC's prima facie showing of defendants' liability, where defendants merely conjectured that purchasers of their assets could have resold the assets on foreign exchanges, but defendants offered no evidence that purchasers in fact limited their resales to foreign exchanges or that defendants believed that purchasers did so. Securities Act of 1933 § 5, 15 U.S.C.A. §§ 77e(a), 77e(c); 17 C.F.R. § 230.901.

[16] **Securities Regulation** Particular interests

Certain cryptocurrency-related assets sold by defendants, company that sold such assets and its founder, did not meet the statutory definition of a security-based swap, and defendants' offer and sale of those assets thus did not violate laws against offering unregistered security-based swaps to, or effecting transactions in security-based swaps with, non-eligible contract participants, even though the assets involved a payment by a purchaser based on the value of an underlying reference security, where the assets did not allow a purchaser to profit from holding them because the purchaser's deposit for holding the assets was required to always exceed the value of the underlying security. Commodity Exchange Act § 1A, 7 U.S.C.A. § 1a(47)(A)(iii); Securities Exchange Act of 1934 §§ 3, 6, 15 U.S.C.A. §§ 78c(a)(68), 78f(l); Securities Act of 1933 § 5, 15 U.S.C.A. § 77e(e).

[17] **Securities Regulation** Questions of law or fact; jury questions

Securities Regulation Questions of law or fact; jury questions

Summary Judgment Securities regulation

Genuine issues of material fact over both scienter and materiality precluded summary judgment for either party in SEC enforcement action against defendants, company that sold cryptocurrency and related assets and company's founder, on

SEC's claims for securities fraud under § 10(b), Rule 10b-5, and the comparable fraud provision in the Securities Act. Securities Act of 1933 § 17, 15 U.S.C.A. § 77q(a); Securities Exchange Act of 1934 § 10, 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[18] **Summary Judgment** Weighing evidence, resolving conflicts, and determining credibility

Credibility determinations, the weighing of the evidence, and the drawing of legitimate inferences from the facts are jury functions, not functions that a judge can engage in on summary judgment.

[19] **Securities Regulation** Fraudulent Statements, Omissions or Conduct

Securities Regulation Manipulative, Deceptive or Fraudulent Conduct

To demonstrate scheme liability under § 10(b), Rule 10b-5, or the comparable fraud provision in the Securities Act, the SEC must prove that a defendant (1) committed a deceptive or manipulative act (2) in furtherance of the alleged scheme to defraud (3) with scienter. Securities Act of 1933 § 17, 15 U.S.C.A. § 77q(a); Securities Exchange Act of 1934 § 10, 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

1 Case that cites this headnote

[20] **Securities Regulation** Fraudulent Statements, Omissions or Conduct

Securities Regulation Manipulative, Deceptive or Fraudulent Conduct

While a defendant's misstatements and omissions can form part of a claim for scheme liability for securities fraud under § 10(b), Rule 10b-5, or the comparable fraud provision in the Securities Act, an actionable scheme-liability claim also requires something beyond misstatements and omissions, such as dissemination. Securities Act of 1933 § 17, 15 U.S.C.A. § 77q(a); Securities Exchange Act of 1934 § 10, 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[21] **Securities Regulation** Scienter; knowledge or intention

Securities Regulation Scienter, Intent, Knowledge, Negligence or Recklessness

The requisite scienter for scheme liability for securities fraud under § 10(b), Rule 10b-5, or comparable provision in the Securities Act barring employment of a device, scheme, or artifice to defraud is an intent to defraud or recklessness. Securities Act of 1933 § 17, 15 U.S.C.A. § 77q(a)(1); Securities Exchange Act of 1934 § 10, 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

1 Case that cites this headnote

[22] **Securities Regulation** Scienter; knowledge or intention

A showing of negligence is sufficient to satisfy the scienter requirement for a claim of scheme liability for securities fraud under section of the Securities Act barring engaging in "any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." Securities Act of 1933 § 17, 15 U.S.C.A. § 77q(a)(3).

[23] **Securities Regulation** Fraudulent Statements, Omissions or Conduct

Securities Regulation Manipulative, Deceptive or Fraudulent Conduct

To establish liability for securities fraud on a standalone basis, rather than on the basis of scheme liability, under § 10(b), Rule 10b-5, or the comparable provision of the Securities Act, the SEC must prove that a defendant (1) made one or more misstatements of material fact, or omitted to state one or more material facts that the defendant had a duty to disclose (2) with scienter (3) in connection with the purchase or sale of securities. Securities Act of 1933 § 17, 15 U.S.C.A. § 77q(a); Securities Exchange Act of

1934 § 10, 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[24] **Securities Regulation** Scienter, Intent, Knowledge, Negligence or Recklessness

The requisite scienter for standalone liability, as opposed to scheme liability, for securities fraud under § 10(b) or Rule 10b-5 is an intent to deceive, manipulate, or defraud or a reckless disregard for the truth. Securities Exchange Act of 1934 § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

1 Case that cites this headnote

[25] **Securities Regulation** Scienter; knowledge or intention

A showing of negligence is sufficient to satisfy the scienter requirement for standalone liability, as opposed to scheme liability, for securities fraud under section of the Securities Act barring obtaining money or property by means of an untrue statement of material fact or an omission of a material fact that rendered affirmative statements misleading under the circumstances. Securities Act of 1933 § 17, 15 U.S.C.A. § 77q(a)(2).

[26] **Evidence** Persons Acting Together; Conspirators

Certain statements made to an SEC confidential informant by executives of a nonparty trading company that allegedly conspired with defendants, a company that sold cryptocurrency-related assets and its founder, were admissible as statements against interest, despite being hearsay, in SEC enforcement action against defendants for securities fraud and other charges, where the speakers were unavailable because they had invoked their Fifth Amendment right against self-incrimination when questioned, and the statements tended to expose the speakers to criminal or civil liability because they suggested participation by nonparty company and the speakers in a secret agreement to ensure that a particular asset sold by defendants would be brought back to its target value. U.S. Const. Amend. 5; Securities Act of 1933 § 17, 15 U.S.C.A. § 77q(a); Securities Exchange Act of 1934 § 10, 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5; Fed. R. Evid. 804(b)(3).

[27] **Evidence** Other particular statements or assertions

Certain statements made to an SEC confidential informant by executives of a third-party trading company that allegedly conspired with defendants, a company that sold cryptocurrency-related assets and its founder, were admissible as statements of each executive's then-existing state of mind, specifically the executive's intent, motive, or plan, despite being hearsay, in SEC enforcement action against defendants for securities fraud and other charges, where the statements were contemporaneous statements about how much capital the trading company was willing to risk and what defendants were offering in return, together with changes in trading company's trading practices, and the statements tended to show a plan to conspire with defendants to restore the value of assets at issue. Securities Act of 1933 § 17, 15 U.S.C.A. § 77q(a); Securities Exchange Act of 1934 § 10, 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5; Fed. R. Evid. 803(3).

[28] **Evidence** Persons Acting Together; Conspirators

Evidence Necessity that statement be made in pursuance of and during pendency of conspiracy

To admit an otherwise inadmissible hearsay statement on the basis of the exception for statements made by a coconspirator, a court must determine by a preponderance of the evidence (1) that there was a conspiracy, (2) that its members included the declarant and the party against whom the statement is offered, and (3) that the statement was made during the course

of and in furtherance of the conspiracy. Fed. R. Evid. 801(d)(2)(E).

[29] **Securities Regulation** In general; control persons

To prevail on a claim of control-person liability for securities fraud under the Securities Exchange Act, a plaintiff must show (1) a primary violation by the controlled person, (2) control of the primary violator by the defendant, and (3) that the defendant was, in some meaningful sense, a culpable participant in the controlled person's fraud. Securities Exchange Act of 1934 § 20, 15 U.S.C.A. § 78t.

[30] **Securities Regulation** In general; control persons

Founder of company that sold cryptocurrency-related assets was a control person for purposes of securities-fraud claims under § 10(b) and Rule 10b-5 in enforcement action brought by SEC against him and company, where many of the statements on which the fraud claims were based were attributed directly to founder, and he was company's CEO and 92% owner. Securities Exchange Act of 1934 §§ 10, 20, 15 U.S.C.A. §§ 78j(b), 78t; 17 C.F.R. § 240.10b-5.

[31] **Constitutional Law** Factors considered; flexibility and balancing

Due process is flexible and calls for such procedural protections as the particular situation demands. U.S. Const. Amend. 5.

[32] **Constitutional Law** Factors considered; flexibility and balancing

Identifying the specific dictates of due process generally requires consideration of three distinct factors: first, the private interest that will be affected by the official action; second, the risk of an erroneous deprivation of such interest through the procedures used, and the probative value, if any, of additional or substitute procedural safeguards; and finally, the government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail. U.S. Const. Amend. 5.

[33] **Constitutional Law** Securities and commodities transactions

Securities Regulation In general; nature and form of remedy

Procedural due-process rights of founder of company that sold cryptocurrency-related assets were not violated by fact that founder was unable, because he was incarcerated in Montenegro on unrelated charges and was not made available by Montenegrin officials for a deposition before the close of discovery, to submit a declaration in SEC enforcement action against him and his company alleging claims including securities fraud under § 10(b) and Rule 10b-5, where he would not be able to be cross-examined about the declaration, and he had been able to actively litigate the case through counsel with whom he was in contact. U.S. Const. Amend. 5; Securities Exchange Act of 1934 § 10, 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

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OPINION AND ORDER

JED S. RAKOFF, United States District Judge

***1** In this case, the Securities and Exchange Commission ("SEC") alleges that the defendants -- Terraform Labs Pte. Ltd., a "crypto-assets" company, and its founder, Do Hyeong Kwon — orchestrated a multi-billion-dollar fraud involving the development, marketing, and sale of various cryptocurrencies. The SEC's claims, all brought under the federal securities laws, include a claim that defendants offered and sold unregistered securities, claims that defendants offered and effected transactions in unregistered security-based swaps, and claims that defendants engaged in fraudulent schemes to lead investors astray. One of the alleged fraudulent schemes is that defendants misrepresented that one of Terraform's crypto asset securities, UST, was permanently pegged to a $1.00 price through an automatic self-stabilizing algorithm, rather than through the intervention of a third-party trading firm with whom defendants struck a secret deal. Another of the alleged fraudulent schemes is that defendants falsely stated that a Korean mobile payment application, Chai, used the Terraform blockchain to process and settle transactions in cryptocurrencies, a lie that defendants concealed by replicating purported Chai transactions on a Terraform server.

In support of its fraud claims, the SEC offers two expert witnesses: Dr. Bruce Mizrach and Dr. Matthew Edman. In response, defendants offer three expert witnesses of their own: Dr. Terrence Hendershott (as rebuttal to Dr. Mizrach), Mr. Raj Unny (as rebuttal to Dr. Edman), and Dr. Christine Parlour. Each side moved under Federal Rule of Evidence 702 to exclude the other side's experts, and the Court, after receiving full briefing, held a "Daubert" hearing on those motions on November 17, 2023, at which it questioned all five putative experts. On November 20, 2023, the Court issued a "bottom-line" order denying defendants' motions to exclude the testimony of Dr. Mizrach and Dr. Edman, denying the SEC's motion to exclude the testimony of Dr. Hendershott, and granting the SEC's motions to exclude the testimony of Mr. Unny and Dr. Parlour. Below, the Court explains the reasons for those rulings.

In addition, this Opinion and Order disposes of the parties' cross-motions for summary judgment, on which the Court received full briefing and held oral argument on November 30, 2023. As the Court explains below, the Court grants summary judgment for the SEC on the claim that defendants offered and sold unregistered securities. The Court grants summary judgment for defendants on the claims involving offering and effecting transactions in security-based swaps. Finally, the Court denies' both sides' cross-motions for summary judgment on the fraud claims.

I. Factual and Procedural Background

Defendant Do Hyeong Kwon, along with an individual named Daniel Shin, founded Terraform Labs Pte. Ltd. ("Terraform") in April 2018. ECF No. 124 ("Defs.' Response to SEC 56.1"), at ¶¶ 1-2. [1] In April 2019, Terraform and Kwon launched and promoted the Terraform blockchain, which would record and display transactions of cryptocurrency tokens, or crypto assets, across computers in a linked network. Id. ¶ 25; ECF No. 126 ("SEC Resp. to Defs.' 56.1"), at ¶¶ 10-13.

A. LUNA and wLUNA

***2** Terraform coded into the blockchain at launch one billion tokens of a particular crypto asset, LUNA, that it created. [2] Defs.' Response to SEC 56.1 ¶ 25. Beginning even before the blockchain was developed, Terraform entered agreements to sell LUNA to buyers in exchange for both fiat currency and other crypto assets, such as Bitcoin. Id. ¶¶ 51, 117; e.g., ECF No. 73, Ex. 26 (July 11, 2018 token sale agreement for an institutional investor to purchase LUNA tokens from Terraform for $3,000,000 worth of Bitcoin). The terms of those agreements referred to an "Initial Token Launch," which was defined as "the online sale and/or distribution of Tokens by the Vendor [Terraform or its subsidiary Terraform BVI] to the general public in a campaign to be initiated and conducted by the Vendor." Defs.' Response to SEC 56.1 ¶ 118.

The agreements further contemplated that "Terraform would undertake efforts to generate a secondary trading market

for the LUNA tokens." Id. The terms of the sales provided incentives for the purchasers to resell LUNA tokens by, for example, setting the purchase price at discounts of 40% or more from expected market prices. Id. ¶ 119. In a fundraising update in December 2018, Terraform co-founder Daniel Shin wrote that Terraform had "begun exchange listing discussions given token listing is a precondition for Terra/Luna ecosystem to operate." Id. ¶ 121. Terraform used proceeds from selling LUNA to, in part, fund Terraform's operating costs. Id. ¶ 56.

In November 2019 and September 2020, Kwon negotiated and signed, on behalf of Terraform, agreements with a U.S. crypto asset trading firm, Jump Crypto Holdings LLC ("Jump"), to receive loans of 30 million and 65 million LUNA tokens, respectively. Id. ¶¶ 124, 130. In a January 13, 2020 email to "Terra's leading investor group," Kwon announced that Terraform had "agreed to enter a partnership with Jump," in which Jump would "deploy its own resources to improve liquidity of Terra and Luna." Id. ¶ 126. Kwon stated that, until then, LUNA's liquidity had been "rather lackluster partly due to our team's inexperience with secondary markets & trading operations." Id. Kwon further explained that Terraform's loan of LUNA tokens to Jump was "with the expectation that they are going to fill bids and offers to improve liquidity of LUNA in secondary trading markets." Id. Moreover, Kwon acknowledged that Jump later provided periodic reports to Terraform of its trading on various crypto asset trading platforms. Id. The second loan agreement, in September 2020, came about because a Jump executive emailed Kwon a proposal to obtain tens of millions of additional LUNA tokens at a discounted price to "thicken up LUNA markets further." Id. ¶ 129.

In a Tweet on April 7, 2021, Kwon wrote: "A bet on the moon [LUNA] is very simple: it goes up in value (inc. scarcity) the more Terra money is used; it goes down in value (inc. dilution) the less Terra money is used. The moon's fate in the long run is tied to how widely the money gets used and transacted." ECF No. 75, Ex. 105. In another post that day, Kwon wrote: "But in the long run, $Luna value is actionable — it grows as the [Terraform] ecosystem grows. As a holder of the [moon], you then have three choices: Sit back and watch me kick ass; Take profits and buy un-valuable assets; Or you can roll up your sleeves and build cool shit." Id., Ex. 108. Around the same time, SJ Park, Director of Special Projects at Terraform, stated in a videotaped presentation that "[o]wning LUNA is essentially owning a stake in the network and a bet that value will continue to accrue over time." Defs.' Response to SEC 56.1 ¶ 63. In a public interview, Jeff Kuan, business development lead at Terraform, explained that "VCs investing in Terra means they're buying LUNA, which is the 'equity' in our co." Id. The price of LUNA increased from under $1.00 in January 2021 to a high of over $119 in April 2022, before plummeting to under a penny in May 2022. ECF No. 175, Ex. 125.

B. UST and the Anchor Protocol

***3** In December 2019, Terraform created another crypto asset called UST, which it described as a "stablecoin" whose value was permanently and algorithmically pegged to one U.S. dollar. Defs.' Response to SEC 56.1 ¶¶ 21–24. As part of the algorithm, one UST could always be exchanged for $1 worth of LUNA, and $1 worth of LUNA could always be exchanged for one UST. Id. ¶ 23. In March 2021, Terraform launched "the Anchor Protocol," which it described as a key component of "the Terra money market," allowing UST holders to earn interest payments by depositing their tokens in a shared pool from which others could borrow UST. ECF No. 73, Ex. 44 at 2; id., Ex. 67. Terraform publicly announced, in a Tweet by Kwon, that "Anchor will target 20% fixed APR," which was "by far the highest stablecoin yield in the market." Id., Ex. 66. A June 2020 white paper described the Anchor Protocol as "an attempt to give the main street investor a single, reliable, rate of return across all blockchains." Id., Ex. 44 at 2.

Returns from the Anchor Protocol were paid out in proportion to the amount of UST a person or entity had deposited. Defs.' Response to SEC 56.1 ¶ 80. The Anchor Protocol website stated that "[d]eposited stablecoins are pooled and lent out to borrowers, with accrued interest pro-rata distributed to all depositors." Id. By May 2022, there were approximately 18.5 billion tokens of UST, 14 billion of which had been deposited in the Anchor Protocol. Id. ¶ 36.

C. MIR, the Mirror Protocol, and mAssets

In December 2020, Terraform launched "the Mirror Protocol." Id. ¶ 38. The Mirror Protocol allowed users to obtain "mAssets" -- tokens whose value would "mirror" the price of a pre-existing non-crypto asset, such as a publicly traded security. Id. ¶ 39. A Mirror Protocol user could mint an mAsset by depositing collateral of 150% or more of the value of the underlying security (the "reference stock"). Id. ¶ 113. The holder of the mAsset would thus hold the value of

the deposit without holding the underlying reference stock or its attendant ownership interests. There was a catch, however. Whenever the price of the underlying reference stock rose above the holder's initial buy-in, the holder would need to deposit additional collateral to maintain the mAsset. Id. ¶ 114. In other words, there is no evidence that suggests, and the SEC does not contend, that an mAsset would lead to profit for its holders or that any holders expected as much.

The same was not true, however, for the Mirror Protocol's governance token, MIR. MIR's value was based on the Mirror Protocol's usage. Id. ¶ 38. A Terraform subsidiary sold MIR tokens directly to purchasers through "Simple Agreements for Farmed Tokens," or SAFTs. Id. ¶ 135. Those agreements did not restrict purchasers from reselling their MIR tokens in secondary trading markets or to U.S. investors. Id. ¶ 136. Terraform also loaned as many as 4 million MIR tokens to Jump, in an agreement that expressly required Jump to trade MIR tokens on crypto asset trading platforms and to provide Terraform with reports of its trading. Id. ¶ 138. Terraform also sold LUNA and MIR tokens to secondary market purchasers on Binance and other crypto trading exchanges. Id. ¶ 142. The record provides no evidence that Terraform took steps to determine whether those trading platforms were available to U.S. investors. Id. ¶ 143.

In September 2020, Kwon emailed promotional materials to a potential purchaser, including a set of slides that described MIR as "a farmable governance token that earns fees from asset trades." Id. ¶ 101. Another slide proclaimed that the "Mirror token will accrue value from network fees and governance" and stated that MIR token holders could receive "trading fee revenues." Id. Kwon even included in those materials a spreadsheet with a revenue projection table, estimating how the price of MIR would increase in tandem with greater usage of the Mirror Protocol. Id.; ECF No. 75, Ex. 148. In a June 2021 presentation, SJ Park, Terraform's Director of Special Projects, stated that the Mirror Protocol had "grown to two billion [dollars] in total value locked and a billion [dollars] in liquidity." Defs.' Response to SEC 56.1 ¶ 110.

D. Chai's Use of the Terraform Blockchain

***4** In mid-2019, Terraform's co-founder Daniel Shin developed Chai, a Korean mobile payment application. Id. ¶¶ 150-51. Terraform and Chai were closely associated until early 2020, including sharing office space and overlapping personnel. Id. ¶ 153. In a July 26, 2019 Terraform "Community Update," Kwon wrote that "Chai launched using the Terra Protocol, and ... already it is one of the most heavily used blockchain applications in existence." Id. ¶ 168. In a February 9, 2020 Terraform chat message available to the public, Kwon stated that "Chai has 12 merchants, all of whom get settled in KRT [a crypto asset pegged to the Korean fiat currency, the won] on the Terraform blockchain." Id. ¶ 173. In an April 16, 2021 interview, Kwon stated that by paying "merchants directly in stablecoin, we're able to cut down settlement times from seven days to six seconds, which [is] the average block time of the entire blockchain." Id. ¶ 181. In another public interview, on March 31, 2022, Kwon added that "the idea was that we could, you know, bootstrap a large network of merchants and users that are willing to transact using Terra." Id. ¶ 182.

According to the SEC, however, the above statements were misrepresentations because Chai never used the Terraform blockchain to process transactions. In a May 26, 2020 email, a Chai employee explained that Chai would "process transaction[s] outside [the] blockchain" and then "write a record on the Terra blockchain in parallel." Id. ¶ 185. In a May 9, 2019 message, Kwon told Shin that he would "do fake transactions on the mainnet to generate staking returns of SDT," another Terraform crypto asset. Id. ¶ 187. Kwon added, "[I] can just create fake transactions that look real which will generate fees and we can wind down as chai grows." Id. When asked by Shin whether people would learn that the transactions were fake, Kwon responded, "All power to those that can prove it[']s fake because I will try my best to make it indiscernable." Id.

Shortly thereafter, Terraform developed what became known as the "LP Server." Id. ¶ 188. On October 9, 2020, a Terraform engineer messaged another Terraform employee, Paul Kim, to ask, "can you quickly explain me what's the role of the lp-server?" Id. ¶ 200. Kim responded, "lp-server creates multisend transactions by receiving transaction information from Chai," adding, "[i]n short: it basically replicates chai transactions." Id. Jihoon Kim, a former Terraform employee who had left to join Chai as lead engineer for its e-wallet and card business, told Chai's Chief Product Officer — an SEC whistleblower in this case -- that "there's no crypto going on within Chai." Id. ¶ 186. When that whistleblower confronted Kwon in September 2021 about the fact that Chai did not really use the Terraform blockchain, Kwon did not deny the allegation but stated merely that he did not "give a fuck about Chai." Id. ¶ 183.

E. UST's May 2021 Depeg

On May 19, 2021, UST's price fell below $1. Id. ¶ 209. On May 23, 2021, it dropped to around $0.90. Id. That same day, Kwon had multiple communications with a Jump executive. Id. ¶ 210. When asked about those communications at a deposition, that Jump executive — as well as another -- invoked the Fifth Amendment and refused to answer. Id. ¶ 211. The SEC asserts that Terraform reached a deal with Jump to take action to restore UST's $1 peg, and that, in return, Jump would no longer be required to achieve vesting conditions to receive additional LUNA tokens under earlier agreements. Id. On the day in question, May 23, 2021, a different Jump executive told employees, "I spoke to Do [Kwon] and he's going to vest us." Id. ¶ 214. The same day, Kwon told Terraform's head of business development that he was "speaking to jump about a solution." Id. ¶ 217. Terraform's head of communications, Brian Curran, took notes at a division head meeting that day, writing that Kwon announced that the "[p]eg had to be defended" and that "Jump was deploying $100 million to buyback UST." Id. ¶¶ 217-18. Indeed, Jump purchased large amounts of UST in bursts that day, and UST's market price was eventually restored to near $1.00. Id. ¶¶ 214-15. Later that year, Kwon told Curran that if Jump had not stepped in, Terraform "actually might've been fucked." Id. ¶ 219. Another Terraform employee added that "they [Jump] saved our ass." Id.

***5** On May 24, 2021, after UST's price had largely recovered, Terraform published dozens of Tweets describing the benefits of "algorithmic, calibrated adjustments of economic parameters" as compared to the "stress-induced decision-making of human agents in [a] time of market volatility." Id. ¶ 222. Terraform referred to UST's $1 peg as the "lynchpin for the entire [Terra] ecosystem" and described the depeg and repeg as a "black swan" event that was "as intense of a stress test in live conditions as can ever be expected." Id. In a June 2021 Terraform Community Update, Terraform stated that "[i]ndustry-wide volatility stress-tested the stability mechanism of the Terra protocol." Id. ¶ 223.

Kwon discussed the depeg again in a May 2022 talk show appearance, at which he pronounced that the UST algorithmic "protocol automatically self-heals the exchanged rate" and that "it took a few days for the slippage cost to naturally heal back to spot." Id. ¶ 224. Later that same month, however, Terraform's crypto assets lost nearly all of their value — according to the SEC, more than $45 billion -- and have not recovered. Id. ¶ 49.

F. Procedural History

The SEC filed this action against Terraform and Kwon on February 16, 2023 and filed an Amended Complaint on April 3, 2023. See ECF Nos. 1, 25. The Amended Complaint contains six claims for relief: fraud in the offer or sale of securities in violation of Section 17(a) of the Securities Act (Count I); fraud in connection with the purchase or sale of securities in violation of Section 10(b) of the Exchange Act and accompanying Rule 10b-5 (Count II); control person liability against Kwon under Section 20(a) of the Exchange Act, for the Section 10(b) violation (Count III); offering and selling unregistered securities in violation of Sections 5(a) and 5(c) of the Securities Act (Count IV); offering unregistered security-based swaps to non-eligible contract participants in violation of Section 5(e) of the Securities Act (Count V); and effecting transactions in unregistered security-based swaps with non-eligible contract participants in violation of Section 6(*l*) of the Exchange Act (Count VI).

Defendants timely moved to dismiss the Amended Complaint on a smattering of grounds, including, among others, the argument that none of the crypto assets at issue is a security. See ECF No. 29. After full briefing and oral argument, the Court denied the motion to dismiss. See ECF No. 51. Discovery closed on October 27, 2023. See ECF No. 44. Each side moved under Rule 702 to exclude the expert witnesses of the other, and after full briefing, the Court heard oral argument on those motions on November 17, 2023. On November 20, 2023, the Court issued a "bottom-line" order granting the motions to exclude two of defendants' three experts, but denying the motions to exclude defendants' other expert and the SEC's two experts. See ECF No. 130. This Opinion and Order first explains the reasons for those Rule 702 rulings, and then goes on to resolve the parties' cross-motions for summary judgment, on which the Court heard oral argument on November 30, 2023 after full briefing.

II. Motions to Exclude Expert Testimony

[1] The SEC offers two expert witnesses, economist Dr. Bruce Mizrach and computer scientist Dr. Matthew Edman, in support of the fraud claims. Defendants offer three expert witnesses: economist Dr. Terrence Hendershott, as a rebuttal witness to Dr. Edman; software developer Mr. Raj Unny, as

a rebuttal witness to Dr. Edman; and economist Dr. Christine Parlour. [3] Rule 702 of the Federal Rules of Evidence provides that: "A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if the proponent demonstrates to the court that it is more likely than not that: (a) the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue; (b) the testimony is based on sufficient facts or data; (c) the testimony is the product of reliable principles and methods; and (d) the expert's opinion reflects a reliable application of the principles and methods to the facts of the case." Fed. R. Evid. 702. [4] The Court must thus make "a preliminary assessment of whether the reasoning or methodology underlying the testimony is scientifically valid and of whether that reasoning or methodology properly can be applied to the facts in issue." Daubert v. Merrell Dow Pharms., Inc., 509 U.S. 579, 592–93, 113 S.Ct. 2786, 125 L.Ed.2d 469 (1993); see Kumho Tire Co. v. Carmichael, 526 U.S. 137, 147, 119 S.Ct. 1167, 143 L.Ed.2d 238 (1999) (extending Daubert to non-scientific expert testimony).

A. Dr. Bruce Mizrach

***6** **[2]** The Court denies defendants' motion to exclude Dr. Bruce Mizrach's testimony. Dr. Mizrach is a professor of economics at Rutgers University, where he has taught since 1995. ECF No. 93-2 ("Mizrach Rep."), at ¶ 1.1. Dr. Mizrach has a Ph.D. in economics from the University of Pennsylvania and has also taught at Boston College, the Stern School of Business at NYU, and the Wharton School at the University of Pennsylvania. Id. Dr. Mizrach specializes "in market microstructure," or "the trading mechanisms of financial markets." Id. Subject to challenge by defendants is Dr. Mizrach's conclusion that third-party trading firm Jump played a role in restoring the price of UST to $1.00 after the May 2021 depeg.

Dr. Mizrach's analysis is based on a variant of an economic model developed and elaborated by Joel Hasbrouck in a 1991 article, "Measuring the information content of stock trades," in The Journal of Finance. Hasbrouck's model has proved highly influential and has been cited in more than 2,000 later publications, including in multiple papers of defendants' expert Dr. Hendershott. See ECF No. 93-3 ("Mizrach Rebuttal Rep."), at 14 n.40. All parties agree on the soundness of Hasbrouck's work.

Defendants nevertheless argue that Dr. Mizrach's analysis is methodologically flawed because Hasbrouck's model "was designed to measure the information content of asset trades, not whether the asset price would have moved more or less if the trading being studied had not occurred." ECF No. 96 ("Mem. against Mizrach"), at 4. Defendants concede that "Hasbrouck's methodology can be used to study what price changes [Jump's] May 23, 2021 trading might have predicted," but contend that the model "cannot be used" "to determine what prices that trading caused." Id.

But in the instant context, this distinction between "predicted" and "caused" is largely semantic and immaterial. Dr. Mizrach's report explains that his model "measure[s] the impact of one additional buy or sell purchase on [UST's] market price." Mizrach Rep., Appendix 1. Because the model "takes into account all the other factors that might be influencing the price," it "enables [one] to isolate the impact of Jump's trading from other factors." Id. And although defendants argue that the model fails to account for the trading of firms other than Jump, Dr. Mizrach explained in his deposition that the model captures such trades by reflecting them in "the mid-quote," or the price of UST in between two Jump trades. Mizrach Dep. 94:16–21. Moreover, Dr. Mizrach also looked at "certain critical junctures" in which "Jump was the only buyer." Mizrach Rebuttal Rep. at 5.

The SEC also points out that in another case, defendants' rebuttal expert Dr. Hendershott (who, as elaborated below, the Court has not excluded) himself relied on two papers by Dr. Mizrach to use a similar model in coming to similarly causal conclusions. See ECF No. 112 ("SEC Opp. for Mizrach"), at 10–11. In a declaration for that other case, Dr. Hendershott wrote that the model "shows that the orders like those from the Layering Algorithm significantly impact the price of the E-mini contract." Id. at 10 (emphasis omitted). [5] Stated differently, as Dr. Hendershott explained in that declaration, the model showed that a particular algorithm "caused prices to decline." Id. Rather than attempt to explain in briefing the apparent discrepancy between Dr. Hendershott's prior work and defendants' criticisms of Dr. Mizrach's analysis in this case, defendants replied that Dr. Hendershott could provide the explanation in person. ECF No. 113 ("Reply against Mizrach"), at 4. Dr. Hendershott may have a chance to do so at trial, but in connection with the Rule 702 motions, he chose not to do so.

***7** To be sure, defendants also advance other alleged flaws in Dr. Mizrach's analysis that Dr. Hendershott, as a rebuttal expert, does describe in his report. For instance, Dr. Mizrach, according to defendants, neither differentiated "between the types of trades that [Jump] appeared to have engaged in for arbitrage or other non-directional trading strategies and potential 'interventional' or directional trades, nor explained why the non-directional strategies should be included in the analysis of [Jump's] supposed trading impact."[6] Mem. against Mizrach at 7. Similarly, defendants note that Dr. Mizrach did not differentiate between active and passive trading or otherwise categorize Jump's trading beyond "buy" or "sell." Id. at 7–9. But these arguments are red herrings. The specific nature of Jump's trading is immaterial to Dr. Mizrach's analysis, which analyzed whether Jump's trading, in any form and in its entirety, played a role in restoring UST's $1 price in May 2021. Indeed, defendants and Dr. Hendershott do not refute that any of Jump's trading -- including passive buys -- could affect UST's price.

Defendants also criticize Dr. Mizrach's model for using average trade sizes to calculate price impact, rather than "using [Jump's] actual trade data." Mem. against Mizrach at 9. That criticism misapprehends the nature of the model. By leaving volume out of his model, as Hasbrouck also does, Dr. Mizrach assessed price impact as "the weighted average across all the trade size groups (i.e. an average size trade)." Mizrach Rebuttal Rep. at 14. Again, Dr. Mizrach's objective was to assess the role of all of Jump's trading on UST's price in May 2021, not to determine the differences in effect of the volume of particular trades. Defendants do not explain why the lack of actual trading volume in Dr. Mizrach's model makes it unreliable or inaccurate. Indeed, for his rebuttal report to Dr. Hendershott, Dr. Mizrach conducted a sensitivity analysis to compare the price impact across four different groups of Jump trading volumes "and compute an average weighted by the frequency of each trade size group." Id. The result was a set of figures that were "less than one cent different" from the estimates in his initial report, a statistically insignificant difference. Id. at 14 & n.41.

Defendants assert that Dr. Mizrach "did not conduct a sanity check" of his model "against the real-world data." Mem. against Mizrach at 11. For instance, the model predicts that, in response to sufficient panic in the UST market, UST's trading price would have been negative -- a clear impossibility. But, as the SEC explains, "[s]uch predictions are common in economic modeling and require the application of logic by the economist and the recognition that selling would stop once the price hit zero." SEC Mizrach Opp. at 18. Similarly, defendants note that Dr. Mizrach's model shows Jump's trading to have increased UST's price by $0.62 over a particular half-hour period, when the actual price increased by just $0.03. In defendants' telling, such a difference shows "the utter lack of reliability of Prof. Mizrach's model." Mem. against Mizrach at 13. But a price can be pulled in different directions from different sources. Dr. Mizrach's model is perfectly consistent with the explanation, which he advances, that in the absence of Jump's trading during that period, the price would have been $0.62 lower than it was. In other words, had Jump not made its trades during that period, UST's price would have declined by $0.59 rather than increase by $0.03, as it did.

Finally, defendants urge the Court to exclude any opinions by Dr. Mizrach about UST's later price crash in 2022. But there are no such opinions to exclude. The SEC and Dr. Mizrach are clear that his opinions are only about the May 2021 depeg, not events in 2022. SEC Mizrach Opp. at 19–20. The Court accepts that representation.

***8** At bottom, some of defendants' criticisms are immaterial, and some are legitimate differences of opinion between two bona fide experts. None, however, is a reason to jettison Dr. Mizrach's testimony.

B. Dr. Matthew Edman

[3] The SEC's other expert, Dr. Matthew Edman, is a computer scientist who founded a cybersecurity and investigations firm that specializes in cryptocurrency, cybersecurity, and digital forensic investigations. ECF No. 87-2 ("Edman Rep."), at ¶¶ 2–3. Dr. Edman has authored multiple peer-reviewed research papers about "techniques for cryptographic security and authentication in wireless networks." Id. ¶ 3. After reviewing the source code of Terraform's "LP Server," Dr. Edman concluded that the "primary functionality" of the LP Server software "was to replicate purported Chai user and merchant transactions onto the Terra blockchain." Id. ¶ 11. Moreover, his review revealed, "[t]he purported Chai user transactions occurred within a 'closed system' of Terra blockchain wallet addresses, and so the purported Chai transactions on the Terra blockchain represented transfers between wallet addresses controlled by Terraform Labs rather than the processing and settlement of Chai transactions between Chai users and merchants." Id.

The Court denies defendants' motion to exclude Dr. Edman's testimony.

Defendants' threshold argument is that Dr. Edman "lacks sufficient expertise in financial payment systems or payment processes." ECF No. 97 ("Mem. against Edman"), at 8. But Dr. Edman does not purport to hold such expertise, nor do his conclusions require it of him. Dr. Edman is a computer scientist who draws conclusions about the Terraform blockchain by examining the source code of a server and its programming. Such analysis and conclusions are well within Dr. Edman's bailiwick. There is no indication that the features of or methods for analyzing source code differ when a financial payment system is involved.

Defendants next contend that Dr. Edman failed to consider sufficient data because he did not "examine each component of the Chai payment system, its data or logs, and the data that was input into the LP Server that resulted in the blockchain transactions." Id. at 11. The rub is that Dr. Edman did not "have enough information to say for certain whether or not the underlying transactions were real." Id. (quoting Edman Dep. 139:25–140:04). But all that meant was that Dr. Edman could not say whether the purported Chai transactions replicated on the Terra blockchain were real Chai transactions that had elsewhere occurred through traditional means of payment or were entirely fake transactions. See Edman Dep. 139:1–14 ("Q. Did any of the information that you did have and did review indicate to you that the purported Chai user merchant transactions were not real? A. Well, the information available to me made clear that they were intended to replicate purported Chai user and merchant transactions. Whether there's a corresponding real world transaction that occurred off of the Terra blockchain, I don't believe I can answer that based on the information that ... was provided."). The answer to that question had no bearing on Dr. Edman's conclusions, nor is it relevant to the ultimate issue of whether defendants fraudulently misrepresented that Chai used the Terraform blockchain to process transactions. Quite aside from the notable fact that the information that defendants criticize Dr. Edman for not considering is information that defendants were unable to produce, ECF No. 136 ("Daubert Hearing Tr."), at 60–61, Dr. Edman was able to reach his conclusions based on the LP Server source code and public blockchain data. Defendants provide no satisfying account of why the information Dr. Edman relied on was insufficient to conclude that the LP Server replicated purported Chai transactions.

***9** Defendants also assert that Dr. Edman's analysis relies on improper speculation about inputs into the LP Server. To the contrary, however, Dr. Edman's analysis is based on his review of the LP Server itself, the "repository" of which contained "scripts" that "use the private keys controlled by the LP Server to create transactions associated with purported merchant user wallets." Edman Dep. 150:9–151:15. That Dr. Edman testified at his deposition that he "would just be speculating" in response to questions from defense counsel about matters he did not analyze and that were outside the scope of his inquiry does not mean that what he did analyze was unreliable.

Defendants also make the puzzling argument that "Dr. Edman's methodology used in forming his opinions fatally lacks any definition of 'processing and settlement' or a framework (let alone an industry-recognized one) for evaluating the meaning of 'processing and settlement' within the Chai payment system." Mem. against Edman at 14. But Dr. Edman did not refer to the "processing and settlement" of payments as a term of art. He "instead was using it to describe that Chai merchants were not being paid by their customers on the Terra blockchain." ECF No. 110 ("SEC Edman Opp."), at 17. It is common parlance to refer to credit card readers or other payment devices as "processing" a payment. And most anyone who has visited a hotel or restaurant has heard reference to "settling" -- in another word, paying -- a bill. Dr. Edman's failure to define those terms in his report will not impede a jury's understanding of his conclusions.

Defendants also argue that Dr. Edman did not reliably apply a proper methodology in concluding that the purported Chai transactions "occurred within a 'closed system' of Terra blockchain wallet addresses." Mem. against Edman at 16. While cast as an argument about methodology, defendants' gripes appear to be mere disagreements with Dr. Edman's categorizations and conclusion. Defendants point to three digital wallet addresses -- out of the more than 2.7 million that Dr. Edman reviewed -- that "were not identified by Dr. Edman as being associated with" Terraform but that made transfers to the LP Server wallet. Id. In his rebuttal report, Dr. Edman explained that "two were associated with Terra blockchain validators operated by Terraform and one appears to be an omnibus wallet on a centralized exchange that received funds from a Terraform wallet address and which Terraform used to send funds to the LP Wallet when it needed to be replenished." SEC Edman Opp. at 21; see ECF No. 87-3 ("Edman Rebuttal Rep."), at ¶¶ 18-29. Defendants describe Dr. Edman's explanation as a silent switch of methodology,

because he previously assessed whether Terraform controlled given digital wallet addresses only by looking to whether Terraform held the "private keys" to those wallet addresses. Defendants' assertion is an overreach. The Court agrees with the SEC that "the three wallet addresses mentioned by [defendants' expert] Mr. Unny do nothing to undermine Dr. Edman's opinion that the LP Server operated a closed system involving millions of supposed Chai merchant and customer wallet addresses," and "even if they did, this is exactly the type of criticism that should be addressed on cross-examination." SEC Edman Opp. at 22.

Lastly, defendants challenge Dr. Edman's conclusions by contending that he failed to account for an alternative explanation that the record provides no evidence to support. Defendants mobilize the opinion of their rebuttal expert, Mr. Raj Unny, that Terraform's control of the digital wallet addresses making and receiving payments on the LP Server is also consistent with Terraform operating the LP Server with "custodial wallets" rather than as a closed system that merely replicates transactions. Mem. against Edman at 18. A "custodial wallet" allows a third party to a transaction to manage assets on behalf of users, so that users need not transfer their crypto assets directly and thus have an added layer of protection. See ECF No. 109-1 ("Unny Rep."), at ¶ 19. For a potentially useful analogy, one might think of a password management system that a person can use to create and store passwords to sign in and out of accounts without having to remember or type in the passwords themselves.

***10** As Dr. Edman explained, "[i]f the LP Server were a 'custodial wallet implementation,' ... [one] would expect to observe deposits to and withdrawals from the supposed Chai user and merchant custodial wallets" at some point. Edman Rebuttal Rep. ¶ 14. Yet, "there are none." Id. Indeed, Mr. Unny testified at his deposition that he saw no evidence on the Terraform blockchain that either Terraform or Chai were providing custodial wallets to Chai customers. Edman Dep. 160:17-161:1. Nor is there any other evidence in the record suggesting as much. There is nothing unreliable about Dr. Edman's failing to credit or discuss an alternative explanation that is nowhere supported by the evidence. [7] Accordingly, Dr. Edman may testify at trial.

C. Dr. Terrence Hendershott

[4] Defendants offer Dr. Terrence Hendershott, a professor of finance at the Haas School of Business at the University of California at Berkeley who focuses on market microstructure, as a rebuttal expert to SEC expert Dr. Mizrach. ECF No. 93-1 ("Hendershott Report"), at ¶¶ 1–2. Dr. Hendershott has "published numerous articles on the structure, design, and regulation of financial markets and how market participants ... affect price discovery and the liquidity of different financial markets." Id. ¶ 3. Dr. Hendershott concludes that "Dr. Mizrach's price impact analysis is conceptually flawed" and cannot "establish[ ] that UST's re-peg would not have happened in the absence of Jump's trading" in May 2021. Id. ¶ 10. In addition, Dr. Hendershott concludes that Dr. Mizrach's price impact analysis is methodologically flawed because it does not distinguish between different types of trades -- such as active versus passive -- and because it uses average trade size rather than Jump's "actual number of net buy trades," leading to "economically nonsensical results." Id. ¶¶ 11–12. The Court denies the SEC's motion to exclude his testimony.

The SEC's primary argument is that Dr. Hendershott's opinions are unreliable because he ignored key factual evidence that Terraform had agreements allowing Jump to acquire LUNA at below-market prices, which gave Jump a strong financial incentive to make trades that pushed UST's price back up to $1.00. ECF No. 93 ("Mem. against Hendershott"), at 6–7. But the SEC fails to explain why it would have been necessary for Dr. Hendershott to consider those agreements for his critiques of Dr. Mizrach's model. By Dr. Mizrach's own description, his model simply assessed whether Jump's trading played a role in moving UST's price back to $1.00 in May 2021. Jump's motive for those trades has no bearing either on Dr. Mizrach's model or on the conceptual and methodological critiques that Dr. Hendershott offers. See ECF No. 104 ("Defs.' Hendershott Opp."), at 2 n.3 ("Prof. Hendershott did not address the agreements about which the SEC complains because the ... methodology employed by Dr. Mizrach did not incorporate any information from those agreements in any way.").

The SEC also contends that Dr. Hendershott should not be permitted to testify regarding the overview in his report "of blockchain technology, as well as the crypto assets and aspects of the Terra ecosystem that relate to his opinions," because he lacks relevant training and experience in these areas. Mem. against Hendershott at 12; see Hendershott Rep. ¶¶ 17-32. But the SEC itself acknowledges that that "[t]his explanation is in service to Dr. Hendershott's analysis of the May 2021 UST depegging." Mem. against Hendershott at 13. Rather than purport to offer opinions about blockchain technology, Dr. Hendershott simply provides context for his

analysis that is helpful to the reader. If, at trial, the SEC disagrees with any of Dr. Hendershott's characterizations, it is free to cross-examine him about them or otherwise rebut them.

D. Mr. Raj Unny

***11** Defendants offer software developer Raj Unny as a rebuttal expert to SEC expert Dr. Edman. Mr. Unny has "been deeply involved in software technologies across a broad spectrum of industries" for 28 years and is the founder and CEO of Indus Finch Group, a Swiss software design and development company. ECF No. 109-1 ("Unny Rep."), at ¶¶ 1–2. He has degrees in computer science and advanced computing. Id. ¶ 7. Mr. Unny has "been involved in several projects that built blockchain applications during the past several years," including developing and launching a cryptocurrency. Id. ¶ 5. Mr. Unny concludes that "Dr. Edman provides insufficient evidence to substantiate his claims and opinions that the 'purported Chai transactions on the Terra blockchain' did 'not represent the actual processing and settlement of real world Chai transactions' and were instead 'transactions generated by the LP Server.' " Id. ¶ 11.

[5] The Court grants the SEC's motion to exclude Mr. Unny's testimony because he has not demonstrated sufficient expertise in blockchain analysis to opine on Dr. Edman's conclusions and, by contrast with Dr. Hendershott's brief excursion into blockchain description to provide context, Mr. Unny's blockchain analysis is central to his opinions here offered. At his deposition, Mr. Unny could not name any specific tools he had used in his professional experience to review blockchain transactions and, even more strikingly, admitted that he did not personally analyze the Terraform blockchain data in this case. See Unny Dep. 9:10–11:6, 11:16–20, 23:23–24:9, 57:11–19. Rather, the analysis discussed in Mr. Unny's report was performed by employees of the consulting firm Cornerstone Research, whose qualifications or methodology Mr. Unny did not know at all. Nor could Mr. Unny even recall which computer program the Cornerstone analysts had used. Unny Dep. 188:2–11.

Defendants retort that Mr. Unny has "substantial experience with building and developing both blockchain applications and payment systems." ECF No. 109 ("Defs.' Unny Opp."), at 7 (emphasis omitted). Yet, as the SEC points out, neither defendants nor Mr. Unny "explain how such experience would allow Mr. Unny to trace and analyze blockchain transactions." ECF No. 118 ("SEC Unny Reply"), at 2. As Mr. Unny acknowledged at his deposition, the projects that defendants reference -- from Mr. Unny's role as Chief Technology Officer at a company called ft.digital Fintech -- were incomplete, had no paying clients, and were never deployed. Id. at 2–3; see Unny Dep. 73:22–74:1 (referring to one project as "an experimental proof of concept").

Moreover, even if Mr. Unny met the threshold level of qualification, the Court would exclude his testimony for the further reason that it is speculative and wholly unsupported by evidence. At his deposition, Mr. Unny testified that the extent of his opinion was that, in addition to Dr. Edman's explanation that the LP Server is a closed system that merely replicated purported Chai transactions, "it's also possible that [the LP Server] is consistent with a custodial wallet system." Unny Dep. 157:7–12. But Mr. Unny disclaimed any opinion that Terraform in fact offered a custodial wallet service. Unny Dep. 169:13–15. Indeed, he acknowledged seeing no evidence on the Terraform blockchain that either Terraform or Chai provided custodial wallet services. Unny Dep. 160:17–161:1 ("Q. Did you see anything on the blockchain that indicated that Terra was custodying crypto assets for its users or merchants? A. No.").

[6] Mr. Unny's conclusion that certain Chai applications "may have interacted with or even directed the LP Server" is similarly conjectural. Unny Rep. ¶ 45. At his deposition, Mr. Unny was unable to explain how any documents or data showed that those Chai applications interacted with the server. See Unny Dep. 116:5–22 ("[A]ll I can do is I can guess from the file names."). Such unsupported, gestural testimony would not aid, and could only mystify, a jury. Because "a trial judge should exclude expert testimony if it is speculative or conjectural," Zerega Ave. Realty Corp. v. Hornbeck Offshore Transp., LLC, 571 F.3d 206, 213-14 (2d Cir. 2009), the Court will not permit Mr. Unny to testify.

E. Dr. Christine Parlour

***12** Defendants' final expert is economist Dr. Christine Parlour, who teaches at the Haas School of Business at the University of California at Berkeley and conducts research on market microstructure and cryptocurrency. ECF No. 94-1 ("Parlour Rep."), at ¶ 1. Dr. Parlour holds a Ph.D. in economics from Queen's University at Kingston. Id. ¶ 3. She has authored a book chapter on cryptocurrencies in the

Handbook of Alternative Finance and has published articles on price dynamics and informed trading in limit order markets (where trades are executed once a particular price is reached). Id. ¶ 4. Dr. Parlour's testimony would "provide an overview of the characteristics and underlying economics of certain tokens on the Terra blockchain" and "discuss whether risks, such as the risk of a de-peg with respect to the TerraUSD [UST] stablecoin, had been discussed by [Terraform], regulators, and other market participants." Id. ¶ 9.

[7] The Court grants the SEC's motion to exclude Dr. Parlour's testimony because it consists of a factual narrative that would not aid a jury. Notwithstanding the language of her report, the SEC correctly points out that "Dr. Parlour does not offer any opinion about how the Terraform crypto assets actually functioned, just how they were 'designed' to work." ECF No. 94 ("Mem. against Parlour"), at 7; see Parlour Dep. 134:9–23 ("Q. So you're not offering any opinions about how UST was actually used, just how it was designed. Is that fair? A. That's fair."). And Dr. Parlour's opinions about the designs of Terraform's crypto assets are largely based on Terraform's own marketing materials. See Parlour Rep. ¶¶ 39-67. Such opinions are, at best, unhelpful to a jury, and at worst, have a serious potential to mislead.

Dr. Parlour's second category of testimony -- whether Terraform, regulators, and market participants discussed the risks of a UST depeg -- is even less defensible as a proper subject of expert opinion. Whether or not certain people were discussing a certain subject is not here relevant, let alone a matter that calls for expert testimony. Moreover, Dr. Parlour did not base her second conclusion on sufficient facts and data. It appears that Dr. Parlour reviewed certain public statements, papers, and communications favorable to defendants' perspective -- that the public was aware of the risk of UST losing its value -- but did not mention a white paper in which Terraform itself downplayed such risk. Yet Dr. Parlour testified at her deposition and at the Daubert hearing that she knew about the white paper, but chose to ignore it because, in her view, it "wasn't relevant" and was "abstruse." Parlour Dep. 201:22–202:10; Daubert Hearing Tr. 16.

Even more problematic is the fact that Dr. Parlour specifically disclaimed performing a comprehensive review of Terraform's or Kwon's Twitter accounts or other public communications. Parlour Dep. 22:11-17 ("Q. Did you make any effort to review the public statements of Terraform Labs before issuing your report? A. I did not do a comprehensive analysis of the statements issued by Terraform Labs when I put together my report."). In other words, Dr. Parlour did not conduct a comprehensive review of the very documents on which the SEC relies to argue that defendants committed fraud by reassuring the public that UST's price was algorithmically stable. And when she was asked at her deposition whether Terraform "ever publicly state[d] that the risk of a depeg was low," her answer was that she did not know. Parlour Dep. 82:15-20.

Nor has Dr. Parlour articulated a reliable methodology to form her conclusions. When asked about any such methodology at her deposition, Dr. Parlour referred only to "the training and experience that [she] got in [her] economics Ph.D." and "the usual economic and general understanding." Parlour Dep. 53:15–23, 54:8–15, 224:11–14. When asked again by the Court at the Daubert hearing, Dr. Parlour explained that she "took" a "long literature" "that basically talks about microeconomics, incentives, how markets work, [and] understanding the relationship between markets" "and then ... put the facts that we know about this new type of business model into that literature just so that it sort of makes sense from an economics and finance point of view." Daubert Hearing Tr. 13-14. This is not remotely the kind of specific methodology that Daubert and Kumho Tire prescribe. Ultimately, the basis for Dr. Parlour's conclusions boils down to her own "ipse dixit," which is plainly insufficient for admission of her testimony under Daubert and Rule 702. Kumho Tire, 526 U.S. at 157, 119 S.Ct. 1167. In sum, the Court excludes Dr. Parlour's testimony because it would place her not in the role of expert, but of narrator — and not even a reliable narrator, at that.

III. Motions for Summary Judgment

A. Offering and Selling Unregistered Securities

1. There is no genuine dispute that UST, LUNA, wLUNA, and MIR are securities because they are investment contracts.

***13** The SEC argues that four of Terraform's crypto assets — UST, LUNA, wLUNA, and MIR — are securities, as defined in Section 2(a)(1) of the Securities Act for the purposes of the federal securities laws, because they are "investment

contract[s].” 15 U.S.C. § 77b(a)(1). Defendants first argue that, even if all the SEC's allegations are credited, those assets are not investment contracts as a matter of law. In the alternative, defendants contest the SEC's assertion that undisputed facts do indeed demonstrate that the crypto assets here at issue are investment contracts.

[8] Defendants' first argument in effect asks this Court to cast aside decades of settled law of the Supreme Court and the Second Circuit. In the seminal decision of SEC v. W.J. Howey Co., 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946), the Supreme Court held in no uncertain terms that “an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.” Id. at 298-99, 66 S.Ct. 1100. Defendants urge this Court to scrap that definition, deeming it “dicta” that is the product of statutory interpretation of a bygone era. [8] The Court declines defendants' invitation. Howey's definition of “investment contract” was and remains a binding statement of the law, not dicta. And even if, in some conceivable reality, the Supreme Court intended the definition to be dicta, that is of no moment because the Second Circuit has likewise adopted the Howey test as the law. [9] See, e.g., Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994).

[9] There is no genuine dispute that the elements of the Howey test — “(i) investment of money (ii) in a common enterprise (iii) with profits to be derived solely from the efforts of others” (id.) — have been met for UST, LUNA, wLUNA, and MIR.

UST. Defendants make much of the fact, undisputed by the SEC, that UST on its own was not a security because purchasers understood that its value would remain stable at $1.00 rather than generate a profit. But, beginning in March 2021, holders of UST could deposit their tokens in the Anchor Protocol, which defendants' efforts developed and which Kwon himself publicly announced would generate “by far the highest stablecoin yield in the market,” with a “target” of “20% fixed APR.” ECF No. 73, Ex. 66; id., Ex. 67. On May 11, 2021, Terraform wrote in a promotional Tweet that the Anchor Protocol would allow “third parties to seamlessly integrate 20% yield on $UST to expand stable savings opportunities to a greater audience.” Id., Ex. 135. A 2020 white paper described Terraform's work on the Anchor Protocol as “an attempt to give the main street investor a single, reliable, rate of return across all blockchains.” Id., Ex. 44 at 2.

***14** Once launched, returns from the Anchor Protocol were indeed paid out in proportion to the amount of UST tokens a person or entity had deposited. Defs.' Response to SEC 56.1 ¶ 80. The Anchor Protocol website stated that “[d]eposited stablecoins are pooled and lent out to borrowers, with accrued interest pro-rata distributed to all depositors.” Id. Terraform promoted in an October 2021 Tweet that it had configured its website to allow deposits of UST into the Anchor Protocol “directly from the Terra Station desktop wallet.” ECF No. 75, Ex. 136. A Terraform manager, Matthew Cantieri, led a team that worked on the Anchor Protocol. Defs.' Response to SEC 56.1 ¶ 83. His responsibilities included the “strategic direction of the protocol, user adoption, making sure that people were accountable for product roadmap items, [and] working with Do [Kwon] and the team on what those products should be.” Id. By May 2022, there were approximately 18.5 billion tokens of UST, 14 billion of which had been deposited in the Anchor Protocol. Id. ¶ 36.

The above undisputed evidence clearly demonstrates that UST in combination with the Anchor Protocol constituted an investment contract. As the Supreme Court has held, it is of no legal consequence that not all holders of UST deposited tokens in the Anchor Protocol, and thus that some holders “ch[o]se not to accept the full offer of an investment contract.” Howey, 328 U.S. at 300, 66 S.Ct. 1100.

LUNA and wLUNA. Defendants' efforts to rebut the evidence that LUNA and wLUNA were securities are even further off the mark. In denying the motion to dismiss, the Court held that, “by alleging that the defendants 'pooled' the proceeds of LUNA purchases together and promised that further investment through these purchases would benefit all LUNA holders, the SEC has adequately pled that the defendants and the investors were joined in a common, profit-seeking enterprise.” ECF No. 51, at 37. Those well-pleaded allegations have now been substantiated with undisputed evidence. [10]

Kwon and others made specific, repeated statements that would lead a reasonable investor in LUNA to expect a profit based on defendants' efforts to further develop the Terraform blockchain. Terraform's business development lead, Jeff Kuan, stated in a 2021 public interview that

"investing in Terra means ... buying LUNA, which is the 'equity' in our co." Response to SEC 56.1 ¶ 63. Terraform's head of communications, Brian Curran, remarked in a June 2021 public interview that "[o]wning LUNA is equivalent to owning a stake in the transaction fees of a network like Visa" because "[a]ll the transaction fees from Terra stablecoins are distributed to LUNA stakers in the form of staking rewards." ECF No. 75, Ex. 107.

[10] In a similar vein, Terraform's Director of Special Projects, SJ Park, stated in a videotaped presentation around the same time that "[o]wning LUNA is essentially owning a stake in the network and a bet that value will continue to accrue over time." Defs.' Response to SEC 56.1 ¶ 63. And Kwon himself wrote in a public Tweet that "$Luna value is actionable — it grows as the [Terraform] ecosystem grows." ECF No. 75, Ex. 108. In Kwon's own words, a holder of LUNA could simply "[s]it back and watch [him] kick ass." Id. In other words, a person could invest their "money in a common enterprise" and be "led to expect profits solely from the efforts of the promoter or a third party," namely, Terraform and Do Kwon himself.[11] Howey, 328 U.S. at 299, 66 S.Ct. 1100. Indeed, the price of LUNA increased from under $1.00 in January 2021 to a high of over $119 in April 2022, before plummeting to under a penny in May 2022. ECF No. 75, Ex. 125.

***15** MIR. Finally, the evidence shows beyond dispute that MIR was a security for similar reasons. "[T]he proceeds from sales of the MIR tokens were 'pooled together' to improve the Mirror Protocol," and "[p]rofits derived from the use of the Mirror Protocol ... were fed back to investors based on the size of their investment." ECF No. 51, at 37. Terraform described MIR as a "governance token that earns fees from asset trades" on the Mirror Protocol that Terraform launched. Defs.' Response to SEC 56.1 ¶¶ 38, 101; ECF No. 73, Ex. 80. A Terraform press release at the launch of the Mirror Protocol touted that "[b]y adding the Mirror governance token -- MIR -- to liquidity pools, MIR holders can earn 0.25% from trading fees." ECF No. 73, Ex. 80. Although Terraform labeled "the protocol [as] decentralized," it explained that "the team behind Terra contributed most of the core development work behind the Mirror." Id. Kwon himself sent promotional materials to a potential MIR purchaser, including a spreadsheet with a revenue projection table estimating how the price of MIR would increase as a result of greater usage of the Mirror Protocol. ECF No. 75, Ex. 148.

Terraform also described to potential investors its efforts to strengthen the Mirror Protocol, such as "deploying its UST reserves to make the markets for mAssets for the first year of the protocol," building the Mirror Protocol website and hiring a firm to audit Terraform's code for doing so, and publishing "dashboards" showing the Mirror Protocol's growth. Defs.' Response to SEC 56.1 ¶¶ 102, 103, 107. In a public question-and-answer session, Terraform's Community Lead, Aayush Gupta, stated on behalf of Terraform that the company was "very upbeat on our marketing campaign" and was "doing [its] best with its global suite of talent and organizing stuff like trading competitions and referral campaign to increase visibility for Mirror." Id. ¶ 108. In an April 2021 interview, Terraform's head of communications, Brian Curran, stated that Terraform intended to launch a "V2" of the Mirror Protocol, which would bring "several major improvements," and that Terraform planned to expand the Mirror Protocol "beyond SE Asia and the typical US market." Id. ¶ 109. Terraform employed a "product manager" for the Mirror Protocol and retained an administrative key to provide software updates to it. Id. ¶ 111. Terraform used proceeds from the sale of MIR, which it pooled, "to make payments for services, salary, and operations." ECF No. 77, at ¶ 25; see id. at ¶¶ 29-32.

In light of all this, defendants cannot meaningfully dispute that they led holders of MIR to expect profit from a common enterprise based on Terraform's efforts to develop, maintain, and grow the Mirror Protocol -- in other words, that MIR passes the Howey test with flying colors.

2. There is no genuine dispute that defendants offered and sold unregistered securities, in violation of Sections 5(a) and 5(c) of the Securities Act.

[11] The Court grants summary judgment to the SEC on Count IV of the Amended Complaint because defendants offered and sold unregistered securities, in violation of Sections 5(a) and 5(c) of the Securities Act. In particular, defendants offered and sold LUNA and MIR in unregistered transactions.

[12] "Section 5 requires that securities be registered with the SEC before any person may sell or offer to sell such securities." SEC v. Cavanagh, 445 F.3d 105, 111 (2d Cir. 2006). Section 5(a) covers unregistered sales and Section 5(c) covers unregistered offers. See 15 U.S.C. § 77e(a), (c).

To prove liability under Section 5, the SEC must show "(1) lack of a registration statement as to the subject securities; (2) the offer or sale of the securities; and (3) the use of interstate transportation or communication and the mails in connection with the offer or sale." Cavanagh, 445 F.3d at 111 n.13. Only the second element is contested here.

Terraform sold LUNA tokens directly to institutional investors through sales agreements that expressly contemplated Terraform's development of a secondary market. Defs.' Response to SEC 56.1 ¶¶ 117–19. The terms of those agreements provided a built-in incentive for secondary resale because Terraform sold LUNA to initial investors at discounts of up to, and sometimes more than, 40%. Id. ¶ 119. In a fundraising update in December 2018, Terraform co-founder Daniel Shin wrote that Terraform had "begun exchange listing discussions given token listing is a precondition for [the] Terra/Luna ecosystem to operate." Id. ¶ 121. Similarly, as Terraform provided loans of tens of millions of LUNA tokens to trading firm Jump, Kwon announced Terraform's expectation that Jump would "improve liquidity of LUNA in secondary trading markets." Id. ¶ 126. Kwon stated that, before Jump's involvement, LUNA's liquidity had been "rather lackluster partly due to our team's inexperience with secondary markets & trading operations." Id.

***16** Terraform's offers and sales of MIR were similar. A Terraform subsidiary sold MIR tokens directly to purchasers through "Simple Agreements for Farmed Tokens," or SAFTs. Id. ¶ 135. Those agreements did not restrict purchasers from reselling their MIR tokens in secondary trading markets or to U.S. investors. Id. ¶ 136. Terraform also loaned up to 4 million MIR tokens to Jump, in an agreement that expressly required Jump to trade MIR tokens on crypto asset trading platforms and to provide Terraform with reports of its trading. Id. ¶ 138. Terraform also sold both LUNA and MIR tokens to secondary market purchasers on Binance and other crypto trading exchanges. Id. ¶ 142. The record provides no evidence that Terraform took steps to determine whether those trading platforms were available to U.S. investors. Id. ¶ 143.

[13] Defendants argue that even if LUNA and MIR were securities, they were exempt from registration. But "[o]nce a prima facie case" of Section 5 liability "has been made, the defendant bears the burden of proving the applicability of an exemption." Cavanagh, 445 F.3d at 111 n.13. Defendants have not carried that burden here.

[14] Defendants contend that their distributions of LUNA and MIR were not public offerings because they only sold directly to sophisticated investors. See ECF No. 100 ("Defs.' Mem."), at 25–27; SEC v. Ralston Purina Co., 346 U.S. 119, 125, 73 S.Ct. 981, 97 L.Ed. 1494 ("An offering to those who are shown to be able to fend for themselves is a transaction 'not involving any public offering.' "). But to avail themselves of that exemption, defendants would need to also show that they "intended" the LUNA and MIR tokens "to come to rest with" those sophisticated investors. SEC v. Telegram Grp. Inc., 448 F. Supp. 3d 352, 380 (S.D.N.Y. 2020). The natural problem for defendants is that "securities do not come to rest with investors who intend a further distribution." Id. at 380. Terraform's own repeated statements about developing a liquid secondary market for LUNA, and its express requirement that Jump trade MIR on exchanges -- and even that Jump provide reports to Terraform about that secondary trading -- make plain that neither Terraform nor its institutional investors had any intent to simply hold onto LUNA or MIR without further trades. It is immaterial that the vesting period in certain sales agreements "precluded immediate resale" or "that LUNA was not listed on any trading platform at the time of the purchases" by those institutional investors. Defs.' Mem. at 25.

[15] Defendants also argue that certain sales agreements for LUNA were exempt from registration under Regulation S, which states that Section 5's reference to offers and sales refers only to those "that occur within the United States." 17 C.F.R. § 230.901. But defendants point to no evidence -- as they must, given that they bear the burden of proof on this exemption -- showing that they reasonably believed "at the commencement of the offering" that there was "no substantial U.S. market interest" or that they took any steps to prevent resale of LUNA and MIR into the U.S. market. Id. § 230.903. Conjecture that "if a purchaser intended to sell its LUNA, it could have done so without violating Section 5 by selling on any of several foreign platforms under Regulation S's exemption," is not evidence that purchasers limited their resales to foreign exchanges or that Terraform believed purchasers did so. Defs.' Mem at 25-26.

The SEC is thus entitled to summary judgment of liability on Count IV of the Amended Complaint for defendants' unregistered offers and sales of LUNA and MIR. The SEC's motion for summary judgment made no mention of potential remedies, which will be determined once the question of liability has been resolved for all claims.

3. As a matter of law, defendants did not offer or effect transactions in security-based swaps.

***17** **[16]** The Court grants summary judgment for defendants on Counts V and VI of the Amended Complaint, alleging that defendants offered unregistered security-based swaps to non-eligible contract participants, in violation of Section 5(e) of the Securities Act, and effected transactions in security-based swaps with non-eligible contract participants, in violation of Section 6(*l*) of the Exchange Act. Although the SEC makes no argument that an mAsset is itself a security, see ECF No. 142 ("Summary Judgment Arg. Tr."), at 6 (counsel for the SEC conceding the point), the SEC asserts that by creating and maintaining the Mirror Protocol through which others could mint mAssets, defendants offered and effected transactions in security-based swaps. The Court holds, however, that an mAsset does not meet the statutory definition of a security-based swap.

The Commodity Exchange Act defines a "swap" as "any agreement, contract, or transaction ... that provides on an executory basis for the exchange ... of 1 or more payments based on the value or level of 1 or more ... securities ... and that transfers, as between the parties to the transaction, in whole or in part, the financial risk associated with a future change in any such value or level without also conveying a current or future direct or indirect ownership interest in an asset." 7 U.S.C. § 1a(47)(A)(iii). A "security-based swap" is such a swap that, as relevant here, "is based on ... a single security." 15 U.S.C. § 78c(a)(68).

The Mirror Protocol's mAssets satisfy most -- but not all -- of the definition's requirements. A user who mints or purchases an mAsset through the Mirror Protocol indeed exchanges a payment based on the value of some underlying reference security, such as a share of Apple. Defs.' Response to SEC 56.1 ¶¶ 112–14. And the user does so without receiving any ownership interest in the underlying security. Id. But, crucially, there is no transfer of financial risk involved here. Whenever the price of an underlying security increases above the user's initial payment, or collateral, for the mAsset, the user is required to deposit additional collateral to meet the higher price. Id. ¶ 114. In other words, a user cannot profit from holding an mAsset because his deposit must always exceed the value of the underlying reference security. If the user fails to deposit sufficient additional collateral, the mAsset will be lost. Id. ¶ 114.

As a result, there is no evidence in the record showing how a holder of an mAsset transfers any "financial risk associated with a future change" in the value of a security to or from a counterparty in a transaction. 7 U.S.C. § 1a(47)(A)(iii). Rather, the holder bears all the risk for himself. The SEC nevertheless waves its hand and contends "that the financial risk is actually being transferred to the investor, to the one minting the asset." Summary Judgment Arg. Tr. 13. But the fact that the minter of an mAsset bears financial risk from his own choice to deposit collateral, which could lead to the loss of that collateral, does not mean that any of that risk was "transfer[red]" to him by a counterparty in a transaction. 7 U.S.C. § 1a(47)(A)(iii). Instead, the minter holds the risk all along. As a result, because mAssets are not security-based swaps, the Court grants summary judgment for defendants dismissing Counts V and VI of the Amended Complaint.

B. Fraud

[17] **[18]** Unlike the claims involving offering or selling unregistered securities or security-based swaps, which the Court has resolved as a matter of law, genuine disputes of material fact linger that preclude summary judgment for any party on the fraud claims. Much of the SEC's evidence of scienter for its two fraud allegations -- regarding the UST depeg and Chai's use of the Terraform blockchain, respectively -- comes from third-party whistleblowers whose credibility is critical and whose testimony is subject to numerous challenges that are best resolved at trial. "Credibility determinations, the weighing of the evidence, and the drawing of legitimate inferences from the facts are jury functions, not those of a judge." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 255, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). Moreover, defendants have shown that there is a genuine dispute whether a reasonable investor would have found the statements involving the UST depeg and Chai to be materially misleading. "Determination of materiality under the securities laws is a mixed question of law and fact that the Supreme Court has identified as especially well suited for jury determination." United States v. Litvak, 808 F.3d 160, 175 (2d Cir. 2015).

***18** The SEC pursues its fraud claims under Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act, including the latter's companion Rule 10b-5. Section 17(a) makes it "unlawful for any person in the offer or sale of any securities ... by the use of any means or instruments of transportation or communication in interstate commerce ... (1) to employ any device, scheme, or artifice to defraud; or (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." 15 U.S.C. § 77q(a).

Similarly, Section 10(b) of the Exchange Act makes it unlawful "[t]o use or employ, in connection with the purchase or sale of any security[,] ... any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe." 15 U.S.C. § 78j(b). One such regulation prescribed by the SEC under Section 10(b) is Rule 10b-5, which makes it "unlawful for any person, directly, or indirectly, by the use of any means or instrumentality of interstate commerce ... (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5.

"Rule 10b-5 and Section 17(a), which largely mirror each other, both consist of a 'misstatement subsection' that is sandwiched between two 'scheme subsections.' " SEC v. Rio Tinto plc, 41 F.4th 47, 49 (2d Cir. 2022); see SEC v. Sason, 433 F. Supp. 3d 496, 508 (S.D.N.Y. 2020) ("Exchange Act § 10(b), Rule 10b-5(a) and (c), and Securities Act § 17(a)(1) and (3) create what courts have called scheme liability for those who, with scienter, engage in deceitful conduct.").

[19] **[20]** **[21]** **[22]** Here, the SEC pursues both standalone misstatement liability and scheme liability. To demonstrate scheme liability, "the SEC must [prove] that defendants: (1) committed a deceptive or manipulative act; (2) in furtherance of the alleged scheme to defraud; (3) with scienter." Id. at 508-09. "[M]isstatements and omissions alone" are not "sufficient to constitute a scheme." Rio Tinto, 41 F.4th at 54. While "misstatements and omissions can form part of a scheme liability claim, ... an actionable scheme liability claim also requires something beyond misstatements and omissions, such as dissemination." Id. at 49. The requisite scienter is intent to defraud or recklessness for each of the scheme liability provisions except Section 17(a)(3), for which "[a] showing of negligence is sufficient." SEC v. Ginder, 752 F.3d 569, 574 (2d Cir. 2014); see Sason, 433 F. Supp. 3d at 509.

The SEC contends that "Kwon was the primary architect of the scheme to mislead investors into believing that Chai was processing and settling transactions on the Terra blockchain, when it was not." ECF No. 71 ("SEC Mem."), at 42. As part of that scheme, according to the SEC, "[d]efendants made and disseminated countless misrepresentations to investors, potential investors, and the public that Chai was processing and settling transactions on the Terra blockchain." Id. at 43. Similarly, the SEC advances a separate scheme wherein "Kwon, on behalf of Terraform, engaged in deceptive conduct when he secretly made a deal with Jump to step in and restore the $1 peg [of UST] in exchange for modifying the terms of an agreement for LUNA tokens." Id. Central to that scheme was that, in the SEC's view, "Kwon and Terraform ... made and disseminated numerous false and misleading statements to investors, potential investors, and the public suggesting that the algorithm alone had caused UST's repeg." Id.

***19** **[23]** **[24]** **[25]** The SEC also presses for liability on a standalone basis, under Section 10(b) and Rule 10b-5(b), as well as Section 17(a)(2), for defendants' materially misleading statements. To establish such liability, "the SEC must prove that the defendant[s] (1) made one or more misstatements of material fact, or omitted to state one or more material facts that the defendants had a duty to disclose; (2) with scienter; (3) in connection with the purchase or sale of securities." SEC v. Thompson, 238 F. Supp. 3d 575, 591 (S.D.N.Y. 2017).[12] The required scienter is again "intent to deceive, manipulate, or defraud" or "reckless disregard for the truth" for Section 10(b) and Rule 10b-5(b). SEC v. Frohling, 851 F.3d 132, 136 (2d Cir. 2016). But, like its neighbor Section 17(a)(3), Section 17(a)(2) can be met with "[a] showing of negligence." Ginder, 752 F.3d at 574.

1. UST's May 2021 Depeg

The SEC's evidence that defendants engaged in a scheme to deceive investors about UST's $1.00 peg, by secretly arranging for Jump to make bulk purchases of UST to drive the price back up to $1.00, is compelling but circumstantial, relying in large part on the testimony of Jump whistleblowers whose credibility the jury will need to determine. There is undisputed evidence that on May 23, 2021, after UST's price had fallen below $1.00, Kwon communicated multiple times with a Jump executive. Defs.' Response to SEC 56.1 ¶ 210. And it is also undisputed that Jump purchased additional shares of UST at various points that day. See ECF No. 123 ("Defs. Opp."), at 29. But those facts alone do not show any secret agreement, and the rest of the SEC's evidence, while damning, does not foreclose a genuine dispute of material fact about the alleged deceptive conduct or related potential misstatements.

The SEC's best evidence of a scheme with Jump comes from text messages between Jeff Kuan, Terraform's business development lead, and Brian Curran, the company's head of communications.[13] In discussing the May 2021 depeg, Curran wrote to Kuan, "Do [Kwon] said if Jump hadn't stepped in we actually might've been fucked lol." ECF No. 76, Ex. 275. Kuan responded, "yeah i know they saved our ass." Id. In another set of texts between Curran and Kuan discussing the depeg, on May 23, 2021, Kuan wrote to Curran, "Do just randomly called me ... [W]e're speaking to jump about a solution." Id. at 23. Curran added, "Spoke with Do, we're gonna deploy $250 million from stability reserve through Jump to stabilize the peg." Id. Curran followed up just over 20 minutes later, "Jump has already started buying ... May not need entire $250 million." Id. A day later, Terraform's official Twitter account posted, "Terra's not going anywhere ... $1 parity on UST already recovered." Id. at 33. Those messages may prove difficult for defendants to explain away, but a reasonable jury could find that they and other circumstantial evidence do not add up to a fraudulent scheme to deceive investors.

In a sworn declaration, an SEC whistleblower ("CW-1") states that he worked at Jump in May 2021 and participated in a Zoom meeting on or about May 23, 2021, in which Jump officers were present. ECF No. 88 ("CW-1 Decl."), ¶¶ 2–12. In that meeting, CW-1 heard the executive tell Jump's co-founder, "I spoke to Do and he's going to vest us." Id. ¶ 12. Before that statement, Jump's co-founder had told CW-1 "that Terraform had made a deal with Jump to promote the adoption of UST." Id. ¶ 13. Later on or about May 23, 2021, CW-1 saw and heard Jump's co-founder direct traders "to adjust the parameters of the [Jump] trading models to control the price, quantity, and timing of UST orders." Id. ¶ 14. CW-1 saw automated alerts about Jump's UST trading. Id. CW-1 also heard Jump's co-founder say that "he was willing for Jump to risk about $200 million to help restore the peg." Id. ¶ 16. In the aftermath, once UST's price returned to $1.00 a few days later, CW-1 "heard [Jump's co-founder] provide general feedback to the Jump Crypto trading team on the sale of UST, for example, advising them not to cause another depeg by selling too quickly." Id. ¶ 18. Jump's co-founder and the other implicated Jump executive refused to answer a single substantive question at their depositions, invoking their Fifth Amendment rights. Defs.' Response to SEC 56.1 ¶ 211.

***20** **[26]** **[27]** **[28]** Defendants categorize nearly all of the above statements from CW-1's declaration as inadmissible hearsay, because they are all statements of other Jump employees that the SEC seeks to offer for their truth. While that argument is not without force, the Court holds that the above statements are admissible under Federal Rule of Evidence 804(b)(3) as statements against interest.[14] Statements suggesting Jump's, and those individuals', participation in a secret agreement to restore UST's peg would tend to expose those individuals "to civil or criminal liability." Fed. R. Evid. 804(b)(3)(A). Indeed, the Jump executives invoked their Fifth Amendment rights rather than answer any questions about those statements at their depositions. And because they have done so, they are unavailable declarants. See United States v. Miller, 954 F.3d 551, 561 (2d Cir. 2020) ("When a witness properly invokes his Fifth Amendment right against self-incrimination, he is unavailable for the purposes of Rule 804(a)."). Moreover, the Court agrees with the SEC that "contemporaneous statements by Jump executives concerning the capital Jump was willing to risk and what Terraform was offering in return, together with changes in Jump's trading practices, tend to show the state of mind of Jump executives -- specifically, their intent, motive, and plan to conspire with Terraform to restore UST's peg." SEC Reply at 4. Such statements are thus likewise admissible under Federal Rule of Evidence 803(3).[15]

The fact that such statements are admissible, however, does not mean that they show beyond dispute that Terraform engaged Jump in a scheme to maintain UST's peg. The evidence remains subject to a determination of CW-1's credibility, which must be made by a jury. Moreover, even if CW-1 may testify about what he heard, any inferences about

what those statements meant and what they suggest about defendants' intent are likewise in the ken of a jury.

The SEC also submitted declarations from Keone Hon, another former Jump employee, and Brandon Ackley, a current member of "ownership entities within Jump Trading Group" and former employee of Jump Operations LLC. ECF No. 90 ("Ackley Decl."), at ¶ 1; see ECF No. 91 ("Hon Decl."). Both declarations state that Jump indeed made trades of UST on May 23, 2021. For instance, Hon wrote that "[s]ometime over the weekend of May 22, 2021, ... [he] was instructed to purchase UST for Jump Trading" even though he "was not responsible for trading crypto assets" at that time. Hon Decl. ¶¶ 6, 8. But other parts of the declaration lack proper foundation and are vague and speculative. E.g., id. ¶ 9 ("I believe, other Jump Crypto team members were also purchasing UST."). Moreover, Hon's declaration itself creates a genuine dispute about whether the implicated Jump executive stated during the May 23 Zoom meeting that Kwon "was going to vest" Jump. Hon joined that Zoom meeting and makes no mention of such a statement. See id. ¶ 8. And, even if admissible, the Ackley declaration also contains facts that a reasonable jury could take to support defendants' position -- that for much of the day on May 23, Jump made no manual purchases of UST and that Jump "primarily ... traded UST through automated strategies." Ackley Decl. ¶¶ 12–14. In any event, the admissibility of Ackley's declaration is questionable because he concedes that it "is not based on [his] personal knowledge." Id. ¶ 2. The Court will need to make any decision about the admissibility of Ackley's testimony at trial in the context of a live record and more information about its basis.

***21** Even assuming arguendo that a jury credits all of the above evidence in the SEC's favor, an agreement with Jump to defend UST's peg is only fraudulent if a reasonable investor would have been materially misled. For evidence of such deception, the SEC points to what it contends were defendants' misstatements, which are relevant to both the scheme liability and standalone misstatement liability theories of fraud.

Once more, the evidence is compelling but susceptible of skepticism by a reasonable jury. In a public message posted on Twitter on May 24, 2021, Terraform wrote that "Assets (LUNA) and liabilities (UST) maintain parity by the Terra protocol acting as a market maker, inflating the LUNA supply during UST contractions and deflating the LUNA supply during UST expansions." Defs.' Response to SEC 56.1 ¶ 222. Other public Terraform Twitter messages that day referred to the "algorithmic, calibrated adjustments of economic parameters" as preferable to "stress-induced decision-making of human agents in [a] time of market volatility." Id. Terraform described UST as the "lynchpin for the entire ecosystem" and categorized the depeg as a "black swan" event that was "as intense of a stress test in live conditions as can ever be expected." Id.

Defendants genuinely dispute the significance of that evidence. In their reading, "the lynchpin statement in its full context is about the demand for UST not the reliability of UST, and is used when comparing UST to other stablecoins." Id. Similarly, defendants insist that "the black swan comment in context stated that the circumstances created as extreme of an event and stress test based on enumerated stresses identified in the cited evidence but not included for context [by the SEC], including drawn down price in LUNA, UST peg deviation, and collateral effects across the ecosystem." Id.

The SEC's most direct evidence of a misstatement to investors was a comment by Kwon during a March 1, 2022 Twitter talk show. In discussing the May 2021 depeg, Kwon stated that "it took a few days for the slippage cost to naturally heal back to spot. So that's another feature of the market module where when the exchange rate has deviated from the peg, the protocol automatically self-heals the exchange rate back to whatever the spot price is being quoted by the oracle. So that's why it took several days for the peg to recover." Id. ¶ 224. But defendants contend "that when the interview with Mr. Kwon is read in context, it is clear that Mr. Kwon was discussing the speed at which the mint-burn mechanism -- which itself depends on human intervention by those who use the mechanism -- 'heals' the exchange rate in times of high slippage cost." Id.

Whether to credit the SEC's interpretation or defendants' interpretation of the statements at issue, or whether any distinction between those interpretations would have been material to a reasonable investor, is a question for a jury, not for the Court. [16]

2. Chai's Use of the Terraform Blockchain

There is also a genuine dispute about whether Chai indeed used Terraform's blockchain to process and settle transactions with crypto assets in addition to traditional payment methods. Defendants argue, with considerable force, that direct evidence of how Chai's data processing system works would

require review of Chai's source code "or logs, data, or records from operation of the Chai System." Defs.' Mem at 30–31. Such evidence is not available because it was never produced by Chai, a Korean corporation, and is not accessible to defendants. Moreover, for summary judgment purposes, the SEC does not rely on -- or even mention -- the testimony of Dr. Mathew Edman, its computer science expert who concluded based on a review of the source code of a Terraform server that the blockchain was merely replicating purported Chai transactions that did not occur on the blockchain itself.

***22** Defendants assert that Chai did use Terraform's blockchain and contend that the SEC's circumstantial evidence does not show otherwise. The evidence, which consists mainly of vague messages that a jury will need to interpret and weigh, is such that a reasonable jury could find either way. In a May 9, 2019 message with Terraform co-founder Daniel Shin, Kwon wrote, "i can just create fake transactions that look real ... which will generate fees ... and we can wind that down as chai grows." ECF No. 76, Ex. 245. Shin responded, "Wouldn't people find out it's fake?" Id. Kwon replied, "All the power to those that can prove it[']s fake because I will try my best to make it indiscernable." Id. Shin followed up, "Well let's test in small scale and see what happens." Id.

Defendants genuinely dispute the meaning of those messages, which were from before Chai began operations. According to defendants, "[a]t that time, members of the Terraform network were publicly discussing the launch of 'Project Santa,' an endeavor to generate transactions to subsidize staking rewards for the purpose of ensuring the security of the nascent Terra ecosystem." Defs.' Response to SEC 56.1 ¶ 187. A jury will need to decide whether those messages, when read in context, are referring to planning fake Chai transactions on the Terraform blockchain or, as defendants' argue, to an altogether different project.

Other messages are similarly open to interpretation. In a September 2020 internal message, Terraform employee Nicolas Andreoulis asks another Terraform employee, Paul Kim, whether "we have a list of all the wallets associated with Chai (merchants + customers)." Id. ¶ 195. Kim responds yes, and says that there are "1297041" wallets "so far haha." Id. According to the SEC, Kim created an internal Terraform server, the LP Server, to merely replicate Chai transactions. The SEC contends that certain messages between Terraform personnel, including Kim and Kwon, show that Terraform was merely moving its own assets from one digital wallet it controlled, to another digital wallet it controlled. In a December 11, 2019 message, Kim wrote, "[d]ue to changes in the LP server, we will make transactions." Id. ¶ 196. Kwon responded by telling Kim to "request KRT funding from CJ," Terraform's Chief Financial Officer.[17] Id. Kwon asked Kim, "[a]fter 14 days, the coins automatically return to the lp server, right?" Id. In an April 21, 2020 chat with another Terraform engineer, Kim writes that "it might be better to just put money back into the merchant wallet in reverse." Id. ¶ 197. Defendants dispute the significance of that message, noting that "in context, Paul Kim is inquiring about 'a transaction from a user to a user' that 'looks strange,' and if [a] particular address is 'a user wallet' because he does not 'fully understand' the issue yet." Id. Indeed, Kim continued, "seems like a case of negative transactions," where "if the merchant's balance becomes zero, there's an issue where cancellations become impossible." Id.

In other sets of messages, the SEC makes much of the word "mirror" used by different Terraform employees to describe the relationship between the blockchain and Chai transactions. In an August 20, 2020 message thread between Terraform employees and a vendor, a Terraform employee asked about a series of blockchain transactions in which "[i]t seems that every block or 2, the same addresses pass funds between themselves." Id. ¶ 199. Another employee, who had been involved in developing the LP Server, responded, "[w]e currently mirror all the actual transactions between user, chai, and merchant accounts." Id. Similarly, in an October 9, 2020 internal chat, a Terraform engineer asked Paul Kim, "can you quickly explain me what's the role of lp-server?" Id. ¶ 200. Kim responded that the "lp-server creates multisend transactions by receiving transaction information from Chai," adding "[i]n short: it basically replicates chai transactions." Id. The engineer replied, "ahhh yes ok, this is mirroring chai traffic on chain kinda," and Kim said, "yes." Id. In a February 28, 2022 internal message, another Terraform employee made a reference to "Chai tx mirroring." Id.

***23** Defendants genuinely dispute what Terraform employees meant by "mirroring." For instance, defendants contend that, when read in context, the October 2020 discussion of mirroring "refers to the fact that the LP Server was not executing transactions" during an outage, but that when the server began functioning again, "48 transfers were recorded on the blockchain." Id. In another message on October 9, 2020, Terraform engineer William Chen wrote to a Terraform communications employee, "we don't want to say stuff about LP server too much ... it breaks the perception that

chai depends on Terra ... Basically chai doesn't need Terra to work ... It's what copies chai's transactions from their data base to create tx activity." Id. ¶ 201. Defendants dispute the foundation for and meaning of Chen's message, because Chen testified at his deposition that he did not work on the LP Server, did not review any LP Server code, and was never told by anyone at Terraform to make such a statement. Id.

The SEC has also submitted the declaration of another whistleblower ("CW-2"), who served as a Chai executive. According to CW-2, each of Chai's "three main business lines (Chai e-wallet, Chai card, and I'mport) involved traditional payment processes of bank accounts, credit cards, and debit cards -- all using fiat currency." ECF No. 78 ("CW-2 Decl."), ¶ 34. CW-2 asserts that with one exception -- the "limited use of KRT top-ups," which allowed Chai customers "to use Terraform crypto assets to fund their Chai e-wallets" -- "Chai did not use the blockchain at all" and "did not execute or settle transactions on Terraform's blockchain." Id. ¶¶ 37–38.

But defendants argue that "CW-2 ... was fired by Chai and attempted to extort Daniel Shin and Do Kwon ... while leaving the company." Defs.' Opp. at 1. Defendants also contend that CW-2's story has shifted over time. For instance, in a recorded conversation with Chai's head of engineering for the Chai e-wallet, CW-2 stated that he did not "have any understanding of the Chai side." Id. at 22 (citing Defs.' Response to SEC 56.1 ¶ 151). And at his deposition, CW-2 stated that his knowledge was based on statements from other Chai employees. CW-2 Dep. 197:7–12. In his declaration, however, CW-2 stated that he personally "had access to an administrative console through which [he] could see how transactions using Chai's e-wallet were settled." CW-2 Decl. ¶ 32. Even assuming all of CW-2's testimony is admissible, a jury has reason to question his credibility or view his testimony as lesser in weight.

[29] **[30]** Of course, the jury will not be asked to determine all the elements of the fraud claims. In particular, the Court's foregoing rulings as to which of the defendants' products are securities will remain binding on the jury, and the jury will be so instructed. But because a reasonable jury could find for either the SEC or for defendants on other elements of the fraud claims, including scienter and materiality, the Court denies both cross-motions for summary judgment on those claims. [18]

C. Due Process

***24** On September 29, 2023, the Court ordered that Kwon, who remains incarcerated in Montenegro for an unrelated offense but may be extradited to face criminal charges in the United States, could not submit a declaration in connection with summary judgment if the Montenegrin authorities did not make him available for a deposition by the close of discovery. See ECF No. 61. The Montenegrin authorities did not so oblige, and Kwon thus did not submit a declaration. Kwon now argues that granting summary judgment for the SEC in the absence of such a declaration violates his Fifth Amendment right to procedural due process. That argument wins credit for color, but that is all.

[31] **[32]** Kwon relies on the Supreme Court's elaboration of procedural due process in Mathews v. Eldridge, 424 U.S. 319, 96 S.Ct. 893, 47 L.Ed.2d 18 (1976). But that very case demonstrates that Kwon's procedural due process rights have been satisfied here. "Due process is flexible and calls for such procedural protections as the particular situation demands." Id. at 334, 96 S.Ct. 893. Identifying "the specific dictates of due process generally requires consideration of three distinct factors: First, the private interest that will be affected by the official action; second, the risk of an erroneous deprivation of such interest through the procedures used, and the probative value, if any, of additional or substitute procedural safeguards; and finally, the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail." Id. at 335, 96 S.Ct. 893.

[33] Applying that three-part balancing test here, it is clear that procedural due process does not require that Kwon be able to submit a self-serving declaration with no opportunity for cross-examination. While Kwon's interest in saying his piece in his own words is not insignificant, Kwon has been able to actively litigate this case through counsel with whom he is in contact. The risk of an erroneous deprivation of his property interests in this civil suit, simply because he could not submit a declaration, is slight, if it exists at all. The evidence in this case is voluminous -- and plenty of it consists of documents and public statements made by Kwon himself. Kwon's counsel has been able, throughout their papers, to provide rebuttals and counter-explanations of that documentary evidence, and they have done so capably.

Indeed, Kwon's counsel has shown that despite the force of that evidence, genuine disputes of material fact preclude summary judgment against him or Terraform on the fraud claims. Finally, the Government's interest firmly counsels against allowing as evidence a statement from a defendant, who has otherwise been involved in the litigation, without the ventilation of a vigorous cross-examination. Accordingly, Kwon's procedural due process rights pose no barrier to the entry of summary judgment against him, which the Court has granted on Count IV.

IV. Conclusion

For the reasons stated above, the Court denies defendants' motions to exclude the testimony of the SEC's experts, Dr. Bruce Mizrach and Dr. Matthew Edman; denies the SEC's motion to exclude the testimony of defense expert Dr. Terrence Hendershott; grants the SEC's motion to exclude the testimony of defense experts Mr. Raj Unny and Dr. Christine Parlour; grants summary judgment for the SEC on Count IV of the Amended Complaint, involving defendants' unregistered offers and sales of LUNA and MIR in violation of Sections 5(a) and (5c) of the Securities Act; grants summary judgment for defendants on Counts V and VI of the Amended Complaint, involving the alleged unregistered offers of and transactions in security-based swaps; and denies both sides' cross-motions for summary judgment on the remaining claims (Counts I-III) of fraud. The Clerk is respectfully directed to close document 71 on the docket of this case.

***25** As previously and firmly scheduled, the jury trial of the remaining claims in this case will commence at 9:30am on Monday, January 29, 2024. However, to accommodate other cases before other judges, the selection of the jury to hear the case will occur at 10:00am on the prior Wednesday, January 24, 2024.

SO ORDERED.

All Citations

--- F.Supp.3d ----, 2023 WL 8944860, Fed. Sec. L. Rep. P 101,738

Footnotes

1 Citations to a particular paragraph in either side's response to the other side's Local Rule 56.1 statement of facts include the content of both the initial Local Rule 56.1 statement and the response.

2 In December 2020, Terraform launched a platform allowing LUNA holders to create a "wrapped" version of LUNA, named wLUNA, that could be traded on non-Terraform blockchains but was otherwise identical to LUNA. Defs.' Response to SEC 56.1 ¶ 42.

3 Importantly, neither side relies on its experts in connection with the motions for summary judgment. However, because the Court denies both sides' motions for summary judgment on the fraud claims, the Court's resolution of the Rule 702 motions will affect what can be offered as expert testimony at the forthcoming trial of those claims.

4 The quoted language includes some small changes that took effect on December 1, 2023, but the Court's decision would be identical under both the old and the new versions.

5 Here and elsewhere, internal alterations, citations, and quotation marks have been omitted unless otherwise indicated.

6 "Directional trading refers to strategies based on the investor's view of the future direction of the market." Investopedia, Directional Trading: Overview, Example, Types (May 23, 2022). By contrast, non-directional trading strategies -- such as purchasing both a call and put option of the same asset — can allow an investor to profit regardless of the future direction of the market.

7 Defendants also argue that Dr. Edman improperly opines about intent. But Dr. Edman's opinions are about software, not the state of mind of any individuals or any broader assessments of corporate strategy.

8 Defendants made other arguments at the motion to dismiss stage, similarly seeking to avoid the application of Howey's test to determine whether their crypto assets are securities. The Court rejected those arguments, which involved the major questions doctrine, due process, and the Administrative Procedure Act. See ECF No. 51, at 18-29. Although the legal argument defendants now newly make was equally available at that earlier stage of this litigation, the SEC does not contend that the argument has been waived or forfeited, so the Court carries on to the merits of it.

9 Defendants' argument that the Supreme Court conducts statutory interpretation differently nowadays, and thus would not today independently reach the same holding it did in Howey, is no more persuasive even if the premise is credited arguendo. The Supreme Court has cautioned that "other courts should [not] conclude that [its] more recent cases have, by implication, overruled an earlier precedent." Agostini v. Felton, 521 U.S. 203, 237, 117 S.Ct. 1997, 138 L.Ed.2d 391 (1997). When a Supreme Court precedent "has direct application in a case," as Howey does here, this Court must follow it, even if it "appears to rest on reasons rejected in some other line of decisions." Id. In any event, neither the Supreme Court nor the Second Circuit has ever suggested that Howey rests on a shaky foundation.

10 As the Court explained in its opinion denying the motion to dismiss, the analysis of LUNA applies equally to wLUNA. See ECF No. 51, at 37 ("[T]he wLUNA investors were just a variation on this theme since wLUNA tokens could be exchanged for LUNA tokens."); see also Defs.' Response to SEC 56.1 ¶ 42.

11 Defendants challenge as inadmissible the declaration of Donald Hong, the SEC's summary witness who reviewed Terraform's financial records to show that the funds from LUNA purchases were indeed pooled. Defendants argue that Hong's declaration is a last-minute, back-door expert report because he states that "the evidence reflects that defendants pooled investor funds into wallet addresses, crypto trading platform accounts, and bank accounts they controlled and used those funds to make payments for business expenses." ECF No. 123 ("Defs.' Opp."), at 7. But a witness providing "a summary of the relevant financial records" is not supplying expert testimony under Federal Rule of Evidence 702. United States v. Lebedev, 932 F.3d 40, 50 (2d Cir. 2019), abrogated on other grounds, Ciminelli v. United States, 598 U.S. 306, 143 S.Ct. 1121, 215 L.Ed.2d 294 (2023). And, as the SEC points out, "Hong's summary is even more mechanical than the analyses approved as summary testimony in Lebedev ..., which relied on accounting methodologies." ECF No. 127 ("SEC Reply"), at 8; see also Fed. R. Evid. 1006 (allowing summary testimony).

12 Section 17(a)(2) contains the more specific requirement that a defendant "obtain money or property by means of" such a misstatement or omission. 15 U.S.C. § 77q(a)(2). Defendants contest that this requirement is met. Because the Court denies summary judgment on the issue of whether there were any such misstatements or omissions, the Court does not reach whether the additional "by means of" element has been satisfied.

13 Defendants object to such messages on hearsay grounds, but when introduced by the SEC, they are admissible statements of a party-opponent under Federal Rule of Evidence 801(d)(2)(A) and (D).

14 The Court does not foreclose any other potential objections defendants may raise to those statements, should they be offered at trial.

15 The SEC also contends that such statements are admissible non-hearsay as statements by Terraform's coconspirator "during and in furtherance of the conspiracy" to inflate UST's price through a secret agreement.

Fed. R. Evid. 801(d)(2)(E). To admit the statements on that basis, the Court must determine by a preponderance of the evidence "(a) that there was a conspiracy, (b) that its members included the declarant and the party against whom the statement is offered, and (c) that the statement was made during the course of and in furtherance of the conspiracy." United States v. James, 712 F.3d 79, 105 (2d Cir. 2013). Although the Court could make such a finding based on the record, it need not do so at this pre-trial stage, given the other routes to admission of the statements.

16 Although the SEC has submitted a handful of investor declarations to make its case about what a reasonable investor would have understood, those cannot compel a jury to reach the same conclusion.

17 KRT is another Terraform crypto asset, a stablecoin that is tied to the value of the Korean won.

18 In addition to primary liability, Count III of the Amended Complaint alleges that Kwon is liable for the fraudulent misstatements as a control person of Terraform under Section 20(a) of the Exchange Act. To prevail on "a claim of control person liability under § 20(a), a plaintiff must show (1) a primary violation by the controlled person, (2) control of the primary violator by the defendant, and (3) that the defendant was, in some meaningful sense, a culpable participant in the controlled person's fraud." Carpenters Pension Tr. Fund v. Barclays PLC, 750 F.3d 227, 236 (2d Cir. 2014). Because the Court denies summary judgment on the claims for primary fraud liability, the Court likewise denies summary judgment for either party on Count III. There is no genuine dispute, however, that Kwon is a control person of Terraform under the relevant standard, and the jury will be so instructed. Many of the allegedly fraudulent statements are attributed to him directly and it is undisputed that he was the founder, CEO, and 92% owner of Terraform. Defs.' Response to SEC 56.1 ¶ 17.

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, -v.- COINBASE, INC. and COINBASE GLOBAL, INC., Defendants.	23 Civ. 4738 (KPF) **OPINION AND ORDER**

KATHERINE POLK FAILLA, District Judge:

The United States Securities and Exchange Commission (the "SEC" or the "Commission") brings this enforcement action against Coinbase, Inc. ("Coinbase") and Coinbase Global, Inc. ("CGI") (collectively, "Defendants"), alleging that Coinbase intermediated transactions in crypto-asset securities on its trading platform and through related services, all in violation of the federal securities laws.

At first blush, the addition of the prefix "crypto" to a commonly understood word like "asset" may suggest a paradigm shift. And, indeed, it is the putative differences between crypto-assets and their more traditional counterparts that animate Defendants' arguments. It is undisputed, for instance, that Coinbase provides a platform and other services that allow customers to transact in hundreds (and in one instance, thousands) of different crypto-assets. It is also undisputed that Coinbase offers these services without registering with the SEC as a securities exchange, broker, or clearing agency. Coinbase reasons that the transactions executed and facilitated through its platform and related services do not qualify as

"securities," and thus fall outside the scope of the SEC's delegated authority. The SEC disagrees, and counters that at least some of the transactions on Coinbase's platform and through related services constitute "investment contracts," which the federal securities laws have long recognized as securities. The parties readily acknowledge that the viability of this enforcement action hinges on this difference of opinion.

Defendants have moved for judgment on the pleadings pursuant to Federal Rule of Civil Procedure 12(c). Having now carefully considered the parties' arguments, as well as the many *amicus curiae* submissions in this case,[1] the Court concludes that because the well-pleaded allegations of the Complaint plausibly support the SEC's claim that Coinbase operated as an unregistered intermediary of securities, Defendants' motion must be denied in large part. As explained herein, the "crypto" nomenclature may be of recent vintage, but the challenged transactions fall comfortably within the framework that courts have used to identify securities for nearly eighty years. Further, the Court finds that the SEC adequately alleges that Coinbase, through its Staking Program, engaged in the unregistered offer and sale of securities. However, the Court agrees with Defendants that they are entitled to dismissal of the claim that Coinbase acts as an unregistered broker by making its Wallet application available to customers.

[1] It is not undue flattery to note that the parties, as well as the *amici*, have articulated the strongest and most cogent arguments for their respective positions, and the Court takes this opportunity to thank all sides for the intellectual rigor evident from their briefing and oral argument presentations.

BACKGROUND[2]

A. Factual Background

1. The Parties

a. The Securities and Exchange Commission and the Regulation of the Securities Markets

The contemporary framework for the regulation of the U.S. securities markets began with the enactment of the Securities Act of 1933 (the "Securities Act"), Pub. L. 73-22, 48 Stat. 74, and the Securities Exchange Act of 1934 (the "Exchange Act"), Pub. L. 73-291, 48 Stat. 881. With the Great Depression ongoing, and the stock market crash of 1929 still top of mind, Congress sought to protect investors in the U.S. capital markets by regulating the offer and sale of securities, theretofore regulated exclusively by the states. With the Securities Act, Congress sought to "protect investors by requiring publication of material information thought necessary to allow them to make informed investment decisions concerning public offerings of securities in interstate commerce." *Pinter* v. *Dahl*, 486 U.S. 622, 638 (1988) (collecting cases). In the Exchange Act, enacted one year later, Congress focused on the oversight of securities through registration and regulation of certain participants in the

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[2] This Opinion draws its facts from the Complaint ("Compl." (Dkt. #1)), the well-pleaded allegations of which are taken as true for purposes of this Opinion. *See Ashcroft* v. *Iqbal*, 556 U.S. 662, 678 (2009).

For ease of reference, the Court refers to Defendants' answer to the Complaint as the "Answer" (Dkt. #22); to Defendants' memorandum of law in support of their motion for judgment on the pleadings as "Def. Br." (Dkt. #36); to the SEC's memorandum of law in opposition to Defendants' motion as "SEC Opp." (Dkt. #69); and to Defendants' reply memorandum of law as "Def. Reply" (Dkt. #83).

securities market, as a means to "insure the maintenance of fair and honest markets in [securities] transactions." 15 U.S.C. § 78b.

Of central importance to the instant case, Section 2(1) of the Securities Act defines the term "security" to include:

> 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, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, 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.

15 U.S.C. § 77b(a)(1). This definition "include[s] the commonly known documents traded for speculation or investment," such as stock and bonds. *SEC.* v. *W.J. Howey Co.*, 328 U.S. 293, 297 (1946). "This definition also includes 'securities' of a more variable character, designated by such descriptive terms as 'certificate of interest or participation in any profit-sharing agreement,' 'investment contract' and 'in general, any interest or instrument commonly known as a 'security.'" *Id.* As discussed in greater detail below, the Supreme Court has further interpreted the meaning of the term "investment contract" to implicate transactions "involv[ing] an investment of money in a

common enterprise with profits to come solely from the efforts of others." *Id.* at 301.

Whereas the Securities Act was concerned with the designation and regulation of securities, the Exchange Act focused on the regulation of transactions in such securities in the secondary market. To that end, the Exchange Act established the SEC and "delegate[d] to [it] broad authority to regulate … securities." *SEC* v. *Alpine Sec. Corp.*, 308 F. Supp. 3d 775, 790 (S.D.N.Y. 2018). The statute also set forth a comprehensive regulatory regime designed to, among other things, protect investors from manipulation and fraud, ensure that securities orders were handled fairly and transparently, and make certain that securities transactions resulted in settlement finality. (Compl. ¶¶ 39, 43).[3] As part of this regulatory regime, Congress imposed registration requirements on certain defined participants in the national securities markets, including but not limited to exchanges, brokers, and clearing agencies. (*Id.* ¶ 22). Regulated entities were subject to certain disclosure, recordkeeping, inspection, and anti-conflict-of-interest provisions. (*Id.* ¶ 2).

b. Coinbase and CGI

Defendant Coinbase is currently the largest crypto-asset trading platform in the United States, servicing over 108 million customers, accounting for billions of dollars in daily trading volume in hundreds of crypto-assets.

[3] Here, the Securities Act clarified the reach of the SEC's regulatory authority, by defining what sorts of assets could be considered "securities" and, therefore, what sorts of market participants could be subject to SEC enforcement. *See* 15 U.S.C. § 77b.

(Compl. ¶ 1). In April 2014, Coinbase became a wholly-owned subsidiary of CGI, as part of the latter's efforts to become a public company. (*Id.* ¶ 15). Further to that end, on February 25, 2021, CGI publicly filed with the SEC a Form S-1 registering an initial offering of its Class A Common Stock. (*Id.* ¶ 111). Since April 2021, Coinbase has been a publicly traded company. (*Id.*).

2. Crypto-Assets Generally[4]

The focus of the SEC's charges — and the core of Coinbase's business — involves the mode of exchange known as cryptocurrency. Also referred to as

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[4] Background information about crypto-assets and the broader crypto industry is also set forth in numerous opinions from courts in this Circuit, including, *e.g.*, *Williams* v. *Binance*, — F.4th —, No. 22-972, 2024 WL 995568, at *1-3 (2d Cir. Mar. 8, 2024); *Risley* v. *Universal Navigation Inc.*, — F. Supp. 3d —, No. 22 Civ. 2780 (KPF), 2023 WL 5609200, at *2-9 (S.D.N.Y. Aug. 29, 2023); *SEC* v. *Terraform Labs Pte. Ltd.*, — F. Supp. 3d —, No. 23 Civ. 1346 (JSR), 2023 WL 4858299, at *1-4 (S.D.N.Y. July 31, 2023) ("*Terraform I*"); and *Underwood* v. *Coinbase Glob., Inc.*, 654 F. Supp. 3d 224, 230-32 (S.D.N.Y. 2023).

A word is in order about the term "ecosystem," which is used in different ways to describe aspects of the crypto industry. In its macro or broadest sense, the crypto "ecosystem" comprises all of the participants in the industry, and has been defined to include:

> issuers (that create or "mint" crypto assets), crypto asset service providers such as exchanges (that facilitate the exchange of crypto assets but can also offer lending and investment services), wallet providers (that store crypto assets and can also be the transfer function), validators or miners (that ensure a consistent, honest, and true ledger), underlying technology (the [distributed ledger technology "DLT"] on which crypto assets are deployed), and regulated financial institutions (that might have exposures to crypto assets). Crypto asset service providers are also carrying out multiple activities, for example, facilitating the exchange of crypto assets, storing client's crypto assets, providing lending and leverage services to the users, offering transfer services, and clearing and settlement for off-chain transactions.

Arma Bains, Arif Ismail, Fabiana Melo, and Nobuyasu Sugimoto, *Regulating the Crypto Ecosystem: The Case of Unbacked Crypto Assets* 15 (2022), https://www.imf.org/en/Publications/fintech-notes/Issues/2022/09/26/Regulating-the-Crypto-Ecosystem-The-Case-of-Unbacked-Crypto-Assets-523715; *see also* Bank for International Settlements, *The crypto ecosystem: key elements and risks* (July 2023), https://www.bis.org/publ/othp72.pdf; U.S. Dep't of Treasury, *Crypto-Assets:*

"crypto-assets," "tokens," or "coins," these digital assets are computer code entries on "blockchain" technology that record their owners' rights to access applications or services on a network. (Compl. ¶¶ 44-45). A blockchain is a database spread across a network of computers that utilizes a complex software protocol to track every transaction on that network, providing a decentralized ledger that operates as a record of the ownership and transfer of all tokens in that network. (*Id.*). Each blockchain has its own "native token," *i.e.*, a digital asset designed to interact directly with the blockchain and ensure the proper function of the blockchain's protocol. (*Id.* ¶ 46).

Implications for Consumers, Investors, and Businesses, Sept. 2022, https://home.treasury.gov/system/files/136/CryptoAsset_EO5.pdf.

In a more micro sense, the term "ecosystem" has been used by participants in the crypto industry to describe a collection of interrelated components, often involved in or implicated by the development of a crypto-asset. *See, e.g.*, *SEC* v. *Kik Interactive Inc.*, 492 F. Supp. 3d 169, 180 (S.D.N.Y. 2020) ("[W]ithout the promised digital ecosystem, [the cryptocurrency] would be worthless … [it has] no inherent value and will generate no profit absent an ecosystem that drives demand."). These components typically include: (i) the blockchain, which provides the infrastructure that allows the ecosystem to function and also allows for the creation of a token to use as currency to access that ecosystem; (ii) the protocols, which govern the operation of the blockchain, or some subset of transactions on the blockchain; (iii) the decentralized applications (or "dApps") that are constructed using the protocols; and (iv) the business platforms that build commercial projects on top of these other layers. *See* Hayden M. Baker, *Tales from the Crypt: The Securities Law Implications of Initial Coin Offerings and a Framework for a Compliant ICO*, 46 No. 4 SEC. REG. L.J. Art. 1 (2018); Shawn S. Amuial, Josias N. Dewey, and Jeffrey R. Seul, *Existing protocols — Ethereum*, THE BLOCKCHAIN: A GUIDE FOR LEGAL & BUSINESS PROFESSIONALS § 3:4 (2016); *see also, e.g.*, *Patterson* v. *Jump Trading LLC*, — F. Supp. 3d —, No. 22 Civ. 3600 (PCP), 2024 WL 49055, at *1 (N.D. Cal. Jan. 4, 2024); *Terraform I*, 2023 WL 4858299, at *1-3; *Friel* v. *Dapper Labs, Inc.*, 657 F. Supp. 3d 422, 426-27 (S.D.N.Y. 2023); *Tari Labs, LLC* v. *Lightning Labs, Inc.*, No. 22 Civ. 7789 (WHO), 2023 WL 2480739, at *1-2 (N.D. Cal. Mar. 13, 2023).

In the instant Complaint, the SEC uses the term "ecosystem" in its narrower sense, to refer to the coordinated enterprises contemplated by the issuers and promoters of the thirteen crypto-assets at issue here. (*See, e.g.*, Compl. ¶ 134). This Court uses the term similarly in its analysis of whether transactions in these crypto-assets qualify as "securities" under the federal securities laws.

Critically important to a crypto-asset owner's exercise of control over her crypto-assets are the "public key" and "private key" associated with a crypto-asset, which keys permit the user to effectuate transactions on the associated blockchain. (Compl. ¶ 47). Owners typically store these keys on a piece of hardware or software known as a "crypto wallet." (*Id.*). The wallets, in turn, use both a public key and a private key. The public key is colloquially known as the user's blockchain "address" and can be freely shared with others. (*Id.*). The private key is analogous to a password and confers the ability to transfer a crypto-asset. (*Id.*).

3. The Crypto-Asset Market

Crypto-assets are created and maintained by developers (also sometimes referred to as "issuers" or "promoters"), often as sources of funding for the developer's underlying venture, even if the assets have some other nominal purpose. Thus, once a crypto-asset is created, it is typically first offered and sold by its developer to institutional investors in capital-raising events, including so-called "initial coin offerings" or "ICOs." (Compl. ¶ 51). ICOs are generally executed via a combination of direct placements, initial exchange offerings, and simple agreements for future tokens ("SAFTs"). (*See, e.g.*, *id.* ¶ 129). In some instances, developers may release a "whitepaper" or other marketing materials describing a project to which the asset relates, the terms of the offering, and any rights associated with the asset. (*Id.* ¶ 51).

In the second phase of offerings, developers typically sell their crypto-assets into the secondary market. (*See, e.g.*, Compl. ¶ 131). Indeed, to

increase the demand for and value of their tokens, and correspondingly to drive secondary trading, crypto-asset issuers often list their tokens on trading platforms — like the Coinbase Platform discussed *infra* — and promote the token's blockchain to retail investors well after the initial coin offering.

Developers must expend considerable efforts to list their crypto-asset on a trading platform. For a crypto-asset to be listed on the Coinbase Platform, for instance, a developer must complete a "listing application," which requires it to provide detailed information about its crypto-asset and blockchain projects. (Compl. ¶ 105). Coinbase's "Listings Team" then works closely with the developer to identify potential roadblocks to the asset's listing. (*Id.* ¶ 109). Coinbase's "Digital Asset Support Committee" ultimately reviews the relevant characteristics of the asset and decides whether to list it on the platform. (*Id.* ¶ 72).

As the number and variety of crypto-assets continue to proliferate — today, there are over 25,000 digital assets in circulation (Answer ¶ 22) — third-party trading platforms have emerged to accommodate the market for transactions in those assets. At their core, trading platforms allow customers to purchase and sell crypto-assets in exchange for either fiat currency or other crypto-assets. (Compl. ¶ 54). Given the increasing size of these markets, trading platforms also offer a variety of more specialized services, including brokerage, trading, and settlement services. (*Id.* ¶ 53).

4. Coinbase's Operations

Coinbase operates one such trading platform (the "Coinbase Platform") through which U.S. customers can buy, sell, and trade crypto-assets. (Compl. ¶¶ 1, 15). Launched in 2012, the Coinbase Platform originally began as a single-asset platform that allowed "anyone, anywhere [to] be able to easily and securely send and receive Bitcoin." (*Id.* ¶ 62). Today, the Coinbase Platform has evolved into an expansive online trading platform that — according to Coinbase's website — allows customers to "buy, sell, and spend crypto on the world's most trusted crypto exchange." (*Id.* ¶ 87). In April 2021, Coinbase made available approximately 55 crypto-assets for trading on the Coinbase Platform; by March 2023, that number had expanded to approximately 254 assets. (*Id.* ¶ 68). Whereas the original platform operated as a mechanism for users to send and receive Bitcoin, the crypto-assets currently on the Coinbase Platform may be bought, sold, or traded for consideration, including U.S. dollars, other fiat currencies, or other crypto-assets. (*Id.* ¶ 115). There are neither restrictions on the number of tokens that a customer may purchase, nor restrictions on the transferability or resale of tokens. (*Id.* ¶¶ 122-123).

In addition to the Coinbase Platform, Coinbase offers several other services. Three services in particular are implicated by the instant enforcement action; they are summarized here, and discussed in greater detail later in the Opinion.[5]

[5] The Court does not address Coinbase's "Asset Hub" service — the specifics of which are contested by the parties — in this Opinion. (*See* Transcript of Oral Argument held on January 17, 2024 ("Jan. 17, 2024 Tr." (Dkt. #101)) at 11:3-12:5).

a. Prime

Since at least May 2021, Coinbase has offered "Prime," a service that institutional customers can use to execute secondary-market transactions at scale. (Compl. ¶ 63). Prime routes orders not only through Coinbase's exchange, but also through third-party platforms, thereby providing customers with what Coinbase describes as "access [to] the broader crypto marketplace rather than relying solely on prices from Coinbase's exchange." (*Id.*). Trades conducted through Prime therefore allow users to execute large-volume trades more effectively across a broader array of digital asset markets. (*Id.* ¶¶ 63, 81).

b. Wallet

Since 2017, Coinbase has made available to both retail and institutional customers a self-custodial "digital wallet," called Coinbase Wallet, or simply "Wallet." (Compl. ¶ 64). Wallet enables customers to store and access their crypto-assets on their own computers or mobile devices. (*Id.* ¶ 47). While crypto wallets generally offer only the ability to store the owner's private key securely, Wallet interlinks with third-party platforms to facilitate transactions. Through Wallet, customers can connect to third-party "decentralized" trading platforms (often referred to as "decentralized exchanges" or "DEXs") to access liquidity outside the Coinbase Platform. (*Id.* ¶ 64). These third-party platforms make possible the sending, receiving, and swapping of crypto-assets, among other decentralized application functions, without using intermediaries like Coinbase. (*Id.*). Unlike with orders placed on the Coinbase Platform or

through the Prime application, Coinbase does not maintain custody over the assets traded through Wallet. (*Id.*).

c. Staking

Since 2019, Coinbase has offered and sold a crypto-asset staking program (the "Staking Program") that allows customers to earn financial returns with respect to certain blockchain protocols. (Compl. ¶ 7). Through the Staking Program, participants' crypto-assets are transferred (without loss of ownership), pooled by Coinbase, and subsequently "staked" (or committed) by Coinbase in exchange for rewards, which Coinbase distributes *pro rata* to participants after deducting for itself a 25% or 35% commission. (*Id.* ¶¶ 7, 310).

5. Coinbase's Challenged Conduct

As alleged, the Coinbase Platform merges three functions that are typically separated in traditional securities markets — that of broker, exchange, and clearing agency. (Compl. ¶ 1). For the purposes of the instant motion, Coinbase does not dispute this characterization (with the exception of the Wallet application).

Specifically, the SEC claims that through the Coinbase Platform, as well as the Prime and Wallet applications, Coinbase operates as: (i) an unregistered broker, including by "soliciting potential investors, handling customer funds and assets, and charging transaction-based fees"; (ii) an unregistered exchange, including by "providing a market place that, among other things, brings together orders of multiple buyers and sellers of crypto assets and

matches and executes those orders"; and (iii) an unregistered clearing agency, including by "holding its customers' assets in Coinbase-controlled wallets and settling its customers' transactions by debiting and crediting the relevant accounts." (Compl. ¶ 3).

In support of its claim that Coinbase acts like a traditional securities intermediary, the SEC alleges that Coinbase regularly solicits customers by advertising on its website and social media (Compl. ¶ 75); expends hundreds of millions of dollars each year on marketing and sales efforts to maintain and recruit new investors (*id.* ¶ 78); and facilitates trading in crypto-assets by assisting customers in opening and using trading accounts, handling customer funds and crypto-assets, and routing and handling customer orders (*id.* ¶ 75). According to the SEC, Coinbase also "holds and controls" customers' funds and crypto-assets,[6] provides services that enable customers to place various types of buy and sell orders that can execute immediately, settles customer trades, and charges fees for trades executed through its platform. (*Id.* ¶¶ 83, 100, 101).

In addition, the Coinbase Platform displays promotional and market information relevant for trading crypto-assets, akin to traditional securities platforms. (Compl. ¶ 87). For example, the Coinbase "Trading Page" provides customers with the current and historical prices of each crypto-asset, the

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[6] Coinbase requires that customers seeking to buy, sell, or trade through the Coinbase Platform and Prime create an account on coinbase.com and transfer their crypto-assets or fiat currency to Coinbase. (Compl. ¶ 83). Once assets are transferred to Coinbase, Coinbase credits the customer account with the corresponding amounts in Coinbase's internal ledger. (*Id.*).

traded volume for that asset over the preceding 24-hour period, and the circulating supply of the crypto-asset. (*Id.* ¶ 91). Coinbase customers can also access asset-specific pages from the "Explore" page on Coinbase's website. (*Id.* ¶ 121). The information on those pages is typically provided by the crypto-asset's promoter or developer, and includes, among other things: links to the persons who created and launched the token; links to any "whitepaper" for the token's original or ongoing sales; links to the website associated with the token and its developers; a compendium of public statements (including on social media) about the token by its developers or creators; information regarding popularity of the token; historical pricing information; and "detailed instructions" on "how to buy" the token via the Coinbase Platform. (*Id.*).

6. The 13 Crypto-Assets at Issue

The SEC alleges that Coinbase, through the Coinbase Platform, as well as the Prime and Wallet applications, made available for trading certain crypto-assets that are offered and sold as investment contracts, and thus as securities. (Compl. ¶¶ 102, 114). These include, but are not limited to, 13 crypto-assets with the trading symbols SOL, ADA, MATIC, FIL, SAND, AXS, CHZ, FLOW, ICP, NEAR, VGX, DASH, and NEXO (together, the "Crypto-Assets"). (*Id.* ¶ 114). With the exception of NEXO (which is available only via Wallet), all of the Crypto-Assets are available for purchase by any person who creates an account with Coinbase. (*Id.* ¶ 119).

The parties do not dispute that, to prevail on its claims, the SEC need only establish that at least one of these 13 Crypto-Assets is being offered and

sold as a security, and that Coinbase has intermediated transactions relating therewith, such that transacting in that Crypto-Asset would amount to operating an unregistered exchange, broker, or clearing agency. (Compl. ¶ 125). Therefore, by way of illustration, the Court focuses on the SEC's factual allegations regarding two of the exemplar Crypto-Assets in this case: SOL and CHZ.

a. SOL

"SOL" is a Crypto-Asset that is the native token of the Solana blockchain. (Compl. ¶ 127). The Solana blockchain was created by Solana Labs, Inc. ("Solana Labs"), a Delaware corporation founded in 2018 and headquartered in San Francisco. (*Id.*). According to Solana's website, the Solana blockchain "is a network upon which decentralized apps ('dApps') can be built, and is comprised of a platform that aims to improve blockchain scalability and achieve high transaction speeds by using a combination of consensus mechanisms." (*Id.*).

To raise capital, Solana Labs conducted a series of initial offerings of SOL to institutional investors. (Compl. ¶ 129). Between May 2018 and early March 2020, initial investors were provided with "sale and issuances rights to receive [SOL] tokens in the future via a Simple Agreement for Future Tokens (SAFTs)." (*Id.*). Through these offers and sales, Solana sold approximately 177 million SOL, raising over $23 million. (*Id.*). Later in March 2020, Solana Labs conducted additional SOL sales on the CoinList trading platform in a "Dutch auction," wherein investors placed bids and the entire offering occurred at the

price with the highest number of bidders. (*Id.* ¶ 130). During this offering, Solana Labs sold approximately 8 million SOL at an average price of $0.22 per SOL, raising approximately $1.76 million. (*Id.*). In August 2021, Solana Labs completed another, purportedly private sale of SOL, raising over $314 million from investors, each of whom paid for SOL with fiat currency and was required to sign a purchase agreement. (*Id.*).

Beginning in February 2020, Solana Labs took steps to make SOL available on the secondary market. (Compl. ¶ 131). To that end, on or about September 17, 2020, SOL became listed on FTX.US and Binance, two then-prominent U.S. exchanges, the fact of which listing Solana publicly announced in posts on its social media account. (*Id.*). In particular, in a September 17, 2020 Twitter post, Solana Labs stated: "The Solana community in the United States has been eagerly awaiting the chance to trade SOL on a U.S. exchange, and now that day has come. SOL/USDT, SOL/USD, and SOL/BTC pairs are all open for trading on @ftx_us." (*Id.*). In another Twitter post later the same day, Solana Labs stated: "@BinanceUS announces Support for SOL, making it the Second US Exchange to list SOL within one day." (*Id.*). SOL has been available for buying, selling, and trading on the Coinbase Platform since approximately June 2021. (*Id.* ¶ 132).

Since the initial offering of SOL, Solana Labs has stated publicly that it would pool proceeds from its private and public SOL sales to "fund the development, operations, and marketing efforts with respect to the Solana blockchain in order to attract more users to that blockchain." (Compl. ¶ 134).

Solana Labs has publicized their promotional efforts to increase participation in its network — and thus demand for SOL — by, among other things, creating a Solana podcast that frequently features interviews with Solana management, a YouTube channel with over 37,000 subscribers, and numerous other promotional channels on platforms such as Twitter, Reddit, GitHub, Telegram, and Discord. (*Id.* ¶ 138).

Promotional statements made in these fora have noted Solana Labs' expertise in developing its blockchain. For example, a July 28, 2019 post on Solana Labs' Medium blog stated that the "Solana team — comprised of pioneering technologists from [several high-profile technology companies] — has focused on building the tech required for Solana to function with these groundbreaking performance standards." (Compl. ¶ 139).

Solana Labs allocated certain percentages of tokens in the initial offering to the company's founders, thereby suggesting that they, too, have a stake in SOL's success. (Compl. ¶ 135). As Solana Labs publicly stated, of the 500 million SOL tokens initially minted, 12.5% were allocated to Solana Labs' founders, and another 12.5% were allocated to the Solana Foundation, a non-profit organization "dedicated to the decentralization, growth, and security of the Solana network." (*Id.*). On April 8, 2020, Solana Labs transferred 167 million SOL tokens to the Solana Foundation, in an effort to further "expand[] and develop[] the ecosystem of the Solana protocol." (*Id.*).

Solana Labs has also emphasized that it exercises control over the supply of SOL by "burning" (or destroying) SOL tokens as part of a

"deflationary model" to reduce the total supply and thereby maintain a healthy SOL price. (Compl. ¶ 140). As explained on the Solana website, since the Solana network was launched, the "Total Current Supply" of SOL "has been reduced by the burning of transaction fees and a planned token reduction event." (*Id.*).

All of these inducements, the SEC argues, led SOL holders "reasonably to view SOL as an investment in and expect to profit from Solana Labs' efforts to grow the Solana protocol," which, in turn, would increase the demand for and the value of SOL. (Compl. ¶ 133).

b. CHZ

Another exemplar Crypto-Asset — "CHZ" (or Chiliz) — is a token on the Ethereum blockchain, advertised as the "native digital token for the Chiliz sports & entertainment ecosystem currently powering Socios.com," a sports fan engagement platform built on the Chiliz blockchain. (Compl. ¶ 213). The CHZ protocol is described by the Chiliz whitepaper as "a platform where fans get a direct Vote in their favorite sports organizations, connect and help fund new sports and e[-]sports entities." (*Id.*). The CHZ token purportedly allows "fans to acquire branded Fan Tokens from any team or organization partnered with the Socios.com platform and enact their voting rights as their fan influencers." (*Id.* ¶ 214). Examples of voting polls that allow holders of "Fan Tokens" (purchased with CHZ tokens) to influence team decisions with their vote include selecting player warm-up apparel and choosing team pennant designs. (*Id.*).

Similar to Solana Labs, in 2018, the Chiliz team engaged in capital raising events through initial private offerings of CHZ tokens, raising approximately $66 million in exchange for approximately 3 billion CHZ in "Chiliz's Token Generation Event." (Compl. ¶ 215). Since the initial offering, the Chiliz team has marketed its efforts to drive secondary trading of CHZ by offering the token on secondary exchanges, including the Coinbase Platform. (*Id.* ¶¶ 216, 228). For example, an earlier version of the Chiliz whitepaper highlighted "ongoing discussions" to offer CHZ on trading platforms across Asia, while the Chiliz website features a "Listing Content and Q&A" document reflecting a proposal to offer CHZ on the Binance DEX platform. (*Id.* ¶ 228).

Like Solana Labs, the Chiliz team stated publicly that it would pool proceeds from CHZ sales to fund the development, marketing, business operations, and growth of the Chiliz protocol and, consequently, to increase the demand for CHZ in connection with the protocol. (Compl. ¶ 220). For instance, the whitepaper explains that a "majority of funds will be passed on from the Issuer [Chiliz] to an affiliate to develop the Socios.com platform, secure partnerships & realize the platform's digital infrastructure." (*Id.*). The paper also states that "funds will be used to acquire new users for the Socios.com platform and grow engagement." (*Id.*).

The Chiliz team advertised its ability to grow its platform by partnering with more sports and e-sports teams, and, in turn, grow the value of CHZ. (Compl. ¶ 225). For example, the FAQ section located on the Chiliz website provided: "Demand for the Chiliz token will increase as more e[-]sports teams,

leagues[,] and game titles are added to the platform, and as more fans want voting rights." (*Id.* ¶ 226).

The Chiliz team also touted its technical and entrepreneurial expertise in developing blockchain. The Chiliz website has introduced the Chiliz team, which operates both the Chiliz protocol and Socios.com, as "comprised of nearly 350+ cross-industry professionals across 27 different nationalities and is constantly growing." (Compl. ¶ 218). The whitepaper and other public statements by Chiliz also have identified several members of the Chiliz leadership teams and their past entrepreneurial and technology experiences and successes. (*Id.* ¶ 219).

Further, the Chiliz team marketed that certain percentages of CHZ tokens would be held by the company's management. 5% and 3% of the total CHZ tokens distributed were allocated to the Chiliz team and an advisory board, respectively — the two groups responsible for the creation and development of the network. (Compl. ¶ 221). Finally, like Solana Labs, the Chiliz team also has told investors that it engages in "burning" CHZ tokens to reduce their total supply as a mechanism to support the price of CHZ. (*Id.* ¶ 229).

As with SOL, the SEC alleges that these representations led CHZ holders reasonably to view CHZ as an investment and to expect profits from the team's technical and managerial efforts to develop, expand, and grow the platform, which, in turn, would increase the demand for and value of CHZ. (Compl. ¶ 217).

B. Procedural Background

The SEC initiated the instant action by filing a complaint on June 6, 2023. (Dkt. #1). Defendants responded to the complaint by filing an answer on June 28, 2023 (Dkt. #22), and, that same day, filing a pre-motion letter seeking leave to file a motion for judgment on the pleadings (Dkt. #23). The SEC filed a letter in opposition to Defendants' pre-motion letter and announced its intent to move to strike several of Coinbase's affirmative defenses on July 7, 2023. (Dkt. #26). On July 12, 2023, Defendants filed a letter in opposition to the SEC's pre-motion letter. (Dkt. #27). On July 13, 2023, the Court held a pre-motion conference, at which the parties discussed Defendants' anticipated motion for judgment on the pleadings and the SEC's anticipated motion to strike Defendants' affirmative defenses. (*See* July 13, 2023 Minute Entry; Dkt. #30 (transcript)). Following the conference, the parties submitted a joint letter proposing a briefing schedule for the motion for judgment on the pleadings. (Dkt. #33). In the letter, the SEC also informed the Court that it would not be filing a motion to strike. (*Id.*). The Court subsequently endorsed the parties' briefing schedule. (Dkt. #34).

In accordance with the briefing schedule, on August 4, 2023, Defendants filed the instant motion for judgment on the pleadings and supporting papers. (Dkt. #35-37). On October 3, 2023, the SEC filed its opposition papers. (Dkt. #69-70). On October 24, 2023, Defendants filed their reply memorandum in further support of their motion. (Dkt. #83). In addition, several *amicus curiae* briefs were filed in support of both parties. (Dkt. #48, 50, 53, 55, 59, 60, 75-1,

77, 78-1). After full briefing, the Court, on January 17, 2024, heard oral argument on the motion. (*See* January 17, 2024 Minute Entry; Dkt. #101 (transcript)).

DISCUSSION

A. Applicable Law

1. Motions for Judgment on the Pleadings Under Federal Rule of Civil Procedure 12(c)

Federal Rule of Civil Procedure 12(c) provides that "[a]fter the pleadings are closed — but early enough not to delay trial — a party may move for judgment on the pleadings." Fed. R. Civ. P. 12(c). Judgment on the pleadings, pursuant to Rule 12(c) is appropriate where material facts are undisputed and a judgment on the merits is possible merely by considering the contents of the pleadings. *Sellers* v. *M.C. Floor Crafters, Inc.*, 842 F.2d 639, 642 (2d Cir. 1988); *Allstate Ins. Co.* v. *Vitality Physicians Grp. Prac. P.C.*, 537 F. Supp. 3d 533, 545 (S.D.N.Y. 2021).

"The standard for granting a Rule 12(c) motion for judgment on the pleadings is identical to that for granting a Rule 12(b)(6) motion for failure to state a claim." *Lively* v. *WARFA Inv. Advisory Grp., Inc.*, 6 F.4th 293, 301 (2d Cir. 2021) (quoting *Lynch* v. *City of N.Y.*, 952 F.3d 67, 75 (2d Cir. 2020)). When considering either a Rule 12(b) or a Rule 12(c) motion, a court must "draw all reasonable inferences in [the non-movant's] favor, assume all well-pleaded factual allegations to be true, and determine whether they plausibly give rise to an entitlement to relief." *Faber* v. *Metro. Life Ins. Co.*, 648 F.3d 98, 104 (2d Cir. 2011) (internal quotation marks omitted) (quoting *Selevan* v. *N.Y. Thruway*

Auth., 584 F.3d 82, 88 (2d Cir. 2009)); *see generally Bell Atl. Corp.* v. *Twombly*, 550 U.S. 544, 570 (2007). A plaintiff is entitled to relief if she alleges "enough facts to state a claim to relief that is plausible on its face." *Twombly*, 550 U.S. at 570; *see also In re Elevator Antitrust Litig.*, 502 F.3d 47, 50 (2d Cir. 2007) ("[W]hile *Twombly* does not require heightened fact pleading of specifics, it does require enough facts to nudge [plaintiff's] claims across the line from conceivable to plausible." (internal quotation marks omitted)).

"On a [Rule] 12(c) motion, the court considers the complaint, the answer, any written documents attached to them, and any matter of which the court can take judicial notice for the factual background of the case." *L-7 Designs, Inc.* v. *Old Navy, LLC*, 647 F.3d 419, 422 (2d Cir. 2011) (internal quotation marks and citation omitted); *see also Lively*, 6 F.4th at 305 (explaining that a court "should remain within the non-movant's pleading when deciding" Rule 12(c) motions). A complaint is "deemed to include any written instrument attached to it as an exhibit, materials incorporated in it by reference, and documents that, although not incorporated by reference, are 'integral' to the complaint." *L-7 Designs, Inc.*, 647 F.3d at 422 (citation omitted).[7]

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[7] The parties disagree over the Court's ability to consider certain materials in the record in resolving the instant motion, including the opening 33 pages of Coinbase's Answer and the Coinbase "User Agreement." On a motion for judgment on the pleadings, a court may consider "all documents that qualify as part of nonmovant's pleading, including [i] the complaint or answer, [ii] documents attached to the pleading, [iii] documents incorporated by reference in or integral to the pleading, and [iv] matters of which the court may take judicial notice." *Lively* v. *WARFA Inv. Advisory Grp., Inc.*, 6 F.4th 293, 306 (2d Cir. 2021) (emphasis omitted). With particular respect to the Answer, the parties appear to agree that the Court may take judicial notice of the public statements made by the SEC, legislative proposals to regulate cryptocurrency, and the SEC filings in other cases. (*See generally* Jan. 17, 2024 Tr.). Additionally, the Court may consider the Coinbase "User Agreement," which is incorporated by reference in the Complaint. (*See, e.g.*, Compl. ¶¶ 84-86, 89, 343, 349-350).

2. Relevant Securities Laws and Regulations

In its Complaint, the SEC asserts five distinct claims against Coinbase for violation of the federal securities laws. The first three broadly allege that Coinbase operated as (i) a national securities exchange; (ii) a broker; and (iii) a clearing agency, all without first registering its operations with the Commission pursuant to the relevant securities laws. Next, the SEC seeks to hold CGI liable as a "control person" under Section 20(a) of the Exchange Act for Coinbase's violations of the securities laws. Finally, the SEC claims that Coinbase violated Sections 5(a) and 5(c) of the Securities Act by engaging in the unregistered offer and sale of securities in connection with its Staking Program.

As the parties acknowledge, the SEC's ability to prevail on any of its claims depends in large part on the threshold question of whether any of the transactions involving Crypto-Assets qualifies as a "security" under the meaning of the Securities Act. For clarity, therefore, the Court details the applicable law governing the interpretation of the term "security" under the Act, followed by the applicable law for each of the five claims.

a. *Howey* and the Definition of "Securities" Under the Securities Act

As a general matter, the Securities Act purports to regulate a wide variety of financial instruments that are termed "securities." *See Howey*, 328 U.S. at 297 (noting that "Section 2(1) of the Act defines the term 'security' to include [both] the commonly known documents traded for speculation or investment … [and] 'securities' of a more variable character'"). This statutory definition includes instruments known as "investment contracts"; the definition of

"investment contracts," in turn, is at the heart of the instant dispute. 15 U.S.C. § 77b(a)(1).

The Supreme Court, in the seminal case of *SEC* v. *W.J. Howey Co.*, interpreted the term "investment contract" to include transactions "involv[ing] an investment of money in a common enterprise with profits to come solely from the efforts of others." 328 U.S. at 301. Bound by that decision, courts in the Second Circuit and elsewhere apply the three-element *Howey* test, under which an investment contract arises out of "(i) an investment of money (ii) in a common enterprise (iii) with profits to be derived solely from the efforts of others." *Revak* v. *SEC Realty Corp.*, 18 F.3d 81, 87 (2d Cir. 1994); *see also SEC* v. *Terraform Labs Pte. Ltd.*, — F. Supp. 3d —, No. 23 Civ. 1346 (JSR), 2023 WL 8944860, at *13 (S.D.N.Y. Dec. 28, 2023) ("*Terraform II*") ("*Howey*'s definition of 'investment contract' was and remains a binding statement of the law, not dicta. And even if, in some conceivable reality, the Supreme Court intended the definition to be dicta, that is of no moment because the Second Circuit has likewise adopted the *Howey* test as the law." (citing, *e.g.*, *Revak*, 18 F.3d at 87)).

b. Registration Requirements for National Securities Exchanges Pursuant to Section 5 of the Exchange Act

In Count I, the SEC alleges that Coinbase operates as a national securities exchange without registering with the SEC pursuant to Section 6 of the Exchange Act, 15 U.S.C. § 78f, in violation of Section 5 of the Exchange Act, *id.* § 78e. Under Section 5, it is unlawful for any "exchange" to make use of any means of interstate commerce "to effect any transactions in a security"

without registering as an exchange with the SEC. *Id.* § 78e. Section 3(a) of the Exchange Act defines "exchange" as

> any organization, association, or group of persons … which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange.

Id. § 78c(a)(1). An organization shall be considered to constitute, maintain, or provide "a market place or facilities for bringing together purchasers and sellers of securities" if it "[i] [b]rings together the orders for securities of multiple buyers and sellers; and [ii] [u]ses established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of a trade." *Intercontinental Exch., Inc.* v. *SEC*, 23 F.4th 1013, 1026-27 (D.C. Cir. 2022) (citing 17 C.F.R. § 240.3b-16(a)(1)-(2)).

c. Registration Requirements for Securities Brokers Pursuant to Section 15(a) of the Exchange Act

In Count II, the SEC contends that Coinbase brokered securities without registering as a broker in violation of Section 15(a) of the Exchange Act, 15 U.S.C. § 78o(a). Under Section 15(a), it is unlawful for any "broker or dealer" to make use of any means of interstate commerce "to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security" without registering as a broker with the Commission. *Id.* § 78o(a)(1). The Exchange Act broadly defines "broker" as one who "engage[s] in the business of effecting transactions in securities for the account of others." *Id.* § 78c(a)(4)(A). In

determining whether a particular entity falls within this definition, courts consider whether the entity may be "characterized by 'a certain regularity of participation in securities transactions at key points in the chain of distribution.'" *SEC* v. *Hansen*, No. 83 Civ. 3692 (LPG), 1984 WL 2413, at *10 (S.D.N.Y. Apr. 6, 1984) (quoting *Mass. Fin. Services, Inc.* v. *Sec. Inv. Prot. Corp.*, 411 F. Supp. 411, 415 (D. Mass.), *aff'd*, 545 F.2d 754 (1st Cir. 1976)); *see also* *SEC* v. *Margolin*, No. 92 Civ. 6307 (PKL), 1992 WL 279735, at *5 (S.D.N.Y. Sept. 30, 1992) (finding that "brokerage" conduct may include receiving transaction-based income, advertising for clients, and possessing client funds and securities). The SEC need not prove the broker's scienter to establish a violation of Section 15(a). *SEC* v. *Martino*, 255 F. Supp. 2d 268, 283 (S.D.N.Y. 2003).

d. Registration Requirements for Clearing Agencies Pursuant to Section 17A(b) of the Exchange Act

In Count III, the SEC asserts that Coinbase performs the functions of a clearing agency with respect to securities without registering in accordance with Section 17A(b), 15 U.S.C. § 78q-1(b). Section 17A(b) of the Exchange Act makes it unlawful to perform the functions of a clearing agency with respect to any security (other than an exempted security) without being registered as such by the SEC. *Id.* The Exchange Act generally defines the term "clearing agency" as "any person who acts as an intermediary in making payments or deliveries or both in connection with transactions in securities or who provides facilities for comparison of data respecting the terms of settlement of securities transactions[.]" *Id.* § 78c(a)(23)(A).

e. Control Person Liability Pursuant to Section 20(a) of the Exchange Act

In Count IV, the SEC argues that CGI is liable as a "control person" of Coinbase under Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a), for Coinbase's violations of Sections 5, 15(a), and 17A(b). Section 20(a) of the Exchange Act provides that "[e]very person who, directly or indirectly, controls any person liable under [the Exchange Act and its implementing regulations] shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable." *Id.* § 78t(a). A claim under Section 20(a) is thus predicated on the existence of an underlying securities violation. Indeed, to establish control-person liability, a plaintiff must show [i] "a primary violation by the controlled person"; [ii] "control of the primary violator by the defendant"; and [iii] that the controlling person "was, in some meaningful sense, a culpable participant in the controlled person's fraud." *ATSI Commc'ns, Inc.* v. *Shaar Fund, Ltd.*, 493 F.3d 87, 108 (2d Cir. 2007); *see also Carpenters Pension Tr. Fund of St. Louis* v. *Barclays PLC*, 750 F.3d 227, 236 (2d Cir. 2014).

f. Registration Requirements for the Sale of Securities Pursuant to Section 5 of the Securities Act

In Count V, the SEC asserts that Coinbase itself offered and sold securities without a registration statement, in violation of Sections 5(a) and 5(c) of the Securities Act, 15 U.S.C. § 77e(a) and (c), through its Staking Program. Sections 5(a) and 5(c) of the Securities Act prohibit any person from selling unregistered securities using any means of interstate commerce unless the

securities are exempt from registration. *Id.* § 77e(a), (c). To prove a violation of Section 5, the plaintiff must show that "[i] no registration statement was in effect for the securities at issue; [ii] the defendant sold or offered the securities; and [iii] interstate transportation, communication, or the mails were used in connection with the offer or sale." *SEC* v. *Sason*, 433 F. Supp. 3d 496, 513 (S.D.N.Y. 2020). If the plaintiff meets this *prima facie* burden, the burden shifts to the defendant to show that an exception applies. *Id.* Section 5 is a strict liability statute that does not require a showing of scienter or negligence. *See SEC* v. *Bronson*, 14 F. Supp. 3d 402, 408 (S.D.N.Y. 2014).

B. Analysis

1. Overview

The central question before the Court is whether Coinbase intermediated transactions involving investment contracts, and thus securities. With the exception of the Wallet application, discussed further *infra*, Coinbase does not dispute that it carried out the functions of an exchange, broker, and clearing agency with respect to transactions in the Crypto-Assets, and that it is not registered with the SEC in these capacities. (Answer 33-24). Thus, as a practical matter, resolution of this motion hinges on whether any of the transactions involving the 13 exemplar tokens qualifies as an investment contract.

To answer this question, it is important to demarcate the parties' dispute. As a preliminary matter, the SEC does not appear to contest that tokens, in and of themselves, are not securities. (*See generally* Jan. 17, 2024

Tr.). The appropriate question, therefore, is whether transactions in which a particular token is implicated qualify as investment contracts. *See SEC* v. *Terraform Labs Pte. Ltd.*, — F. Supp. 3d —, No. 23 Civ. 1346 (JSR), 2023 WL 4858299, at *11 (S.D.N.Y. July 31, 2023) ("*Terraform I*") ("A product that at one time is not a security may, as circumstances change, become an investment contract that is subject to SEC regulation." (citing *SEC* v. *Edwards*, 540 U.S. 389, 390 (2004))). The SEC also does not dispute that blind bid/ask transactions carried out on the Coinbase Platform and through Prime — the only type of transaction implicated in this case — "involve no continuing promises from the issuer or developer to the token holder, impose no post-sale obligations on the issuer or developer, and involve no profit-sharing between the issuer or developer and the holders." (Jan. 17, 2024 Tr. 52:20-53:17). Rather, the SEC argues that the absence of post-sale obligations is not dispositive as to the existence of an investment contract, and should not foreclose the securities laws from applying in circumstances where token holders reasonably expect the value of their asset to increase based on the issuer's broadly-disseminated plan to develop and maintain the asset's ecosystem.

Coinbase has also made concessions in its position, at least for purposes of the instant motion. Coinbase does not dispute, for example, that the Court should deny its motion if it finds that a transaction involving at least one of the 13 Crypto-Assets qualifies as a security. Moreover, Coinbase accepts the SEC's pleadings that at least some Coinbase customers purchased or traded tokens

on the Coinbase Platform and through Prime hoping that they would appreciate in value (Jan. 17, 2024 Tr. 81:5-9), and, further, that some of these customers bought tokens with knowledge of the statements of intent of the token's issuer to promote and develop their respective token's ecosystem (*id.* at 83:7-12).

That said, Coinbase sharply parts ways with the SEC on the question of whether secondary market transactions can constitute investment contracts. (Jan. 17, 2024 Tr. 83:19-84:7). Because an issuer owes no contractual obligation to a retail buyer on the Coinbase Platform or through Prime, Coinbase argues that these transactions in the Crypto-Assets do not constitute "investment contracts," and are therefore not "securities," such that Coinbase's conduct does not fall within the ambit of the securities laws. (*See, e.g.*, Def. Br. 6-7 ("Decades of precedent confirm that for an investment to constitute an investment contract, the buyer must have a contractually-grounded expectation of delivery of future value.")).

2. The SEC Is Not Barred from Asserting That Coinbase Intermediated Transactions in Securities

Before reaching the merits of Coinbase's arguments, the parties press the Court to consider the question of whether one or more of the "Major Questions Doctrine," the Due Process Clause, and the Administrative Procedure Act (the "APA") prevent the SEC from that alleging the Crypto-Assets transacted on Coinbase are "investment contracts." The Court considers each argument in turn.

a. The SEC's Enforcement Action Does Not Implicate the Major Questions Doctrine

While it has evolved over the years, the major questions doctrine proceeds from the premise that Congress does not delegate extraordinary powers that transform an agency's authority without speaking clearly. *See West Virginia* v. *EPA*, 597 U.S. 697, 716 (2022). As such, the major questions doctrine requires that an agency point to "clear congressional authorization" in the "extraordinary" case where it claims the "power to regulate a significant portion of the American economy" that has "vast economic and political significance." *Util. Air. Regul. Grp.* v. *EPA*, 573 U.S. 302, 324 (2014) (citations omitted). In *West Virginia*, the Supreme Court rooted the major questions doctrine in "both separation of powers principles and a practical understanding of legislative intent." 597 U.S. at 700. It is premised on the notion that "one branch of government" should not "arrogat[e] to itself power belonging to another," *Biden* v. *Nebraska*, 600 U.S. —, 143 S. Ct. 2375, 2373 (2023), and the "presum[ption] that Congress intends to make major policy decisions itself," *West Virginia*, 597 U.S. at 723 (alteration adopted).

That said, the doctrine is reserved for the most "extraordinary cases," and is therefore rarely invoked. *West Virginia*, 597 U.S. at 721 (stating that the major questions doctrine applies only in "extraordinary cases … in which the history and breadth of the authority that the agency has asserted, and the economic and political significance of the assertion, provide a reason to hesitate before concluding that Congress meant to confer such authority"). Indeed, in the nearly twenty-five years since its recognition in *FDA* v. *Brown &*

Williamson Tobacco Corp., 529 U.S. 120, 159 (2000), the doctrine has rarely been successfully invoked.

With this standard in mind, the Court finds that the instant enforcement action does not implicate the major questions doctrine. *First*, while certainly sizable and important, the cryptocurrency industry "falls far short of being a 'portion of the American economy' bearing 'vast economic and political significance.'" *Terraform I*, 2023 WL 4858299, at *8 (citing *Util. Air Regul. Grp.*, 573 U.S. at 324). Simply put, the cryptocurrency industry cannot compare with those other industries the Supreme Court has found to trigger the major questions doctrine. *See, e.g.*, *West Virginia*, 597 U.S. at 724 (finding Clean Power Plan to be major because it would empower the EPA to "substantially restructure the American energy market"); *Nebraska*, 143 S. Ct. at 2375 (finding student loan forgiveness program to be major where it aimed to forgive approximately $430 billion in debt). Indeed, the securities industries over which Congress has expressly given the SEC enforcement authority are even broader than the markets for cryptocurrencies, and implicate larger portions of the American economy.

Perhaps more importantly, the SEC is asserting neither a "transformative expansion in its regulatory authority," nor a "highly consequential power beyond what Congress could reasonably be understood to have granted" it. *West Virginia*, 597 U.S. at 724 (alteration adopted). To the contrary, in filing this action, the SEC is exercising its Congressionally bestowed enforcement authority to regulate "virtually any instrument that might be sold as an

investment," "in whatever form they are made and by whatever name they are called," including "[n]ovel, uncommon, or irregular devices" like the crypto-assets at issue here. *Edwards*, 540 U.S. at 393; *SEC* v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943); *see also Terraform I*, 2023 WL 4858299, at *9 ("[T]here is no indication that Congress intended to hamstring the SEC's ability to resolve new and difficult questions posed by emerging technologies where these technologies impact markets that on their face appear to resemble securities markets.").

The very concept of enforcement actions evidences the Commission's ability to develop the law by accretion. The SEC has a long history of proceeding through such actions to regulate emerging technologies and associated financial instruments within the ambit of its authority as defined by cases like *Howey* — a test that has existed for nearly eight decades. *See, e.g.*, *SEC* v. *SG Ltd.*, 265 F.3d 42, 44 (1st Cir. 2001) (applying federal securities laws to "virtual shares in an enterprise existing only in cyberspace"). Using enforcement actions to address crypto-assets is simply the latest chapter in a long history of giving meaning to the securities laws through iterative application to new situations. More to the point, a finding that transactions involving certain crypto-assets qualify as investment contracts would merely result in those sales having to comply with longstanding securities laws. Accordingly, the Court declines in this instance to permit the major questions doctrine to displace or otherwise limit SEC enforcement actions under *Howey*. *See Terraform I*, 2023 WL 4858299, at *9 ("Defendants cannot wield a doctrine

intended to be applied in exceptional circumstances as a tool to disrupt the routine work that Congress expected the SEC … to perform."); *cf. FTC* v. *Kochava Inc.*, No. 22 Civ. 377 (BLW), 2023 WL 3249809, at *13 (D. Idaho May 4, 2023) (concluding that the major questions doctrine was inapplicable to bar an FTC enforcement action because the FTC "is merely asking a court to interpret and apply a statute enacted by Congress").

Nor does Congressional consideration of new legislation implicating cryptocurrency, on its own, alter the SEC's mandate to enforce existing law, notwithstanding Defendants' arguments to the contrary. (Def. Br. 23). As the Supreme Court recently remarked in *Slack Technologies, LLC* v. *Pirani*, although "Congress remains free to revise the securities laws at any time … [the judiciary's] only function lies in discerning and applying the law as we find it." 598 U.S. 759, 770 (2023). Until the law changes, the SEC must enforce, and the judiciary must interpret, the law as it is.

b. The SEC Has Not Violated Defendants' Rights Under the Due Process Cause and the APA

Next, Defendants argue that the SEC violated their due process rights by bringing this enforcement action without first providing "fair notice" that crypto-assets traded on the Coinbase Platform and through Prime would be treated as securities. (Answer ¶¶ 18, 71, 76). This line of argument evokes the Due Process Clause, under which agencies bringing an enforcement action must provide "fair notice" of what conduct is required or proscribed. *FCC* v. *Fox Television Stations, Inc.*, 567 U.S. 239, 253-54 (2012) (ruling that the Due Process Clause requires that agencies bringing an enforcement action

"provide … a person of ordinary intelligence fair notice" that the regulated conduct was "prohibited"). Here, Defendants argue that the SEC's enforcement action marks a dramatic shift in position regarding its authority to regulate secondary crypto-markets.

In support of their argument, Defendants make much hay out of a position taken by SEC Chair Gary Gensler in his May 2021 Congressional testimony, in which he suggested that "only Congress" could address any gap in the SEC's ability to regulate crypto-exchanges. (Def. Br. 4-5). Yet an examination of the broader timeline of the SEC's positions regarding crypto-assets reveals that the SEC provided Coinbase (and similarly situated actors) fair notice — through written guidance, litigation, and other actions — that the sale or offering of certain crypto-assets could prompt an enforcement action by the SEC.

In July 2017, the SEC issued *The Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: the DAO* (the "DAO Report"), cautioning "those who would use … distributed ledger or blockchain-enabled means for capital raising[] to take appropriate steps to ensure compliance with the U.S. federal securities laws." (Compl. ¶ 60).[8] In April 2019, the SEC published additional guidelines that admonished those

[8] The DAO Report also advised that "any entity or person engaging in the activities of an exchange must register as a national securities exchange or operate pursuant to an exemption," even "with respect to products and platforms involving emerging technologies and new investor interfaces." (Compl. ¶ 61). The DAO Report further found that the trading platforms at issue "provided users with an electronic system that matched orders from multiple parties to buy and sell [the crypto asset securities at issue] for execution based on non-discretionary methods," and therefore "appear to have satisfied the criteria" for being an exchange under the Exchange Act. (*Id.*).

"engaging in the offer, sale, or distribution of a digital asset" to consider "whether the digital asset is a security" that would trigger the application of "federal securities laws." SEC, *Framework for "Investment Contract" Analysis of Digital Assets* (April 2019). Within this document, the SEC also provided (i) "a framework for analyzing whether a digital asset is an investment contract," and (ii) a list of characteristics that, if present in a given digital asset, would make the SEC more likely to view the asset as a "security." *Id.* In doing so, the SEC signaled its view that whether an offer and sale of crypto-assets was in fact an offer and sale of securities was dependent on individualized facts and circumstances.

Aware of this guidance, Defendants conducted risk assessments that acknowledged the potential application of the federal securities laws to Coinbase's products and services. (Answer ¶ 55). Indeed, Defendants admit that — in accordance with SEC guidance — they "established a systematic analytical process for reviewing crypto assets" specifically to determine which "could be deemed 'securities' under the SEC's definition." (*Id.*).

As detailed in the Complaint, Coinbase repeatedly touted to the investing public its familiarity with the relevant legal standards governing the offer and sale of securities, as well as its awareness of the risk it would create if it facilitated transactions in crypto-assets that were found to be securities. For example, in or around December 2016, Coinbase released on its website a document entitled, "A Securities Law Framework for Blockchain Tokens." (Compl. ¶ 103). This document included a section on "How to determine if a

token is a security," and explained: "The US Supreme Court case of *SEC* v[.] *Howey* established the test for whether an arrangement involves an investment contract." In that section, Coinbase acknowledged that, "[f]or many blockchain tokens, the first two elements of the *Howey* test" — *i.e.*, investment of money and common enterprise — "are likely to be met." (*Id.*).

In 2018, Coinbase also publicly released the "Coinbase Crypto Asset Framework," which included a listing application form for issuers and promoters seeking to make their tokens available on the Coinbase Platform. (Compl. ¶ 104). Among other information, the application requested that issuers provide information relevant to a *Howey* analysis of the respective token, such as "any statements … made about the token/network noting the potential to realize returns, profits or other financial gain." (*Id.* ¶ 105).

In 2019, Coinbase and other crypto-asset businesses founded the Crypto Rating Council (the "CRC"). (Compl. ¶ 106). The CRC subsequently released a framework for analyzing crypto-assets that "distilled a set of yes or no questions which are designed to plainly address each of the four *Howey* test factors" and provide conclusions regarding whether an asset has characteristics strongly consistent with treatment as a security. (*Id.*). Coinbase itself used and relied on the CRC framework to assess whether certain crypto-assets had the characteristics of securities under *Howey*. (*Id.* ¶ 108). While Coinbase may have come to a different conclusion than the SEC, it can hardly claim to have lacked notice that (i) the legal framework potentially applied and (ii) the SEC could bring an action under it. Accordingly, the SEC

has satisfied its obligations under the Due Process Clause. *See United States* v. *Zaslavskiy*, No. 17 Cr. 647 (RJD), 2018 WL 4346339, at *9 (E.D.N.Y. Sept. 11, 2018) ("[T]he abundance of caselaw interpreting and applying *Howey* at all levels of the judiciary, as well as related guidance issued by the SEC as to the scope of its regulatory authority and enforcement power, provide all the notice that is constitutionally required."); *see also SEC* v. *Kik Interactive Inc.*, 492 F. Supp. 3d 169, 183 (S.D.N.Y. 2020) ("[T]he law regarding the definition of investment contract gives a reasonable opportunity to understand what conduct and devices it covers.").

It follows from the foregoing that the APA also does not foreclose the SEC from bringing this enforcement action. While it may be true that in cases where an agency purports to promulgate *new* regulatory authority, notice-and-comment rulemaking may offer a "better, fairer, and more effective" method of implementing agency policy than punitive enforcement actions, such is not the case here. *Cmty. Television of S. California* v. *Gottfried*, 459 U.S. 498, 511 (1983). Here, the SEC is not announcing a new regulatory policy, but rather is simply engaging in a fact-intensive application of an existing standard — an application that Coinbase also conducted — to determine whether certain transactions involving crypto-assets meet the characteristics of an "investment contract."[9]

[9] The Court acknowledges Coinbase's representations that it has sought to comply with the applicable laws and regulations and to work cooperatively with the SEC, including by engaging the SEC, on multiple occasions, to discuss the applicability of the securities laws to its business. (Answer ¶ 11). While commendable, such conduct does not foreclose the SEC from bringing this enforcement action.

3. The SEC Plausibly Alleges That at Least Some Crypto-Asset Transactions on Coinbase's Platform and Through Prime Constitute Investment Contracts

Having determined that the SEC's action is not barred by the above-described threshold considerations, the Court now turns to the merits of the parties' arguments. In particular, the Court contends with Defendants' position that judgment on the pleadings is appropriate because none of the transactions in the Crypto-Assets identified by the SEC could qualify as an "investment contract," and thus as a "security" implicating the Securities Act and the Exchange Act.

As laid out above, the Securities Act sets out an expansive definition of the term "security" that includes, as relevant here, the undefined term "investment contract." *See* 15 U.S.C. § 77b(a)(1) (stating that "the term 'security' means any … investment contract"); *see also United Housing Found., Inc.* v. *Forman*, 421 U.S. 837, 847-48 (1975) ("[Congress] sought to define the term 'security' in sufficiently broad and general terms so as to include … the many types of instruments that in our commercial world fall within the ordinary concept of a security." (internal quotation marks omitted)); *Edwards*, 540 U.S. at 393 ("Congress' purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called." (citation omitted)). And as previously noted, *Howey* and subsequent precedent interpret the meaning of "investment contract" to implicate "a contract, transaction[,] or scheme whereby a person [i] invests his money [ii] in a common enterprise and [ii] is led to expect profits solely from the

efforts of the promoter or a third party." 328 U.S. at 298-99; *see also Edwards*, 540 U.S. at 393.

Importantly, the Supreme Court has made it clear that, in analyzing whether a contract, transaction, or scheme is an investment contract, "form should be disregarded for substance and the emphasis should be on [the] economic reality" of the parties' arrangement. *Tcherepnin* v. *Knight*, 389 U.S. 332, 336 (1967); *see also Forman*, 421 U.S. at 849 (stating "Congress intended the application of [the securities laws] to turn on the economic realities underlying a transaction, and not on the name appended thereto"). Further, in assessing economic realities, courts look at the "totality of the circumstances" surrounding the offer of an investment contract, *Glen-Arden Commodities, Inc.* v. *Constantino*, 493 F.2d 1027, 1034 (2d Cir. 1974), including the "intentions and expectations of the parties at that time," *SEC* v. *Aqua-Sonic Prod. Corp.*, 524 F. Supp. 866, 876 (S.D.N.Y. 1981), *aff'd*, 687 F.2d 577 (2d Cir. 1982). *See also Marine Bank* v. *Weaver*, 455 U.S. 551, 560 n.11 (1982) (stating that a given transaction needs to be "evaluated on the basis of the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole").

Thus, the definition of an investment contract "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profit." *Howey*, 328 U.S. at 299. Indeed, *Howey* and its progeny have held a wide range of intangible and tangible assets to be

securities. *See, e.g.*, *Edwards*, 540 U.S. 389 (payphones); *SEC* v. *Scoville*, 913 F.3d 1204 (10th Cir. 2019) (bundled internet advertising services); *Eberhardt* v. *Waters*, 901 F.2d 1578 (11th Cir. 1990) (cattle embryos); *Glen-Arden*, 493 F.2d 1027 (whiskey casks); *SEC* v. *Telegram Grp. Inc.*, 448 F. Supp. 3d 352 (S.D.N.Y. 2020) (digital tokens). This makes sense, given that the *Howey* standard was intended to effectuate "[t]he statutory policy of affording broad protection to investors." 328 U.S. at 301.

a. Recent Crypto Cases in This Circuit

Of note, both the SEC and private litigants have brought several successful actions in this Circuit predicated on crypto-assets falling within the *Howey* definition of an "investment contract." *See, e.g.*, *Zaslavskiy*, 2018 WL 4346339, at *1 (securities fraud prosecution of crypto-asset investment schemes and ICOs); *Balestra* v. *ATBCOIN LLC*, 380 F. Supp. 3d 340 (S.D.N.Y. 2019) (class action involving digital token offerings); *Kik Interactive*, 492 F. Supp. 3d 169 (enforcement action regarding the sale of crypto-assets); *Williams* v. *Binance*, — F.4th —, No. 22-972, 2024 WL 995568, at *1 (2d Cir. Mar. 8, 2024) (class action seeking recission of transactions in seven crypto-assets facilitated through Binance).

In *SEC* v. *Telegram Group Inc.*, the SEC sought to enjoin the defendants from engaging in a plan to distribute 2.9 billion "Grams," a crypto-asset, to 175 purchasers in exchange for $1.7 billion, in what the Commission considered to be an unregistered offering of securities. 448 F. Supp. 3d at 358. The defendants there argued that only the agreements with the individual

purchasers were securities, but that the anticipated resales of Grams by the 175 purchasers into the secondary market were "wholly-unrelated transactions" and not offerings of securities. *Id.* Judge Castel disagreed, finding that, although the resale of Grams on the public market was not pursuant to any written contract, it amounted to "the distribution of securities." *Id.* at 381.

In reaching this holding, the *Telegram* court found that the initial offering of Grams to the 175 purchasers was "part of a larger scheme to distribute those Grams into a secondary public market, which would be supported by Telegram's ongoing efforts." 448 F. Supp. 3d at 358. Specifically, the *Telegram* court found that Telegram entered into agreements and understandings with the initial purchasers who provided upfront capital "in exchange for the future delivery of a discounted asset, Grams, which … would be resold in a public market with the expectation that the Initial Purchasers would earn a profit." *Id.* at 367. As such, a reasonable initial purchaser of Grams understood and expected that she would earn a profit, so long as "the reputation, skill, and involvement of Telegram and its founders remain[ed] behind the enterprise, including through the sale of Grams from the [i]nitial [p]urchasers into the public market." *Id.* Taken together, the court found that the initial purchasers and the anticipated resale of the Grams constituted a "single scheme" under *Howey*, and therefore that the contemplated transaction was a security within the scope of the federal securities laws. *Id.*

More recently, in *SEC* v. *Terraform Labs Pte. Ltd.*, the SEC brought an action against a crypto-asset issuer and its founder for orchestrating a multi-billion-dollar fraud in the sale of cryptocurrencies. *See* 2023 WL 4858299. There, Judge Rakoff held that the SEC alleged facts sufficient to claim that the defendants' products qualified as "investment contracts" under the three-pronged *Howey* test. In so concluding, the *Terraform* court looked to "readouts of investor meetings, excerpts of investor materials, and screenshots of social media posts made by … Terraform executives," and concluded from those materials that the defendants' representations led token holders to reasonably believe that they would profit from their purchases. *Id.* at *14. The *Terraform* court also found that the SEC demonstrated the existence of a common enterprise through allegations of "horizontal commonality," under which arrangement the defendants used proceeds from coin sales to further develop the tokens' broader "ecosystem," representing that these improvements would increase the value of the tokens themselves. *Id.* at *2, 12.

Pertinent to the arguments raised in this case, the *Terraform* court further found that, contrary to the defendants' assertions, the "supposed absence of an enforceable written contract" did *not* "preclude" the SEC from asserting that the defendants' crypto-assets were investment contracts. 2023 WL 4858299, at *11. "By stating that 'transaction[s]' and 'scheme[s]' — and not just 'contract[s]' — qualify as investment contracts," Judge Rakoff wrote, "the Supreme Court made clear in *Howey* that Congress did not intend the

term to apply only where transacting parties had drawn up a technically valid written or oral contract under state law." *Id.* (internal citations omitted).

In concluding its *Howey* analysis, the *Terraform* court declined to draw a distinction between token offerings based on their manner of sale — expressly rejecting the approach adopted in *SEC* v. *Ripple Labs, Inc.*, No. 20 Civ. 10832 (AT), 2023 WL 6445969 (S.D.N.Y. Oct. 3, 2023). 2023 WL 4858299, at *15. Specifically, the *Terraform* court found that, as part of their campaign, the defendants had stated that proceeds from purchases of all crypto-assets — no matter where the coins were purchased — would be fed back into the Terraform blockchain to generate additional profits for *all* crypto-asset holders. *Id.* "These representations," Judge Rakoff wrote, "would presumably have reached individuals who purchased their crypto-assets on secondary markets — and, indeed, motivated those purchases — as much as it did institutional investors." *Id.* As such, retail purchasers had "every bit as good a reason to believe that the defendants would take their capital contributions and use it to generate profits on their behalf." *Id.*

Several teachings can be gleaned from these thoughtful decisions. To begin, there need not be a formal contract between transacting parties for an investment contract to exist under *Howey*. Indeed, courts in this Circuit have consistently declined invitations by defendants in the cryptocurrency industry to insert a "contractually-grounded" requirement into the *Howey* analysis. *See Terraform I*, 2023 WL 4858299, at *11 (declining to adopt defendants' assertion that "an enforceable written contract" was required for an investment contract

to exist); *see also Kik Interactive*, 492 F. Supp. 3d at 169, 178 (rejecting defendant's "ongoing contractual obligation" requirement, observing that "contractual language is important to, but not dispositive of, the common enterprise inquiry, and courts regularly consider representations and behavior outside the contract" (citations omitted)); *cf. Ripple Labs,* 2023 WL 6445969, at *2 (rejecting defendants' "essential ingredients" test requiring a finding of a contract and post-sale obligation between promoter and investor).

Next, when conducting the *Howey* analysis, courts are not to consider the crypto-asset in isolation. Instead, courts evaluate whether the crypto-assets and the "full set of contracts, expectations, and understandings" surrounding its sale and distribution — frequently referred to using the shorthand "ecosystem" — amount to an investment contract. *Telegram*, 448 F. Supp. 3d at 379 (noting that the "security in this case is not simply the [token], which is little more than alphanumeric cryptographic sequence"); *see also Terraform I*, 2023 WL 4858299, at *12 (declining to erect an "artificial barrier between the tokens and the investment protocols with which they are closely related" for the purposes of the analysis); *cf. Howey*, 328 U.S. at 297-98 (declining to "treat[ ] the contracts and deeds as separate transactions").

Finally, in assessing the circumstances surrounding the sale of a crypto-asset, courts should look to what the offeror invites investors to reasonably understand and expect. To do so, courts examine how, and to whom, issuers or promoters market the crypto-asset. *See, e.g.*, *Terraform I*, 2023 WL 4858299, at *14 (analyzing "social media posts," "investor materials," and

"readouts of investor meetings" to identify investors' expectations); *Balestra*, 380 F. Supp. 3d at 355 (finding that investors' expectation of profits came from "a marketing campaign," a "press release," "advertisements," and the promoter's website); *Zaslavskiy*, 2018 WL 4346339, at *2, 4-7 (finding that indictment sufficiently alleged the existence of investment contracts based on marketing in online advertising and websites); *Audet* v. *Fraser*, 605 F. Supp. 3d 372, 395-96 (D. Conn. 2022) (finding expectation of profits premised on issuer's "promotional materials," "press release[s]," and "graphic[s] on its website").

b. The *Howey* Test, as Applied to the SEC's Claims, Dictates That Certain Transactions Involving the Crypto-Assets Qualify as Investment Contracts

Against this backdrop, the Court turns to the specific question of whether the SEC has adequately pleaded that Coinbase intermediated transactions involving Crypto-Assets that suffice to constitute "investment contracts" under the three-pronged *Howey* test. Because Defendants do not dispute that purchasers of the Crypto-Assets make an "investment of money," the Court's analysis focuses on the two remaining *Howey* prongs. Taking each in turn, the Court concludes that the SEC has adequately alleged that purchasers of certain crypto-assets on the Coinbase Platform and through Prime invested in a common enterprise and were led to expect profits solely from the efforts of others, thereby satisfying the *Howey* test for an investment contract.

i. Crypto-Asset Purchasers Were in a Common Enterprise with the Developers of Those Assets

The second *Howey* prong, the existence of a common enterprise, may be demonstrated through horizontal commonality. *Howey*, 328 U.S. at 298-99. Horizontal commonality is established when "investors' assets are pooled and the fortunes of each investor [are] tied to the fortunes of other investors as well as to the success of the overall enterprise." *Telegram*, 448 F. Supp. 3d at 369 (citing *Revak*, 18 F.3d at 87); *see also SG Ltd.*, 265 F.3d at 49 (describing "horizontal commonality" as "a type of commonality that involves the pooling of assets from multiple investors so that all share in the profits and risks of the enterprise").[10]

Here, the SEC has plausibly alleged horizontal commonality. As detailed in the Complaint, token issuers, developers, and promoters frequently represented that proceeds from crypto-asset sales would be pooled to further develop the tokens' ecosystems and promised that these improvements would benefit all token holders by increasing the value of the tokens themselves.

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[10] *See Kik Interactive*, 492 F. Supp. 3d at 178 n.5:

> "Some circuits hold that a common enterprise can also exist by virtue of 'vertical commonality', which focuses on the relationship between the promoter and the body of investors." [*Revak* v. *SEC Realty Corp.*, 18 F.3d 81, 87 (2d Cir. 1994).] The Second Circuit has expressly rejected broad vertical commonality, which only requires the fortunes of the investors to be linked to the efforts of the promoter. *Id.* at 87-88. The Second Circuit has not yet decided whether strict vertical commonality, which requires that the fortunes of the investor be tied to the fortunes of the promoter, can satisfy the "common enterprise" element of the *Howey* test. *Id.*

As with the court in *Kik Interactive*, because this Court finds that horizontal commonality is present here, it does not consider whether vertical commonality (i) is sufficient for a finding of a common enterprise or (ii) is present here.

(*See, e.g.*, Compl. ¶¶ 133-134 (alleging public statements by Solana Labs that it would pool the proceeds from its private and public SOL sales and use those proceeds to grow Solana's developer ecosystem), 172-179 (alleging online postings by Protocol Labs that it had pooled investment proceeds from FIL sales to fund the development and growth of the Filecoin network, which in turn would "drive demand for the token"), 209 (alleging statements by Sky Mavis that the "team has used funds raised" in the sale of AXS on "development and marketing"); 220 (alleging Chiliz whitepaper statements that funds raised through token sales would be used to "acquire new users" for the CHZ platform and "grow engagement").

The ability of a Crypto-Asset purchaser to profit, therefore, is dependent on both the successful launch of the token and the post-launch development and expansion of the token's ecosystem. If the development of the token's ecosystem were to stagnate, all purchasers of the token would be equally affected and lose their opportunity to profit. As such, the SEC has adequately pleaded that investors and issuers were joined in a common, profit-seeking enterprise. *See, e.g.*, *Terraform I*, 2023 WL 4858299, at *13 (finding that the SEC demonstrated horizontal commonality "by alleging that the defendants[] used proceeds from LUNA coin sales to develop the Terraform blockchain and represented that these improvements would increase the value of the LUNA tokens themselves"); *Kik Interactive*, 492 F. Supp. 3d at 178-79 (finding horizontal commonality where the issuer of the crypto-assets pooled funds and used the funds to construct and develop its digital ecosystem); *Balestra*, 380 F.

Supp. 3d at 354 (holding that "the value of [a post-launch digital asset] was dictated by the success of the [blockchain] enterprise as a whole, thereby establishing horizontal commonality").

Contrary to Defendants' assertions, neither *Howey* nor its progeny have held that profits to be expected in a common enterprise are limited just to shares in income, profits, or assets of a business. (Def. Br. 18-21). Indeed, the Supreme Court itself has clarified that "when [it] held that 'profits' must 'come solely from the efforts of others,' [it] w[as] speaking of the profits that investors seek on their investment, not the profits of the scheme in which they invest." *Edwards*, 540 U.S. at 394. In this way, the Supreme Court "used 'profits' in the sense of income or return, to include, for example, dividends, other periodic payments, *or the increased value of the investment*." *Id.* (emphasis added); *see also Forman*, 421 U.S. at 852 (stating that "[b]y profits, the Court has meant either capital appreciation resulting from the development of the initial investment … or a participation in earnings resulting from the use of investors' funds"). Here, the SEC has sufficiently alleged that investors reaped their profits in the form of the increased market value of their tokens. *See Terraform I*, 2023 WL 4858299, at *13 (concluding that allegations that issuer "used proceeds from LUNA coin sales to develop the Terraform blockchain and represented that these improvements would increase the value of the LUNA tokens themselves" were sufficient to allege "pooling"); *Balestra*, 380 F. Supp. 3d at 354 (finding that a "formalized profit-sharing mechanism," such as rights to *pro rata* distributions, "is not required"); *Kik Interactive*, 492 F. Supp. 3d at

178 ("Rather than receiving a pro-rata distribution of profits, which is not required for a finding of horizontal commonality, investors reaped their profits in the form of the increased value of [the asset.]").

ii. Purchasers of the Crypto-Assets Had a Reasonable Expectation of Profits from the Efforts of Others

The final *Howey* prong considers whether investors were led to believe they could earn a return on their investment solely by the efforts of others. 328 U.S. at 298-99 (defining an investment contract as one in which an investor is "led to expect profits solely from the efforts of the promoter or a third party"). "An investor possesses an expectation of profit when their motivation to partake in the relevant 'contract, transaction or scheme' was 'the prospect[] of a return on their investment.'" *Telegram*, 448 F. Supp. 3d at 371 (citing *Howey*, 328 U.S. at 301). "The inquiry is an objective one focusing on the promises and offers made to investors; it is not a search for the precise motivation of each individual participant." *Id.* (citing *Warfield* v. *Alaniz*, 569 F.3d 1015, 1021 (9th Cir. 2009)).

Here again, the SEC has adequately pleaded this requirement. The SEC has plausibly alleged that issuers and promoters of the Crypto-Assets — through websites, social media posts, investor materials, town halls, and other fora — repeatedly encouraged investors to purchase tokens by advertising the ways in which their technical and entrepreneurial efforts would be used to improve the value of the asset, and continued to do so long after the tokens were made available for trading on the secondary market. (*See, e.g.*, Compl. ¶¶ 139 (alleging that Solana Labs touted its technical expertise in developing

blockchain networks and described the efforts it would take to develop the blockchain and attract users to the technology), 160 (alleging that Polygon founders promoted MATIC tokens by stating that the team had "a very hands on approach" and was "working around the clock" to scale the platform)). What is more, Coinbase concedes that these statements reached not only the purchasers in the primary market at the initial coin offering stage, but also those potential investors considering whether to acquire the Crypto-Assets in the secondary market. (*See* Jan. 17, 2024 Tr. 83:7-12). Accordingly, an objective investor in both the primary and secondary markets would perceive these statements as promising the possibility of profits solely derived from the efforts of others. *See SEC* v. *LBRY, Inc.*, 639 F. Supp. 3d 211, 220 (D.N.H. 2022) (finding expectation of profits derived from the efforts of the issuer's management team, because the issuer "signaled that it was motivated to work tirelessly to improve the value of its blockchain for itself and any [token] purchasers"); *see also Terraform I,* 2023 WL 4858299, at *14 (finding expectation of profits from the efforts of others when the issuer "repeatedly touted" that profitability would come about through its "investing and engineering experience").

The SEC's claim is further supported by allegations of communications, marketing campaigns, and other public statements to the effect that token issuers would employ deflationary strategies to reduce the total supply of tokens and thereby affect the token price. (*See, e.g.*, Compl. ¶ 140 (alleging public statements by Solana Labs that "Solana transaction fees are paid in SOL

and burnt (or permanently destroyed) as a deflationary mechanism to reduce the total supply and thereby maintain a healthy SOL price")). *See Telegram*, 448 F. Supp. 3d at 372 (finding an expectation of profits, in part, because token issuers promoted their ability to support the token's market price by reducing the supply of available tokens).

Additionally, Crypto-Asset issuers publicized to investors in the primary and secondary markets that profits from the continued sale of tokens would be fed back into further development of the token's ecosystem, which would, in turn, increase the value of the token. (*See, e.g.*, Compl. ¶¶ 154 (alleging that Polygon advertised to investors that the $450 million raised through sale of MATIC would "secure Polygon's lead"), 243 (alleging that FLOW development team promoted planned development activities to support adoption of its blockchain technology)). *See Telegram*, 448 F. Supp. 3d at 375-76 (holding that purchasers' dependence on the issuer to "develop, launch, and support" the token's blockchain was sufficient to find that purchasers' expectations of profits were reliant on the efforts of another); *see also Terraform I*, 2023 WL 4858299, at *14 (finding expectations of profits, in part, because investors were told that profits from the continued sale of LUNA coins would be used to grow the LUNA ecosystem).

In sum, these specific factual allegations, taken as true at this stage, support the SEC's claim that investors in a common enterprise were motivated to purchase certain crypto-assets based on an expectation of profits solely derived from the efforts of others. Accordingly, the Court finds that the SEC

has adequately pleaded that Coinbase customers engaged in transactions involving the Crypto-Assets that amounted to "investment contracts" under *Howey*.

iii. Transactions in Crypto-Assets on the Secondary Market Are Not Categorically Excluded from Constituting Investment Contracts

Contrary to Defendants' assertion, whether a particular transaction in a crypto-asset amounts to an investment contract does not necessarily turn on whether an investor bought tokens directly from an issuer or, instead, in a secondary market transaction. (Def. Br. 13-17). For one, *Howey* does not recognize such a distinction as a necessary element in its test of whether a transaction constitutes an investment contract, nor have courts, in the nearly eighty years of applying *Howey*, read such an element into the test. Rather, under *Howey*, the Court must consider the "economic reality" of the transaction to determine whether that transaction is an investment contract. 328 U.S. at 298.

And with specific regard to the Crypto-Assets at issue here, there is little logic to the distinction Defendants attempt to draw between the reasonable expectations of investors who buy directly from an issuer and those who buy on the secondary market. An investor selecting an investment opportunity in either setting is attracted by the promises and offers made by issuers to the investing public. Accordingly, the manner of sale "has no impact on whether a reasonable individual would objectively view the [issuers'] actions and

statements as evincing a promise of profits based on their efforts." *Terraform I*, 2023 WL 4858299, at *15.

Indeed, while it is theoretically possible that developers of a crypto-asset could intentionally avoid promoting that asset to retail purchasers, the SEC alleges with respect to the 13 Crypto-Assets at issue here that promoters and issuers publicly encouraged *both* institutional investors *and* investors trading in the secondary market to buy their tokens. (Compl. ¶¶ 114-305). This marketing makes sense, as the profitability of the enterprise relies, in part, on the success of the token in the resale market and on capital contributions from both institutional investors and retail purchasers. It is therefore unsurprising that Coinbase itself rebroadcasts these representations by featuring whitepapers and other information that could lead a secondary-market purchaser of a crypto-asset reasonably to expect to earn a profit. (*See, e.g.*, *id.* ¶¶ 77, 121, 137, 212, 226, 242).

Further, because these inducements target purchasers in either market, the risk of manipulation, fraud, and other abuses that the securities laws seek to prevent can be found in both markets. Tellingly, the text of the federal securities laws does not distinguish the nature of the instrument based on its manner of sale. 15 U.S.C. §§ 77e(a), (c), 78e (defining "security" regardless of whether someone "sell[s]" or "offer[s] to sell" the instrument, or whether they "effect any transaction" utilizing the facility of an "exchange"). Consequently, the applicability of the federal securities laws should not be — and indeed, as to more traditional securities, is not — limited to primary market transactions.

Coinbase also reasons that because the transfer of a crypto-asset from one investor to another on its platform does not involve the transfer of any contractual undertaking, no sale of an investment contract can take place. (Def. Br. 7-13; *see id.* at 8 (suggesting that a formal contractual undertaking is "an irreducible feature of the investment contract")). Such a requirement, however, is not formal, but formalistic, and cannot be fairly read into the *Howey* test.

One need go no further than *Howey* itself, where investors purchased tracts of orange groves pursuant to land sale agreements; all were offered, but only a certain percentage entered into, a separate service contract whereby the defendants committed under state law to undertake efforts to cultivate the land for the investors' benefit. 328 U.S. at 296-99. There, the Supreme Court held that the lower court erred by "treat[ing] the contracts and deeds as separate transactions involving no more than an ordinary real estate sale and an agreement by the seller to manage the property for the buyer." *Id.* at 297-98. Rather, the Court explained that the written contracts only "evidenced" the relationships, and the formal legal transfer of rights was "purely incidental." *Id.* at 300. In other words, the Court found that while the presence of these formalities was instructive, it was not dispositive.

This understanding was also evidenced by the Supreme Court's earlier decision in *Joiner*. There, in deciding whether the sale of oil leasehold interests gave rise to investment contracts, the Court found it "unnecessary to determine" whether the purchaser had acquired "a legal right to compel" the

promoter to undertake efforts under state law. 320 U.S. at 349. In doing so, the Court in *Joiner* made it clear that the ability to compel managerial efforts was a state-law concern, and not a necessary element with respect to the federal securities laws.

In support of their argument, Defendants here cite to state court decisions interpreting "Blue Sky" statutes that predate the federal securities laws. (Def. Br. 6-7, 11; *see also* Br. for Securities Law Scholars as *Amici Curiae* 3-12). Tellingly, however, the Court in *Howey* explicitly considered the "many state 'blue sky' laws" in interpreting "investment contract" under the Securities Act, and nevertheless arrived at the foundational principle that "form" should be "disregarded for substance." 328 U.S. at 298. Indeed, taking note of *Howey's* deliberately expansive language to account for future developments in securities transactions, the Supreme Court has repeatedly emphasized that it is the totality of circumstances — the economic reality — surrounding the offer and sale of an asset that matters, and that reality includes the promises and undertakings underlying the investment contract. *See, e.g.*, *Forman*, 421 U.S. at 849; *Tcherepnin*, 389 U.S. at 336.

Defendants' reliance on cases involving real estate transactions similarly does not sway the Court. Coinbase argues that in cases like *Rodriguez* v. *Banco Ctr. Corp.*, 990 F.2d 7 (1st Cir. 1993), and *De Luz Ranchos Inv. Ltd.* v. *Coldwell Banker & Co.*, 608 F.2d 1297 (9th Cir. 1979), courts held that land sale contracts were not securities because promotional statements to develop the land were not legally enforceable. (Def. Br. 9-10). These cases serve as

poor comparators to the facts at hand. As the *Kik Interactive* court explained, real estate has "inherent value," whereas a crypto-asset "will generate no profit absent an ecosystem that drives demand," 492 F. Supp. 3d at 180 — which is precisely what the issuers and promoters of the Crypto-Assets here promised to design and build. In other words, *Howey's* focus on the economic reality of the transaction undermines any attempt to equate the sale of real properties, which possess inherent value and utility, to discrete groups of buyers, with capital raises on Coinbase's platform by issuers and promoters, through the sale of fungible assets with no inherent value, to a potentially unlimited number of public buyers.

Ultimately, since *Howey*, no court has adopted a contractual undertaking requirement. And, as previously noted, courts in this Circuit have repeatedly rejected efforts by defendants in the cryptocurrency industry to insert such a requirement into their *Howey* analysis. *See, e.g.*, *Terraform I*, 2023 WL 4858299, at *11; *Kik Interactive*, 492 F. Supp. 3d at 178. This Court declines to be the first.[11]

Defendants warn that without a contractually grounded obligation, the SEC could claim authority over essentially all investment activity. (Def.

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11 Coinbase seemingly advances a textual argument that the word "contract" cannot be read out of the "investment contract" set forth in the securities laws. (Def. Br. 12). By stating that investment contracts comprise "transaction[s]" and "scheme[s]," and not just "contract[s]," however, the *Howey* Court made clear that a "contract" is not a prerequisite to an "investment contract." 328 U.S. at 298-99. A reading to the contrary would be in direct tension with *Howey's* intentionally broad interpretation of "investment contract" to encompass the sale and offer of securities in whatever form or manner they make take. *See SEC* v. *Terraform Labs Pte. Ltd.*, — F. Supp. 3d —, No. 23 Civ. 1346 (JSR), 2023 WL 8944860, at *13 (S.D.N.Y. Dec. 28, 2023) ("*Howey*'s definition of 'investment contract' was and remains a binding statement of the law, not dicta.").

Reply 2). Not so. Contrary to Defendants' characterization, a Coinbase customer does more than simply "part[] with capital" in the hopes that her purchase "will increase in value." (*Id.*). Such a characterization ignores *Howey's* second element, the need for a common enterprise. When a customer purchases a token on Coinbase's platform, she is not just purchasing a token, which in and of itself is valueless; rather, she is buying into the token's digital ecosystem, the growth of which is necessarily tied to value of the token. This is evidenced by, among others, the facts that (i) initial coin offerings are engineered to have resale value in the secondary markets (*see, e.g.*, Compl. ¶¶ 137-139), and (ii) crypto-asset issuers continue to publicize their plans to expand and support the token's blockchain long after its initial offering (*see, e.g.*, *id.* ¶¶ 138-139). In a similar vein, developers advertise the fact that capital raised through retail sales of tokens will continue to be re-invested in the protocol, leading token holders reasonably to expect the value of the tokens to increase in accordance with that protocol. (*See, e.g.*, *id.* ¶ 220). Therefore, the sale of an investment contract, here, necessarily includes the investment in the token's broader enterprise, manifested by the full set of expectations and understandings surrounding the sale and distribution of the asset.

In this way, the offer and sale of cryptocurrencies can be distinguished from commodities or collectibles. Unlike in the transaction of commodities or collectibles (including the Beanie Babies discussed during the oral argument, *see* Jan. 17 Tr. 55:8-58:9), which may be independently consumed or used, a crypto-asset is necessarily intermingled with its digital network — a network

without which no token can exist. *See Balestra*, 380 F. Supp. 3d at 357 (stating that "without the promised ATB Blockchain, there was essentially no 'market' for ATB Coins, which clearly distinguishe[d] the coins from the precious metals to which Defendants attempt to analogize them"); *cf. Friel* v. *Dapper Labs, Inc.*, 657 F. Supp. 3d 422, 439 (S.D.N.Y. 2023) (rejecting comparison of non-fungible token transactions to collectibles).

4. The Court Declines to Dismiss Counts I, II, III, and IV as Applied to the Coinbase Platform and Prime Service

Having found that the SEC plausibly asserts that Coinbase facilitated transactions in crypto-asset "securities" as the term is defined in the Securities Act, the Court now addresses whether Coinbase acted as an exchange, a broker, and a clearing agency, without registering, in violation of Sections 5, 15(a), and 17A(b) of the Exchange Act (Counts I, II, III), and whether, for purposes of Coinbase's violations of the Exchange Act, CGI was a control person of Coinbase under Section 20(a) of the Exchange Act (Count IV).

According to the well-pleaded allegations of the Complaint, Coinbase provides a marketplace that, among other things, "bring[s] together purchasers and sellers of [crypto-asset] securities" and matches and executes their orders. 15 U.S.C. § 78c(a)(1) (defining "exchange"). Coinbase also "engage[s] in the business of effecting transactions in securities for the account of others" by, for example, soliciting potential investors, holding itself out as a place to buy and sell crypto-asset securities, facilitating trading in crypto-asset securities by opening customer accounts and handling customer funds and assets, and charging transaction-based fees. *Id.* § 78c(a)(4) (defining "broker"). Finally,

Coinbase "acts as a custodian of securities" by requiring customers to deposit their crypto-asset securities in Coinbase-controlled wallets, creating a system for the central handling of securities to settle customers' transactions. *Id.* § 78c(a)(23)(A) (defining "clearing agency"). For the purposes of this motion, Coinbase does not dispute (with the exception of the Wallet application) that it carried out these functions. Accordingly, with respect to the Coinbase Platform and Prime service, the Court denies Defendants' motion to dismiss Counts I, II, and III of the Complaint.[12]

Further, the SEC has adequately pleaded that CGI is liable as a control person of Coinbase for the purposes of Exchange Act Section 20(a). At all relevant times, CGI exercised power and control over its wholly-owned subsidiary, Coinbase, including by managing and directing Coinbase, and by directing and participating in the acts constituting Coinbase's Exchange Act violations. (Compl. ¶ 384). Accordingly, the Court denies Defendants' motion to dismiss Count IV of the Complaint.

5. The SEC Plausibly Alleges That Coinbase, Through Its Staking Program, Engages in the Unregistered Offer and Sale of Securities in Violation of Section 5 of the Securities Act

In its Fifth Claim for Relief, the SEC alleges that Coinbase itself is the promoter of a crypto-asset investment contract. In particular, the SEC alleges that Coinbase has violated, and continues to violate, Sections 5(a) and 5(c) of the Securities Act by engaging in the unregistered offer and sale of securities in

[12] Here, the Court discusses Count II only insofar as it relates to acts engaged by Coinbase apart from its offering of the Wallet service. The Opinion discusses the Wallet service itself *infra*.

connection with its Staking Program. (Compl. ¶ 309). Through the Staking Program, customers' crypto-assets are transferred to and pooled by Coinbase and subsequently "staked" by Coinbase in exchange for rewards, which Coinbase distributes *pro rata*.

The Staking Program, discussed in greater detail *infra*, enables Coinbase customers to stake five different crypto-assets. (Compl. ¶¶ 7, 339). As the SEC asserts, the Staking Program as applied to each of these five assets constitutes an investment contract under *Howey* and, therefore, a security subject to registration under the Securities Act. (*Id.* ¶ 339).[13] Yet, Coinbase has never filed or otherwise effected a registration statement with the SEC for its offer and sale of its Staking Program. This failure, the SEC alleges, deprives investors of material information about its offerings in connection with the Staking Program, including information concerning how Coinbase uses the proceeds of those offerings and the risks and trends that affect the staking enterprise. (*Id.* ¶¶ 309, 369).

Coinbase, consistent with its broader crypto ethos, maintains that the Staking Program does not constitute an investment contract under *Howey*, and that it was therefore under no obligation to register or otherwise undertake SEC compliance obligations with respect to the Program. (Def. Br. 27). As set forth herein, the Court finds that the SEC has adequately alleged that the

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[13] Consistent with the broad definition of securities under the Securities Act, courts have found that programmatic offerings akin to the Staking Program can constitute investment contracts, to the extent they satisfy the elements of the *Howey* analysis. *See, e.g.*, *SEC* v. *Edwards*, 540 U.S. 389 (2004) (payphone investment program).

Staking Program constitutes an investment contract under *Howey*, given, among other things: (i) the risk of loss associated with participation in the Staking Program, (ii) Coinbase's significant technical efforts in implementing and maintaining the Program, and (iii) Coinbase's promotional efforts to drive customer participation in the Program.

a. Factual Background

Coinbase's Staking Program is a crypto-asset staking service. Broadly speaking, staking is an essential component of many blockchains' consensus protocols, which, among other things, are necessary to achieve agreement among users as to a data value or as to the state of a ledger on a given blockchain. (Compl. ¶ 48). *See generally Dapper Labs*, 657 F. Supp. 3d at 427-28 (distinguishing "proof of work" and "proof of stake" blockchain validation methods). These consensus protocols employ a decentralized method to agree on which ledger transactions are valid, when and how to update the blockchain, and — importantly — when and how to compensate participants for validating transactions and adding new blocks. (Compl. ¶ 49). The potential for compensation can provide significant upside to holders of a crypto-asset, essentially allowing them to earn a financial return on their crypto-asset simply through participation in the protocol.

To participate in such a protocol requires "[p]roof of stake," which is a type of "consensus mechanism" used by a given blockchain that involves selecting block "validators" from crypto-asset holders who have committed or "staked" a minimum number of crypto-assets. (Compl. ¶ 50). Any holder of a

crypto-asset may qualify for selection into a group or pool of validators, provided that she commit, or "stake," a threshold amount of the blockchain's native asset (*e.g.*, ETH for Ethereum) and secure the technical resources required to run a "validator node" to perform the necessary computing functions. (*Id.* ¶ 313). The staked assets are then held as collateral in the protocol to incentivize the validator to perform required functions. (*Id.*). In addition, certain protocols charge crypto-asset validators fees to stake and unstake crypto-assets and require an upfront refundable deposit (in addition to the crypto-assets staked). (*Id.*). A "correction penalty" is deducted, or "slashed," from the staked crypto-assets of validators who underperform. (*Id.*). Conversely, validators earn rewards, often in the form of additional amounts of the blockchain's native crypto-asset, by timely voting on proposed blocks, proposing new blocks, and participating in other consensus activities. (*Id.*).

Importantly, a crypto-asset holder's chances of being selected as a validator, and thereby qualifying to receive rewards through participation in the consensus protocol, depend on its "proof of stake" and its reliability. (Compl. ¶ 314). A crypto-asset holder can maximize her chances of receiving the maximum staking reward by, in turn, maximizing her "proof of stake" (*i.e.*, the amount of crypto-assets committed to the protocol as collateral) and committing significant processing power to the validation node, to minimize any potential server downtime. (*Id.*). In short, the most successful staking programs maximize the chances of being selected by staking a larger number of

assets and by optimizing computer resources to minimize server downtime, relative to other competing programs on a given blockchain. (*Id.*).

The amount of time set by a protocol for a crypto-asset to be staked by a validator before that validator is eligible to earn rewards is referred to as the "bonding period." (Compl. ¶ 315). In certain cases, a bonding period may require a commitment of several weeks before a validator can begin earning rewards. (*Id.*). During the time the crypto-assets are bonded to a protocol, the crypto-asset owners are typically unable to transact in them, even to react to market price fluctuations of the crypto-assets. (*Id.*). To "unstake" assets and transfer or use them for other purposes can also take weeks. (*Id.*).

Coinbase's Staking Program capitalizes on the reward structure of the "proof of stake" consensus mechanisms used by the XTZ (Tezos), ATOM (Cosmos), ETH (Ethereum), ADA (Cardano), and SOL (Solana) tokens. (Compl. ¶¶ 310, 312, 316). To participate in the Coinbase Staking Program, staking customers must tender their crypto-assets to Coinbase by either purchasing staking-eligible crypto-assets from Coinbase or transferring their own crypto-assets to their Coinbase account for staking. (*Id.* ¶ 340). Once each eligible crypto-asset is in a customer's Coinbase account and designated for staking, it is then transferred by Coinbase to an omnibus crypto-asset wallet controlled by Coinbase (and segregated by asset),[14] wherein Coinbase pools the assets along with its own crypto-assets. (*Id.* ¶¶ 310, 348). Thereafter, Coinbase "stakes" (or

[14] In other words, Staking Program participants' XTZ, ATOM, ETH, ADA, and SOL tokens are pooled by asset. (Compl. ¶ 339).

commits) these crypto-assets in connection with validation nodes run by both Coinbase and third-party validators that Coinbase selects, to obtain rewards, which Coinbase then distributes *pro rata* to investors after deducting for itself a 25% or 35% commission. (*Id.* ¶ 310).

While an individual can stake on her own behalf, or "solo stake," the SEC claims that Coinbase offers and markets several features of its Staking Program that differentiate it from solo staking — a process that, according to Coinbase, can be "confusing, complicated, and costly." (Compl. ¶¶ 316, 360). For one, Coinbase's Staking Program offers no, or low, staking minimums (the threshold number of crypto-assets discussed above) or deposits to participate in staking. (*Id.* ¶ 318). This offer is significant, as the minimums required by many blockchains are considerable, and thus unattainable for solo investors. For example, the Ethereum blockchain requires users to stake a minimum of 32 ETH (worth approximately $60,000 at the time the Complaint was filed) to run a validator node. (*Id.*). But the Coinbase Staking Program allows participants to participate in staking without having to meet such thresholds; as Coinbase advertises, customers can "[s]tart earning with as little as $1." (*Id.*).

Relatedly, the SEC alleges that running a validator node is often expensive, for example, due to the significant up-front cost of the equipment and/or software needed to perform the computing functions associated with staking. (Compl. ¶ 319). Through the Coinbase Staking Program, investors avoid incurring these expenses directly, because Coinbase operates its own

validator nodes to earn and pay investor rewards, in addition to contracting with third-party validators. (*Id.* ¶¶ 319, 345). Operating the equipment and software needed to stake can also be complex and time-consuming. For example, CGI's February 21, 2023 Form 10-K filed with the SEC stated: "Staking independently requires a participant to run their own hardware, software, and maintain close to 100% up-time." (*Id.* ¶ 319). Similarly, Coinbase acknowledges on its website that "[b]ecoming a validator is a major responsibility and requires a fairly high level of technical knowledge." (*Id.*). Through the Staking Program, however, Coinbase "reduces the[se] complexities." (*Id.*).

Further, until approximately April 2023, the Coinbase Staking Program maintained a "liquidity pool" of crypto-assets for each of the five stakeable assets that were held in reserve, which pool enabled Coinbase to provide participant customers with faster liquidity in connection with unstaking requests. (Compl. ¶ 320). While a staking participant would not typically be able to trade or "cash out" their cryptocurrency while earning rewards through staking, Coinbase's liquidity pool allowed customers using Coinbase's staking services to do so. (*Id.*). As a result, during the relevant period, Coinbase was able to offer Staking Program participants enhanced liquidity and quicker reward payments compared to staking on their own.[15]

[15] Effective April 1, 2023, Coinbase purports to no longer maintain reserves of stakeable assets. Accordingly, investors' crypto-assets cannot be traded or sent while they are staked and earning rewards without first unstaking them. (Compl. ¶ 320).

Coinbase seeks to capitalize on these advantages. For example, on its website, Coinbase states:

> [S]taking your own crypto is a challenge for most investors. To stake on your own requires running a node on your own hardware, syncing it to the blockchain, and funding the node with enough cryptocurrency to meet minimum thresholds, including providing a sizable deposit and bond. On Coinbase, we do all this for you.

(Compl. ¶ 360). Further, Coinbase touts its technical and entrepreneurial skills, for example, stating that it possesses a "fairly high level of technical knowledge," as well as "state-of-the-art encryption and security" required to stake successfully and safely, and that it has "experience [that] allows [it] to … safely support new products like staking." (*Id.* ¶ 364). Coinbase also promotes the returns that customers could earn by participating in the Coinbase Staking Program. (*Id.* ¶ 322). For example, Coinbase advertises the "estimated reward rate" for each of the five staking-eligible crypto-assets as ranging between approximately 2% and 6.12%. (*Id.* ¶ 324).

Finally, Coinbase markets the growth of the Staking Program and Coinbase's correlative success in generating returns for customer participants. (Compl. ¶ 326). For example, in a post on its Twitter account on or about May 28, 2020, Coinbase stated that "[s]ince launching in the US last fall, customers have earned over $2 million in Tezos staking rewards." (*Id.* ¶ 327). And Coinbase's efforts have borne fruit: As of July 2022, over 4 million U.S. customers were invested in the Coinbase Staking Program, and as of the end of 2021, the total value of crypto-assets committed by participants to the Staking

Program was approximately $28.7 billion, earning Coinbase approximately $275 million in revenue. (*Id.* ¶¶ 334, 336).

b. Analysis

To review, the SEC alleges that the Staking Program allows Coinbase customers to invest their assets and earn financial returns through Coinbase's managerial efforts. (Compl. ¶ 7). Accordingly, the SEC asserts that the Staking Program, as applied to each of the five stakeable assets, is an investment contract under *Howey*. Coinbase does not contest the SEC's allegations regarding the presence of a "common enterprise." Instead, Coinbase asserts that (i) Staking Program participants' tendering of their crypto-assets to Coinbase does not constitute an "investment of money" (Def. Br. 27-29); and (ii) Coinbase's efforts to generate the returns it marketed to participants are not "managerial" but merely "ministerial," such that the profits associated with the Staking Program do not arise from the "efforts of others" (*id.* at 2, 4, 29-30). Taking each argument in turn, the Court finds the SEC has sufficiently pleaded at this stage that Coinbase offered and sold its Staking Program as an investment contract.

i. The Complaint Adequately Alleges an Investment of Money

Coinbase argues in the first instance that staking participants do not "invest money" under *Howey* because the Staking Program "create[s] no risk" of loss. (Def. Br. 27-29). This risk-of-loss requirement was added to the *Howey* test by the Supreme Court in *Marine Bank* v. *Weaver*, wherein the Court observed that for an instrument to be a security, the investor must risk loss.

See 455 U.S. at 558-59; *see also SEC* v. *Rubera*, 350 F.3d 1084, 1090 (9th Cir. 2003) ("We have stated that *Howey's* 'investment of money' prong requires that the investor 'commit his assets to the enterprise in such a manner as to subject himself to financial loss.'" (quoting *Hector* v. *Wiens*, 533 F.2d 429, 432 (9th Cir. 1976))). This requirement makes sense, for if an investor did not risk financial loss, the need for the protection of the federal securities laws would be "obviate[ed]." *Gary Plastic Packaging Corp.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 756 F.2d 230, 240 (2d Cir. 1985).

Here, however, the Complaint's well-pleaded allegations sufficiently detail the ways in which staking participants' assets are put at a risk of loss. For one, once a customer's crypto-assets are tendered to Coinbase and staked to the underlying blockchain protocol, those assets are at risk of being "slashed." (Compl. ¶ 343). The fact that Coinbase has never suffered a slashing event (*see* Answer ¶ 161), does not change the fact that the risk of loss exists. *See Rubera*, 350 F.3d at 1090 ("[W]hether the majority of investors in the telephone investment program actually suffered a monetary loss is immaterial so long as there existed the risk of loss."). And while Coinbase pledges to indemnify customers for slashing penalties, the indemnification is limited to, among other things, penalties resulting from Coinbase's acts or omissions. (User Agreement App'x 4 § 3.1.3).[16] Conversely, staking customers are expressly not entitled to

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[16] In full, the "Slashing" provision of the User Agreement states:

> Some Digital Asset networks subject staked assets to "slashing" if the transaction validator representing those assets incorrectly validates a transaction. Coinbase will use commercially reasonable efforts to prevent any staked assets from slashing; however, in the

indemnification for slashing losses arising out of "acts or omissions of any third party service provider"; "a force majeure event as defined in Section 9.6 of the User Agreement"; "acts by a hacker or other malicious actor"; or "any other events outside of Coinbase's reasonable control." *Id.* While the chances of such downsides might be remote, the downsides themselves are not insignificant, and present a plausible scenario in which a customer may face a significant risk of loss through participation in the Staking Program.

Even if Coinbase's indemnification of customer participants for slashing-related losses were complete, the SEC alleges that customers are still exposed to additional risks that inhere in Coinbase's operation of the Staking Program. For example, once a customer's crypto-assets are staked to the underlying blockchain protocol, those assets are at risk of being lost in the event the relevant blockchain is forced (or chooses) to shut down or cease operations. (Compl. ¶ 344). Further, CGI itself acknowledges other risks in its SEC regulatory filings, including that "customers' assets may be irretrievably lost" due to cybersecurity attacks, loss of customers' private keys, or other security issues, or if Coinbase's node "validator, any third-party service providers, or smart contracts fail to behave as expected." (*Id.* ¶ 345).

> event they are, Coinbase will replace your assets so long as such penalties are not a result of: (i) protocol-level failures caused by bugs, maintenance, upgrades, or general failure; (ii) your acts or omissions; (iii) acts or omissions of any third party service provider; (iv) a force majeure event as defined in Section 9.6 of the User Agreement; (v) acts by a hacker or other malicious actor; or (vi) any other events outside of Coinbase's reasonable control.

(User Agreement App'x 4 § 3.1.3).

Contrary to Coinbase's assertions, the risk of loss matters even if it applies broadly to all Coinbase customers (not just staking participants), and even if the risk applies equally to solo-staking and non-solo-staking customers. (Def. Br. 27-28). In each circumstance, the customer still commits her assets to the Coinbase Staking Program in such as a manner as to "subject h[erself] to financial loss." *Rubera*, 350 F.3d at 1090. What is more, the Second Circuit has held that risks need not be promoter-specific to constitute a risk of loss for purposes of the *Howey* test. *See Gary Plastic*, 756 F.2d at 241 (finding investors relied on the solvency of both the underlying bank and the promoter). To that point, the economic reality is such here that certain broader risks — including failures by Coinbase or of the underlying protocol — are also inherent in the investments in the staking service and are thus sufficient to demonstrate a risk of loss.

Defendants next take issue with the Complaint's allegation that staking participants "invest money" by "giv[ing] up control" of their crypto-assets in order to stake with Coinbase as additional evidence of risk of loss. (Def. Br. 28-29 (citing Compl. ¶¶ 341-342 (alleging that "investors tender their crypto[-]assets to Coinbase in order to participate in the Coinbase Staking Program"))). Defendants contend that "at no point in the staking process do users ever give up ownership or control of their assets to Coinbase" (*id.*), as the User Agreement makes clear that users at all times "control the Digital Assets held in [their] Digital Asset Wallet" (User Agreement § 2.7.3), and that staking "does

not affect the ownership of [users'] digital assets in any way" (*id.* App'x 3 § 3.1.1).

As it happens, *Howey* imposes no requirement that investors give up permanent "ownership" over the capital invested in the enterprise. *See Edwards*, 540 U.S. at 391-92 (investors purchased payphones but entered into a buyback agreement promising to refund the purchase). Indeed, the sole case Defendants identify in support of their argument — *International Brotherhood of Teamsters* v. *Daniel* — states, in relevant part, "[i]n every decision of this Court recognizing the presence of a 'security' … the person found to have been an investor chose to give up a *specific consideration* in return for a separable financial interest." 439 U.S. 551, 559 (1979) (emphasis added).

Such a condition is satisfied here. To stake with Coinbase, customer participants must transfer their staking-eligible assets to Coinbase's omnibus wallets, where they are commingled with Coinbase's own crypto-assets and treated as fungible. (Compl. ¶¶ 310-311, 340-341, 348-350). Coinbase then stakes the assets, at which point they are locked-in to participate in the staking. (*Id.* ¶¶ 315, 341). During this time, participants are unable to transact in their crypto-assets, including to quickly react to market price fluctuations, and thus their control over their crypto-assets is necessarily constrained. (*Id.*). As such, staking participants provide "specific consideration" in return for financial rewards derived from staking. *Int'l Bhd. of Teamsters*, 439 U.S. at 559.

In sum, taking the well-pleaded allegations as true, which the Court must at this juncture, the SEC has sufficiently alleged that Coinbase customers' tendering of their crypto-assets in connection with the Staking Program constitutes an "investment of money" under *Howey*.

ii. The Complaint Adequately Alleges That Staking Participants Reasonably Expect to Profit Based on Coinbase's Managerial Efforts

Alternatively, Defendants argue the SEC does not "allege any managerial efforts on the part of Coinbase," thereby "negat[ing] *Howey's* efforts-of-others element as a matter of law." (Def. Br. 29-30).[17] Again, the Court must disagree.

By its terms, *Howey* requires that profits be generated solely from the "efforts of others." 328 U.S. at 298. Prior cases have established that for this prong to be met, the activities of the promoter must be of a managerial or entrepreneurial character, and not merely ministerial or clerical. *See, e.g.*, *SEC* v. *Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, 482 (9th Cir. 1973) (stating that efforts of others must be "undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise"); *see*

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[17] Defendants also argue that "[s]taking rewards are not properly conceived as investment profit," but are instead simply "payments" for putting crypto-assets to work. (Def. Br. 29). Here, the SEC has sufficiently pleaded that the investing public is attracted by representations of investment income, as customers were in this case by Coinbase's invitation to "[e]arn as much as you want." (Compl. ¶ 322). While it is true that staking rewards are determined by the protocols of the applicable blockchain network, Coinbase has acknowledged its ability to change the reward payout amount at its discretion. (*Id.* ¶¶ 324 (stating publicly that Coinbase "ha[s not] changed the reward payout rate on [its] retail [staking] product within the year"), 351 (stating on its website that the staking "reward rate can also be influenced by factors including, but not limited to, validator performance" and the "amount staked/stakers," and not just the "rates set by the network")).

also Forman, 421 U.S. at 852 ("The touchstone [of the *Howey* test] is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."). In *Howey*, for example, the promoter not only sold orchard lots, but also contracted to manage the lots as an orchard after they were purchased. 328 U.S. at 299-300. Such a requirement helps distinguish between investment contracts that are securities and investment contracts that are simply investments. Where the realization of profits depends significantly on the success of the promoter's managerial or entrepreneurial efforts, the degree of dependence between the investors' profits and the promoter's activities is heightened. In contrast, a promoter's ministerial or clerical activities that are routine in nature are less important to investors' expectations, as "anyone including the investor himself could supply these services." *SEC* v. *Life Partners, Inc.*, 87 F.3d 536, 545-46 (D.C. Cir. 1996).

Here, the Complaint sufficiently alleges that Coinbase has promised and undertaken significant post-sale managerial efforts, including: retaining third parties to stake participant assets (in addition to its own validators); deploying proprietary software and equipment; maintaining "liquidity pools" (or reserves) to allow for quicker participant withdrawals; drawing "stake" from pools of investor assets; working to increase the likelihood that a blockchain network will select Coinbase to validate transactions by pooling customer assets across multiple validator nodes; and marshalling its technical expertise to operate and maintain nodes and stake customer assets in a manner that provides

maximum server uptime, helps prevent malicious behavior or hacks, and protects keys to staked assets. (*See* Compl. ¶¶ 312-321, 351, 357-367).[18]

Contrary to Defendants' assertion, the fact that Coinbase's efforts may be technical in nature does not mean they cannot also be managerial or entrepreneurial. (Def. Reply 15). Indeed, courts have recognized investment contracts in situations where a promoter has taken an established technology and built an enterprise on top of it. *See, e.g.*, *Edwards,* 540 U.S. at 391-92 (creating an investment program involving payphones by "install[ing] the equipment," maintain[ing] and repair[ing]" the payphones, arranging for connection service, and collecting coin revenues). Here, Coinbase, through its deployment of sophisticated and expensive software and hardware, has created, at a large scale, an opportunity to profit from the complex staking infrastructure, making it more likely that Coinbase's staking customers will receive returns because Coinbase can support maximum server uptime and amass a considerably larger pool of assets to be staked at its validator nodes. In doing so, Coinbase can more reliably earn rewards and distribute those returns to participants. Accordingly, in the aggregate, such efforts cannot be

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[18] The parties disagree as to whether a promoter's pre-sale or post-sale efforts alone may suffice under *Howey*, and both identify authority from outside the Second Circuit in support of their positions. *Compare SEC* v. *Life Partners*, 87 F.3d 536, 545 (D.C. Cir. 1996) (observing that "post-purchase entrepreneurial activities are the 'efforts of others' most obviously relevant to the question whether a promoter is selling a 'security'"), *with SEC* v. *Mut. Ben. Corp.*, 408 F.3d 737, 743 (11th Cir. 2005) ("We are not convinced that either *Howey* or *Edwards* require such a clean distinction between a promoter's activities prior to his having use of an investor's money and his activities thereafter."). Resolution of the significance *vel non* of a promoter's pre-sale efforts is unnecessary here because, as the SEC argues and the Court agrees, Coinbase's post-sale managerial efforts alone are sufficient to satisfy *Howey*. (SEC Opp. 29-30 ("However any distinction between pre-sale and post-sale efforts is … meaningless here where the Complaint alleges Coinbase has … undertaken significant post-sale managerial efforts[.]")).

said to have no "material impact upon the profits of the investors." *Life Partners, Inc.*, 87 F.3d at 546.

Further, while it remains the case that customers can stake on their own, Coinbase's arguments to this Court downplaying the economic and technical barriers to solo staking stand in sharp contrast to Coinbase's representations to its customers of the significant efforts it exerts to offer and market those features that differentiate the Coinbase Staking Program from staking independently. (*See* Compl. ¶¶ 316 (emphasizing that staking is "confusing, complicated, and costly," but that with the Staking Program, Coinbase is "changing all that"), 319 (explaining that staking independently "requires a participant to run their own hardware, software, and maintain close to 100% up-time," but that Coinbase "reduces the[se] complexities"), 360 (telling potential participants that staking "your own crypto is a challenge," but that Coinbase "do[es] all this for you")). All this is consistent with what Coinbase tells customers when promoting its Staking Program — that Coinbase, and not prospective solo stakers, possesses the "fairly high level of technical knowledge," as well as the "experience [that] allows [it] to … safely support new products like staking." (*Id.* ¶ 364). Anyone reading these statements would expect to rely on the promoter's (here, Coinbase's) managerial efforts to generate the profits. Accordingly, the SEC adequately pleads a reasonable expectation of profits from the efforts of a third party under *Howey*.

By virtue of the foregoing, the Court finds that the SEC has sufficiently alleged that Coinbase offers and sells the Staking Program as an investment contract. Since, for the purposes of this motion, Coinbase does not dispute that it has never had a registration statement filed or in effect with the SEC for the Coinbase Staking Program as it applies to each of the five stakeable crypto-assets, and no exemption from registration applies, the Court finds that the SEC has plausibly alleged that Coinbase has violated Securities Act Sections 5(a) and 5(c). Accordingly, at this stage of pleading, the Court denies Defendants' motion to dismiss Count V of the Complaint.

6. The Court Dismisses the SEC's Claim That Coinbase Acts as an Unregistered Broker Through Its Wallet Service in Violation of Section 15(a) of the Exchange Act

Finally, the SEC alleges that Coinbase conducts brokerage activity though its Wallet application. (Compl. ¶ 4). On this point, Coinbase contests the SEC's allegations by reverting to its foundational argument that the underlying Crypto-Assets are not securities, as well as more specific arguments that the allegations regarding Wallet do not support any finding that Coinbase acted as an unregistered broker. While the Court finds that the SEC has alleged sufficient facts to show that at least some of the transactions in the tokens it identifies in the Complaint (which can be accessed by customers using Wallet) are "investment contracts," it ultimately concludes that the SEC's claim as to Wallet fails for the independent reason that the pleadings fall short of demonstrating that Coinbase acts as a "broker" by making Wallet available to customers.

a. Factual Background

As discussed *supra*, important to a crypto-asset owner's exercise of control over her crypto-asset is the "private key" associated with that asset. (Compl. ¶ 47). A "private key" allows owners to transfer their assets. (*Id.*). Crypto wallets offer a method to store and manage information about the crypto-assets, including the "private key" associated with a crypto-asset. (*Id.*). Crypto wallets can reside on devices that are connected to the internet (sometimes called a "hot wallet"), or on devices that are not connected to the internet (sometimes called a "cold wallet" or "cold storage"). (*Id.*). Because the "private key" is stored locally on the user's device, no one but the person who physically has access to that device, including the creator of the wallet application, can transact on that user's behalf. (*Id.* ¶¶ 47, 64). It is for this reason that crypto wallet applications are frequently described as "self-custodial." (*Id.* ¶¶ 64, 72).

Coinbase offers customers these custodial functions through Coinbase Wallet. Wallet is a separate product from the Coinbase Platform, and customers use Wallet by downloading a separate program on their device. (Compl. ¶ 67). Moreover, Coinbase does not maintain custody over the crypto-assets traded through Wallet — unlike assets held on the Coinbase Platform — as the assets held through Wallet are "self-custodied." (*Id.* ¶ 64).

To enhance its functionality, Coinbase's Wallet application also interlinks with third-party platforms to facilitate a user's transactions. (Compl. ¶ 64). Specifically, Wallet allows a Coinbase customer to access third-party

decentralized trading platforms (or DEXs) to participate in retail trades outside the Coinbase Platform. (*Id.*). A user can therefore transact in crypto-assets from numerous blockchains, including to buy, sell, receive, "swap," or "bridge," via assets held in that user's Wallet. (*Id.*). Coinbase advertises that "Coinbase Wallet brings the expansive world of DEX trading to your fingertips, where you can easily swap thousands of tokens, trade on your preferred network, and discover the lowest fees," and further proclaims that Wallet "makes it easy to access [] tokens through its trading feature, which compares rates across multiple exchanges." (*Id.* ¶ 82). In exchange for this service, through at least March 2023, Coinbase charged a flat fee of 1% of the principal amount for each transaction executed through the swap/trade feature in Wallet. (*Id.* ¶ 101).

b. Analysis

Under the Exchange Act, a "broker" is broadly defined as "any person engaged in the business of effecting transactions in securities for the account of others." 15 U.S.C. § 78c(a)(4)(A). Courts consider a number of factors to determine whether an entity is acting as a broker, including whether it

> (1) actively solicits investors; (2) receives transaction-based compensation; (3) handles securities or funds of others in connection with securities transactions; (4) processes documents related to the sale of securities; (5) participates in the order-taking or order-routing process; (6) sells, or previously sold, securities of other issuers; (7) is an employee of the issuer; (8) is involved in negotiations between the issuer and the investor; and/or (9) makes valuations as to the merits of the investment or gives advice.

SEC v. *GEL Direct Tr.*, No. 22 Civ. 9803 (JSR), 2023 WL 3166421, at *2 (S.D.N.Y. Apr. 28, 2023); *see also Found. Ventures, LLC* v. *F2G, Ltd.*, No. 08 Civ.

10066 (PKL), 2010 WL 3187294, at *5 (S.D.N.Y. Aug. 11, 2010) (collecting cases). The key inquiry is whether a promoter's conduct may be characterized by "a certain regularity of participation in securities transactions at key points in the chain of distribution." *Mass. Fin. Serv., Inc.*, 411 F. Supp. at 415; *see also SEC* v. *Kramer*, 778 F. Supp. 2d 1320, 1336 (M.D. Fla. 2011) ("The evidence must demonstrate involvement at key points in the chain of distribution, such as participating in the negotiation, analyzing the issuer's financial needs, discussing the details of the transaction, and recommending an investment." (internal quotation marks omitted)). A determination of whether a person acts as a broker is based on the totality of the circumstances. *SEC* v. *RMR Asset Mgmt. Co.*, No. 18 Civ. 1895 (AJB) (LL), 2020 WL 4747750, at *2 (S.D. Cal. Aug. 17, 2020), *aff'd sub nom. SEC* v. *Murphy*, 50 F.4th 832 (9th Cir. 2022).

As an initial matter, the SEC's allegations do not implicate many of the factors courts use in identifying a "broker." Notably, the SEC does not allege that the Wallet application negotiates terms for the transaction, makes investment recommendations, arranges financing, holds customer funds, processes trade documentation, or conducts independent asset valuations. (SEC Opp. 25-27). Rather, the Complaint alleges that Coinbase: charged a 1% commission for Wallet's brokerage services (Compl. ¶ 101); actively solicits investors (on its website, blog, and social media) to use Wallet (*id.* ¶ 75);

compares prices across different third-party trading platforms (*id.* ¶ 82);[19] and "routes customer orders" in crypto-asset securities to those platforms (*id.* ¶ 64). Upon closer examination, these allegations, alone or in combination, are insufficient to establish "brokerage activities."

For starters, the SEC's allegations do little to suggest that Wallet undertakes routing activities in a manner recognized by courts to have been traditionally carried out by brokers, such as by providing trading instructions to third parties or directing how trades should be executed. *See, e.g.*, *GEL Direct Tr.*, 2023 WL 3166421, at *3 (finding that complaint alleged defendant routed securities orders in part because broker "exercised discretion" and "provided trading instructions on behalf of its customers," including directives on "price and volume").

As alleged, Coinbase's participation in the order-routing process is minimal. While Wallet "provide[s] access to or link[s] to third-party services, such as DEXs" (User Agreement App'x 4 § 8.1.2), the SEC does not allege that Coinbase performs any key trading functions on behalf of its users in connection with those activities. As the Complaint acknowledges, Coinbase has no control over a user's crypto-assets or transactions via Wallet, which product simply provides the technical infrastructure for users to arrange transactions on other DEXs in the market. (Compl. ¶ 64). Only a user has

[19] While not pleaded in the Complaint, the SEC cites to Coinbase's website in its opposition; the website defines the swap/trade feature in Wallet as using the "0x decentralized exchange protocol" to help customers "find the best value for [her] trade." (SEC Opp. 27).

control over her own assets, and the user is the sole decision-maker when it comes to transactions.

What is more, while Wallet helps users discover pricing on decentralized exchanges, providing pricing comparisons does not rise to the level of routing or making investment recommendations. *See Rhee* v. *SHVMS, LLC*, No. 21 Civ. 4283 (LJL), 2023 WL 3319532, at *8 (S.D.N.Y. May 8, 2023) ("[M]erely providing information … do[es] not implicate the objectives of investor protection under the Exchange Act and do[es] not constitute effecting a securities transaction."). Similarly, the fact that Coinbase has, at times, received a commission does not, on its own, turn Coinbase into a broker. *See id.* at *9 ("Commission-based payment, standing alone, is not dispositive of whether a party acts as a broker-dealer under the Exchange Act." (quoting *Quantum Cap., LLC* v. *Banco de los Trabajadores*, No. 14 Civ. 23193 (UU), 2016 WL 10536988, at *7 (S.D. Fla. Sept. 8, 2016))).[20]

In sum, even when considered in the aggregate, the factual allegations concerning Wallet are insufficient to support the plausible inference that Coinbase "engaged in the business of effecting transactions in securities for the account of others" through its Wallet application. 15 U.S.C. § 78c(a)(4)(A). In

[20] During oral argument, the SEC stressed the fact that Coinbase has relationships with — and provides its investors connections to — DEXs. (Jan. 17, 2024 Tr. 33:5-17). Facilitation or bringing together parties to transact, however, is not enough to warrant broker registration under Section 15(a). *See Rhee* v. *SHVMS, LLC*, No. 21 Civ. 4283 (LJL), 2023 WL 3319532, at *8 (S.D.N.Y. May 8, 2023) ("[M]erely … bringing two sophisticated parties together" does not suffice to constitute broker activity).

consequence, the Complaint does not plausibly allege that Coinbase is a broker with respect to its Wallet service.

CONCLUSION

For the forgoing reasons, the Court DENIES Defendants' motion for judgment on the pleadings insofar as the Court finds the SEC has sufficiently pleaded that Coinbase operates as an exchange, as a broker, and as a clearing agency under the federal securities laws, and, through its Staking Program, engages in the unregistered offer and sale of securities. The Court further finds that the SEC has sufficiently pleaded control person liability for CGI under the Exchange Act. The Court GRANTS Defendants' motion, however, with respect to the SEC's claims regarding Wallet.

The Clerk of Court is directed to terminate the motion at docket entry 35. The parties are directed to submit a proposed case management plan on or before **April 19, 2024.**

SO ORDERED.

Dated: March 27, 2024
New York, New York

Katherine Polk Failla

KATHERINE POLK FAILLA
United States District Judge

Before the
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

In the Matter of:	)	
	)	**HO-14317**
Uniswap Labs	)	

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May 21, 2024

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I. Introduction

The Uniswap Protocol (the "Protocol") is a groundbreaking technology that enables the efficient, secure, and intermediary-free trading of digital assets—to the great benefit of users. It is not an exchange, broker, or clearing firm under any reasonable reading of the securities laws. It is a technological solution to many of the problems that plague traditional commercial and financial markets. The Protocol removes the need for a central order book, third-party custody, and a private order matching engine—and therefore eliminates the need for many of the middlemen who extract fees and add hidden risks. If traditional equity markets adopted the Protocol's model, American investors would save 30% of all transaction costs—roughly $12 billion a year according to independent research. The Protocol is exactly the kind of innovation the Commission should welcome and encourage.

The Protocol reimagines market structures. Unlike traditional markets—which tend to have various centralized intermediaries facilitating an exchange (for a fee), custodying assets (for a fee), and clearing and settling transactions (for a fee, and only after a 1-2 day delay)—the Protocol is autonomous software that enables users to transact digital file formats securely, without a host of centralized intermediaries. Each user can custody their own assets, and automatic settlement takes place instantaneously.

Many traditional markets also depend on centralized "market makers"—often high-frequency trading firms—who are willing to buy and sell certain assets, only so long as they can avoid directional risk and earn a spread between buying and selling. This centralized intermediation leads to potential costs and risks in the form of opaque and volatile pricing, front-running, deceptive sales practices, settlement delays, lost or stolen customer funds, and potential flash-crashes due to liquidity disappearing. The Protocol, by contrast, enables increased, more persistent liquidity because (i) a wide range of people can essentially crowdfund liquidity into

liquidity pools, and (ii) these liquidity providers ("LPs") generally already take market risk in both assets they contribute to the pool and therefore require lower spreads than traditional market makers.

The Protocol is already revolutionizing how people trade commodities and other assets. Since being first deployed as a set of "smart contracts" to the Ethereum blockchain, the Protocol has become the most used protocol on that blockchain. The Protocol enables anyone to trade assets using Ethereum's standard file format called ERC-20. Much as the PDF file format can represent any type of document (not just a stock certificate), ERC-20s can represent any kind of value (from commodities to collectibles). In enabling people to trade one ERC-20 for another, the Protocol has supported over 2 trillion dollars' worth of commerce across 18.5 million wallet addresses over the past six years. Tens of thousands of independent software applications have connected independently to the Protocol. Moreover, thousands of unrelated developer teams have forked (or copied) the Protocol to support hundreds of billions of dollars more in volume on other trading protocols. In short, the Protocol is a *tool* that millions of people use today in order to trade standardized crypto tokens—and that may eventually change how business is done in traditional finance and elsewhere.

At the same time that it provides these vast benefits, the Protocol is not an exchange under the securities laws:

- Secondary market trading does not constitute an investment contract, and the vast majority of volume traded on the Protocol is Bitcoin, Ethereum, and stablecoins, or foreign transactions, none of which are subject to SEC jurisdiction;
- The Protocol was not designed "for the purpose" of securities trading, as the law requires for it to be considered a "securities exchange." Rather, the Protocol is a

passive, internet-based communications protocol that enables users to post their interest in trading items online, similar to how HTML provides a standard way for people to display digital content in a web browser;

- The Protocol is not controlled by, or comprised of, any "group of persons," let alone Universal Navigation Inc. ("Uniswap Labs" or "Labs"). Labs initially developed the Protocol, but the Protocol is open-source and fully autonomous. Labs cannot change the Protocol's core code. Nobody needs Labs' permission to trade, add assets, or remove assets using the Protocol. Just as Satoshi Nakomoto does not control Bitcoin, Labs does not control or maintain the Protocol or its use; and
- The Protocol does not have the other aspects of an exchange: it does not match orders, bring together buyers and sellers, or constitute a market place.

In fact, the Protocol's basic nature renders it so obviously not an "exchange" that the Commission kicked off a still-pending rulemaking to change its own definition of "exchange" to capture communications protocols. That proposal unlawfully ignores dictionary definitions and statutory history, contravening the limits imposed by Congress and extending the statute's reach into open-source software with general-purpose, non-securities applications, like the Protocol.

Similarly, none of Labs' other conduct runs afoul of the securities laws. As the Commission has already learned in its recent loss in the Coinbase litigation, passive web interfaces for viewing, analyzing, and communicating with blockchain protocols, like Coinbase's wallet software and Labs' web-based interface (the "Interface"), even combined with an open-source trade path algorithm (like Labs' "Autorouter"), do not satisfy the test for a "broker." The "clearing agency" definition likewise does not reach Labs, as Labs does not take possession of third-party assets, become party to transactions, or otherwise function as a depository or

intermediary of securities or securities transactions. And Labs did not offer or sell (and has never offered or sold) any tokens in transactions that required registration. Labs' distributions of UNI governance tokens were exempt from registration, were non-securities transactions under the *Howey* test, or both. And fungible and non-fungible receipts evidencing LPs' ownership of tokens in pools ("LP Tokens") are not profit-sharing agreements and are not issued by Labs.

This case implicates constitutional questions as well. Before accepting the Commission's broad new assertion of authority to regulate and potentially ban the use of many crypto assets and decentralized finance generally, a court would have to consider whether the major questions doctrine precludes the Commission from making such economically significant decisions in the absence of specific congressional authorization. A court would also have to consider whether the Commission failed to provide fair notice that Labs' activities could violate the securities laws, given that many of the questions raised by this case are squarely before the Commission in a still-pending rulemaking regarding expansion of the "exchange" definition. Courts are likely to conclude that the Commission lacks authority to act under both doctrines.

The Commission should not take on these significant litigation risks. Bringing this case would encourage Americans to use harder-to-regulate foreign interfaces and trading protocols, while also discouraging future innovators from attempting to foster new ideas that bring much-needed competition and innovation to financial and commercial markets. Although there are legitimate questions about how best to protect customers and market integrity when traders transact on a peer-to-peer basis without an intermediary, those are policy questions that are primarily for Congress—and are part of ongoing policy discussions that Labs has helped lead. The Commission cannot obtain its desired answers through litigation in this matter.

For these reasons and more, the Commission should not pursue this case. The

Commission has more to lose than gain from doing so. And the Commission's time and resources would be better spent crafting a policy framework that responsibly addresses and promotes innovations like those developed by Labs—and encourages them to be adopted in the markets over which the Commission has jurisdiction.

II. Factual Background

A. Uniswap Labs Is an Innovative Software Company Based in New York

Universal Navigation Inc., doing business as Labs, is a private software company founded in 2018 and located in New York City.[1] Hayden Adams, the CEO of Labs, invented the Protocol, a peer-to-peer system for transacting in ERC-20 tokens on the Ethereum blockchain.[2] Labs primarily focuses on operating and developing software that enhances user experience in connection with the Protocol, including a web application for accessing the Protocol (the "Interface") and a mobile app-based wallet.

B. The Protocol Is an Automated Market Maker Technology Controlled by No Individual or Entity

The Protocol is an autonomous set of "smart contracts"[3] that run on the Ethereum[4] network—that is, software on the Ethereum blockchain programmed to automatically execute trades, akin to a pre-programmed digital vending machine. The Protocol is the first widely successful automated market maker ("AMM"), and relies on LPs contributing liquidity into a

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[1] Unlike many companies in the digital asset space, Labs made a deliberate decision to be domiciled in the United States. Labs counts among its shareholders leading U.S. institutional investors, such as Paradigm, Andreessen Horowitz, and Union Square Ventures. It has more than 100 employees, almost all of whom are within the United States, including in New York, Missouri, Texas, and California.

[2] *A Short History of Uniswap*, Uniswap Labs Blog (Feb. 10, 2019), https://blog.uniswap.org/uniswap-history.

[3] Versions 1 and 2 of the Protocol were released as open source under a general public license. Version 3 of the Protocol was launched by Labs under a business-source license that limited the use of its source code in a commercial or production setting until April 1, 2023, at which point it converted to a general public license. For more than a year now, anyone has been able to fork the code for their own use, so long as they keep it open source. *See Uniswap Help Center: Uniswap v3 Licensing*, https://support.uniswap.org/hc/en-us/articles/14569783029645-Uniswap-v3-Licensing (last visited May 20, 2024).

[4] The Uniswap Protocol has been deployed to other blockchains, but we focus on Ethereum here.

liquidity pool that generally contains two specific assets. Liquidity pools represent the quantity of assets that users in the aggregate are willing to have swapped at prices determined using a constant-product market maker formula ($x*y = k$), which automatically rebalances with swaps as the ratios of various assets fluctuate. The formula ensures that the product of x and y, representing the balance of the two tokens in any pool, equals a constant, k. Because the relative price of the assets can be changed only through trading, divergences between the Protocol price and external prices create market opportunities. The combination of the formula plus the rebalancing mechanism thus ensures that Protocol prices always trend toward the market-clearing price.

Labs has released three versions of the Protocol to date, each of which introduced additional features but performs the same basic function. Although Labs has been involved in developing and releasing different versions of the Protocol, the Protocol itself is autonomous and self-executing, and it is not centrally governed, controlled, or maintained by Labs or by any other person or organization. The developers of the Protocol, including Labs and its employees, lack the ability to approve or block any swaps on the Protocol, to "run" or shut off the Protocol, or to otherwise change the Protocol's code. Instead, the Protocol operates in accordance with a "governance minimization" principle: that automation of open-source software components is a strong form of decentralization and that anything that can be automated should be, leaving as little as possible in fundamental software operation open to human decision-making. In accordance with this principle, all of the core operations of the Protocol, including approving swaps, adding new pools, and providing liquidity, are initiated by users, not Labs, and implemented automatically according to the Protocol's code. If Labs disappeared tomorrow,

users could continue to use the Protocol like they do today—just as people can continue to use Bitcoin even after the disappearance of Satoshi Nakamoto.

Swappers on the Protocol use their self-custodial wallets—software that helps them manage the private keys controlling their assets—in order to connect with the Protocol's Ethereum smart contracts and swap against a liquidity pool, exchanging one asset in the pool for the other. The swaps take place on-chain. Labs never takes possession or custody of users' tokens during a swap and never approves or declines any transaction. Unlike a traditional exchange, the Protocol does not involve third-party custody, a central order book, or a private order matching engine, and users do not need to match with individual counterparties to complete a swap. Nor is there a clearing agency or any need for an intermediary or depository—the swaps are automatically processed and added to an updated ledger of who controls which assets by a vast network of unaffiliated, competing Ethereum validators who validate all swaps that occur on the Protocol. A substantial majority of daily volume on the Protocol comes from pools exclusively involving the swapping of Ether, wrapped Bitcoin, and stablecoins, all of which the Commission has acknowledged are not securities.[5]

LPs are remunerated for providing liquidity through fees paid by swappers. Fees vary based on the pool, but currently in version 3 of the Protocol, they can be set at 0.01%, 0.05%, 0.30%, or 1% by the user who first creates the liquidity pool.

[5] Since the first deployment of the Uniswap V3 smart contract on May 4, 2021, for example, 63.37% of Protocol trading volume across all blockchains exclusively consisted of wrapped Ether, wrapped Bitcoin, and stablecoins, according to on-chain data. *Uniswap Protocol key stats (token subset)*, Dune, https://dune.com/queries/3749536/6306642 (last visited May 20, 2024).

C. The Interface Is One of Many Applications that Allows Users to Access the Protocol

Labs created and operates the Interface, a web application that allows users to connect a self-custodial wallet and enables them to generate instructions that they communicate to the Protocol. Labs' Interface is not the only way to access the Protocol. In fact, only about 10–15% of volume (and only about 20% of total transactions) on the Protocol originates from the Interface[6]—and, of the subset of those Interface-enabled transactions, only 25% originate within the United States.[7] The remaining 85-90% of Protocol volume that does not originate on the Interface either originates from other interfaces developed by persons or entities unaffiliated with Labs or from users who are sophisticated enough to write their own code to communicate with the smart contracts. As a result, swappers who use the Interface to help them communicate with the Protocol could be accessing liquidity provided by someone who did not use the Interface to provide that liquidity, and liquidity provided with help from the Interface is often accessed by someone using a different interface entirely, or no interface at all.

D. The Autorouter Is an Open-Source Tool that Recommends the Best Trading Path on the Protocol

The Autorouter is an open-source tool that analyzes all of the potential paths for a swap to take place on the Protocol (*e.g.*, someone swapping Ether for wrapped Bitcoin could swap Ether for a stablecoin and then swap that stablecoin for wrapped Bitcoin). It then attempts to provide the Interface user with information about the most efficient swap with the lowest fees available at that time. This path could be "split" across multiple pools, if doing so produces a

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6 *Uniswap Protocol Key Stats (Volume and Swaps)*, Dune, https://dune.com/queries/3749558/6306663 (percentage of swaps that originated from Labs' interface in the year preceding May 20, 2024) (last visited May 20, 2024); *Uniswap Protocol Key Stats (Volume and Swaps)*, Dune, https://dune.com/queries/3749558/6306658 (percentage of transaction volume that originated from Labs' interface in the year preceding May 20, 2024) (last visited May 20, 2024).

7 Uniswap Labs internal data for the prior twelve months.

better price for the user. The Autorouter also takes into account "gas costs"—the network costs of submitting a transaction to the Ethereum blockchain collected by Ethereum validators. The user elects whether to take the proposed route. If a user chooses to proceed with the route identified by the Autorouter, it is the user's own, self-custodial wallet that submits the instructions to the blockchain to make the swap with the user's tokens. The Autorouter does not interact with the user's assets at any time. The user is the only entity exercising any discretion in the process.

E. The UNI Token Is a Governance Token that Allows Holders to Control the Limited Modifiable Aspects of the Protocol

UNI, the governance token of the Protocol, was launched on September 15, 2020. Shortly before the launch, another decentralized finance ("DeFi") entity, SushiSwap, had forked the Protocol and launched a "vampire attack" that attempted to lure LPs away from Uniswap with a Sushi governance token.[8] The user response to that incident revealed that the Uniswap community of users and LPs was interested in a governance token associated with the Protocol. UNI was released to enable "shared community ownership and a vibrant, diverse, and dedicated governance system" and to "officially enshrine Uniswap as a publicly-owned and self-sustainable infrastructure while continuing to carefully protect its indestructible and autonomous qualities."[9]

UNI holders may participate in the Protocol's governance system, which allows for limited decisions relating to the Protocol. Those decisions include, for example, voting to create new LP fee tiers on version 3 of the Protocol or allocating a portion of LP fees elsewhere (commonly referred to as the "fee switch"). The decisions are few and do not include the

[8] jakub, *What is a Vampire Attack? SushiSwap Saga Explained*, Finematics (Dec. 9, 2020), https://finematics.com/vampire-attack-sushiswap-explained/.

[9] *Introducing UNI*, Uniswap Labs Blog (Sept. 15, 2020), https://blog.uniswap.org/uni.

technical ability to block transactions, approve transactions, modify Protocol code, lock funds, or steal funds. Although Labs employees may own UNI tokens and delegate the associated voting power, Labs' policy currently forbids its employees (and Labs as an entity) from voting on governance proposals.

At launch, the UNI token was allocated to historical users of the Protocol (both swappers and liquidity providers), a governance treasury (which is collectively controlled by UNI holders), certain Labs investors and advisors, and, for approximately a two-month period, to LPs of four pools on Uniswap v2 (ETH/USDT, ETH/USDC, ETH/DAI, and ETH/WBTC). Labs also retained a portion of the original UNI supply, much of which was earmarked for current and future employees.

F. The Protocol Is Widely Used and Provides Tremendous Benefits to Consumers, with Even Greater Future Potential

The Protocol is the most popular decentralized trading software on the Ethereum network by volume. Across multiple blockchains, it has supported over $2 trillion in volume since launching in 2018, with current daily volume around $1.57 billion.

The Protocol also has earned the respect of leaders in finance and economics. For example, J.P. Morgan and DBS Bank partnered with the Singaporean government to launch a foreign exchange and government-bond trading pilot called Project Guardian, which is built on a fork of the Protocol.[10] And research by prominent academics, such as Stephen Boyd at Stanford, David Parkes at the Harvard School of Engineering, and Christine Parlour at the Hass School of Business, has shown that AMMs provide deep markets, prices that are aligned with those in

[10] Ornella Hernandez and Ben Strack, *JPMorgan Trade on Public Blockchain 'Monumental Step' for DeFi*, Blockworks (Nov. 2, 2022), https://blockworks.co/news/jpmorgan-trade-on-public-blockchain-monumental-step-for-defi; *Project Guardian*, Monetary Authority of Singapore (Oct. 19, 2022), https://www.mas.gov.sg/schemes-and-initiatives/project-guardian.

centralized exchanges, and lower costs for traders.[11] That can result in better functioning markets, especially for assets that are relatively less liquid.[12]

Additionally, research by professors at McMasters and the University of Toronto determined that, if the Protocol's model were adopted in traditional equity markets, it would have saved U.S. investors $34 billion over the previous three years—30% of all trading costs.[13] Research also suggests that the Protocol can provide efficient markets for the multi-trillion-dollar non-securities market of currency trading.[14]

III. Under the Plain Language of the Exchange Definition, Labs Does Not Operate an Exchange

The Staff alleges that Labs is operating an unregistered exchange in violation of Section 5 of the Exchange Act. This allegation is meritless. First, no securities transactions occur on the Protocol, and second, even if some number of securities transactions were occurring via the Protocol, Labs does not operate a "securities exchange" within the meaning of the Exchange Act. Choosing to litigate these issues would expose the Commission to serious risk of (a) an adverse decision concerning its authority over crypto tokens, and (b) precedent confining the scope of the "exchange" definition in ways that undermine the SEC's pending rulemaking in that area.

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[11] Guillermo Angeris et al., *Optimal Routing for Constant Function Market Makers*, Proceedings of the 23rd ACM Conference on Economics and Computation, 115–128 (July 2022); Zhou Fan et al., *Strategic Liquidity Provision in Uniswap v3* (Sept. 1, 2023), https://arxiv.org/pdf/2106.12033; Alfred Lehar and Christine A. Parlour, *Decentralized Exchange: The Uniswap Automated Market Maker* (Aug. 14, 2021), Journal of Finance forthcoming, https://ssrn.com/abstract=3905316.

[12] Katya Malinova and Andreas Park, *Learning from DeFi: Would Automated Market Makers Improve Equity Trading?*, 5 (Nov. 18, 2023), https://ssrn.com/abstract=4531670.

[13] *Id.* at 4.

[14] *See generally* Austin Adams et al., *On-chain Foreign Exchange and Cross-border Payments* (Jan. 18, 2023), https://uniswap.org/OnchainFX.pdf.

A. Because an Investment Contract Requires a Contract, Transactions on the Secondary Market Through the Protocol Are Not Investment Contracts

The Securities Act defines various categories of securities, including stocks, bonds, and "investment contract[s]." 15 U.S.C. § 77b(a)(1). Under the test announced by the Supreme Court in *Howey*, an "investment contract" exists only where "a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946). Token transactions on the protocol do not satisfy the *Howey* test.

First, both case law and the SEC's own guidance confirm that crypto assets themselves are not investment contracts. For instance, the court in *Ripple* held that a crypto "token[]is not in and of itself a 'contract, transaction[,] or scheme' that embodies the *Howey* requirements of an investment contract." *SEC v. Ripple*, 682 F. Supp. 3d 308, 324 (S.D.N.Y. 2023). The Commission has accepted this reality. *SEC v. Coinbase, Inc.*, No. 23 Civ. 4738, 2024 WL 1304037, at *13 (S.D.N.Y. Mar. 27, 2024) ("[T]he SEC does not appear to contest that tokens, in and of themselves, are not securities."); Tr. of Oral Arg., *SEC v. Coinbase, Inc.*, No. 23 CIV. 4738 (KPF) (S.D.N.Y. Mar. 27, 2024), Dkt. No. 101, at 21:11 (Staff admitted the "token itself is not the security."). Yet the Commission has taken the position that secondary market *transactions* in digital tokens are themselves "investment contracts" because token purchasers are buying into the whole "ecosystem" surrounding such tokens.[15]

That "ecosystem" theory does not satisfy the *Howey* test. Secondary buyers on the Protocol do not have contracts with their counterparties, do not join a common enterprise, or expect to profit solely from the efforts of the token projects. The projects "issuing" the tokens

[15] Although there have been conflicting decisions on these issues from different courts in the Southern District of New York, the decision in *Ripple*—which did not accept this theory—came on a full record at summary judgment.

have generally made no promises or commitments to users of the Protocol to exert any efforts or share profits from their business, and secondary market buyers "could not have known if their payments of money went to" the project or to someone else. *Ripple*, 682 F. Supp. 3d at 328.

If transactions in digital tokens are nonetheless treated as "investment contracts" under the Commission's "ecosystem" theory, then all sorts of secondary sales of obvious non-securities and assets would be converted into investment contracts as well. That would include, for example, sales of luxury, limited-edition goods where the producers spend heavily on marketing and control who purchases which items, such as Hermes Birkin bags; collectibles such as baseball cards or stamps where quantities are artificially limited; and gems and metals including gold, thanks to an ecosystem anchored by the World Gold Council. These physical goods cannot be distinguished simply by saying they are tangible or have "inherent" utility, both because digital tokens *also* often have utility and because there are numerous intangible commodities—*e.g.*, emissions allowances, renewable energy credits, and carbon credits—that are recognized as non-securities commodities but that have value and utility derived entirely from their ecosystems.

Whether an investment contract can exist absent an actual contract, or at least the offer of one, remains a live question that is likely to be definitively decided by higher courts. Despite the Commission's arguments in district court proceedings, neither the Supreme Court nor a court of appeals has ever found an "investment contract" to exist in the absence of a contract. The Commission should refrain from bringing additional enforcement actions against new targets until appellate courts have had the chance to consider the Commission's novel interpretation of its authority under the securities laws.

Finally, and just as importantly, the vast majority of swaps on the Protocol are definitively not securities transactions even under the SEC's own view of its jurisdiction. On the Protocol, 65% of its volume unquestionably consists of pools that the SEC has conceded are not securities: Ether, wrapped Bitcoin, and stablecoin pools. U.S. securities law also does not extend to foreign transactions, and Labs estimates that roughly 75% of users transacting on the Protocol are foreign (assuming that Interface data is representative of the Protocol). Given that approximately 25% of users are domestic and only 35% of that domestic volume comes from outside of those BTC, ETH, and stablecoin pools, only 8.75% of the Protocol volume could arguably be within the SEC's jurisdiction, even under the SEC's own (incorrect) approach to the *Howey* test. Moreover, that 8.75% includes many tokens that are clearly not securities, such as (a) meme tokens like Pepe, Doge, or Jeo Boden, which the market understands to be "for entertainment purposes only"[16] and about which their creators (if they are even known) generally make no promises of future efforts or improvements and take no actions to support such enhancements, and (b) utility tokens whose functionality likely renders them non-securities in most transactions.[17]

B. Labs Does Not Operate a Securities Exchange as Defined by the Text of the Exchange Act

Even if there were securities transactions occurring via the Protocol, Labs does not operate a "securities exchange" within the meaning of the Exchange Act. "Exchange" is defined by the Exchange Act as "any organization, association, or group of persons, whether

[16] VanEck, an investment manager with $89.5 billion in assets under management, has launched a Meme Coin Index through its MarketVector platform, with the explanation that "these coins are intended for entertainment purposes." *Meme Coin Index*, MarketVector, https://www.marketvector.com/indexes/digital-assets/marketvector-meme-coin (last visited May 20, 2024).

[17] The Commission has noted that a token is less likely to be part of an investment contract if the network is operational and "delivering currently available goods or services for use on an existing network." *Framework for 'Investment Contract' Analysis of Digital Assets* 8 (Apr. 3, 2019), https://www.sec.gov/files/dlt-framework.pdf.

incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities." 15 U.S.C. § 78c(a)(1). Neither the Protocol (which Labs does not control) nor any of Labs' products or technology fall within the plain language of the statute. Notably, in March 2022, the Commission released its proposal to amend Rule 3b-16 of the Exchange Act, which in part would expand the definition of "exchange" to reach "communication protocols" like the Protocol. The fact that the Commission has proposed a wholesale change to the meaning of "exchange" underscores that the Protocol is *not* already an "exchange" under the current rules. And even a new Commission rule cannot change the boundaries of the Exchange Act itself, as numerous comments to that rulemaking explained.

1. The Protocol Does Not Meet the Statutory Definition of an Exchange

The Protocol does not fall within the statutory definition of an "exchange."

First, the Protocol is not a "market place . . . *for* bringing together purchasers and sellers of securities." 15 U.S.C. § 78c(a)(1) (emphasis added). "For" requires purpose.[18] Thus, the Exchange Act's definition of "exchange" extends to marketplaces designed for the purpose of facilitating securities transactions, but not marketplaces where securities transactions are incidental or unintentional. *See Intercontinental Exch., Inc. v. SEC*, 23 F.4th 1013, 1025 (D.C. Cir. 2022) ("[B]y speaking of 'facilities *for* bringing together etc.,' and not of 'facilities *that* bring together,' the statute could be limited to facilities that are maintained for the purpose of bringing together purchasers and sellers of securities."). Tellingly, the Commission itself endorsed this interpretation in the Proposing Release for its proposal to amend Rule 3b-16 of the Exchange Act, explaining that "a system that displays trading interest and provides only

[18] *See* For, The Shorter Oxford English Dictionary (2d ed. 1936) ("With the object or purpose of," "In order to obtain," "Indicating the object to which the activity of the faculties or feelings is directed"); For, The Winston Simplified Dictionary (1931) ("for the sake of").

connectivity among participants without providing a trading facility to match orders or providing protocols for participants to communicate and interact would not meet the criteria of Rule 3b-16(a)" because "such providers are not specifically designed to bring together buyers and seller[s] of securities or provide procedures or parameters for buyers and sellers [of] securities to interact." 87 Fed. Reg. 15496, 15507-08 (Mar. 18, 2022).

Thus, even if the Staff were correct that some small number of securities transactions occur on the Protocol, a court could not conclude that the Protocol is therefore a securities exchange because it is not specifically designed for the purpose of facilitating such transactions. To the contrary, the Protocol supports a general file format for all forms of value—the ERC-20 file format—and the Protocol is almost exclusively used for non-securities transactions, with a vast majority of its swapping volume consisting of swaps of Ethereum, wrapped Bitcoin, stablecoins, and meme coins. A court has already ruled that the Protocol is used for lawful purposes in such trades. *See Risley v. Universal Navigation Inc.*, No. 22 Civ. 2780, 2023 WL 5609200, at *14 (S.D.N.Y. Aug. 29, 2023) (Judge Failla holding that "[w]hile no court has yet decided this issue in the context of a decentralized protocol's smart contracts, the Court finds that the smart contracts here were themselves able to be carried out lawfully, as with the exchange of crypto commodities ETH and Bitcoin"). Congress plainly did not intend the Commission to require other general-purpose protocols such as SMTP, TC/IP, or HTTP, let alone Gmail, Twitter, eBay, or Indiegogo, to register as exchanges simply because a security may occasionally be sold via their technologies. Reading "exchange" to cover the Protocol is equally irreconcilable with the statutory text.[19]

[19] In other areas of law, courts have distinguished between protocols built for infringement and those that have "significant noninfringing uses." *MGM Studios Inc. v. Grokster, Ltd.*, 545 U.S. 913, 931-33 (2005) (citation omitted). Analogous reasoning applies here, as DeFi protocols are general-purpose technology that can be used

Second, the Protocol is not "an organization, association, or group of persons." 15 U.S.C. § 78c(a)(1). Unlike centralized exchanges, including those with active SEC enforcement actions, the Protocol is an autonomous smart contract created from software code and not controlled by any person or entity. This feature necessarily excludes the Protocol from the statutory definition of exchange, because there is no person or entity that "constitutes, maintains, or provides" the Protocol. 15 U.S.C. § 78c(a)(1); *see* 17 C.F.R. § 240.3b-16(a). To the extent the Staff contends that the Protocol is a "group of persons" because independent programmers contributed code to "a protocol for buyers and sellers to negotiate a trade," Reopening Release, Amendments to Exchange Act Rule 3b-16 Regarding the Definition of Exchange, Release No. 34-97309 at 29456 n.78 (May 5, 2023), that interpretation unreasonably reads "group" to include people who do not know one another—and may not even know *of* each other—and even people who are *competing* with each other.

Third, the Protocol is not a "market place," 15 U.S.C. § 78c(a)(1), and, in fact, it eliminates the need for one. When the Exchange Act was enacted, a "market place" was defined as "[a]n open square or place in a town where markets or public sales are held." *Market place*, Webster's New International Dictionary of the English Language (2d ed. 1935); *see also Market*, The Winston Simplified Dictionary (1931) ("a public or private place for the sale or purchase of provisions"); *Market*, The Comprehensive Standard Dictionary of the English Language (1934) ("A place where things can be bought or sold"). Although it may be possible to interpret the statutory phrase "market place" to reflect new ways of constituting virtual "places," such as a centralized digital exchange, the fundamental requirement of "place" remains. The key feature of DeFi protocols is that they *do not* provide a single, centralized market, but rather enable users to

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for trading of unregulated cash commodities (and overwhelmingly are used for that purpose) as well as for trading of other types of assets.

engage with one another through decentralized transactions. Consequently, the fundamental requirement of "place" is not satisfied.

Fourth, since the Protocol is autonomous, there is no person, entity, or place acting as an intermediary "bringing together purchasers and sellers." 15 U.S.C. § 78c(a)(1). Instead, the Protocol connects a swapper on one side and an automated market making function coded into the autonomous Protocol on the other. In other words, a user connects with the smart contracts underlying the Protocol to trade against the liquidity pool. *See Risley*, 2023 WL 5609200, at *2 ("instead of users interacting with each other and matching trades, they interact with the pool"). The Protocol also does not match "orders" as that term is defined in Rule 3b-16(c); nor does it provide a centralized order book. *See* § 240.3b-16(c) (defining an "order" as "any firm indication of a willingness to buy or sell a security . . . including any bid or offer quotation, market order, limit order, or other priced order").[20]

Fifth, even if the Protocol could qualify as an exchange, the Protocol is not an "organization, association, or group of persons" *under the control of Labs*—and Labs therefore cannot be penalized for how others use it. Once a particular version of the Protocol is deployed, it exists indefinitely, even if Labs were to stop operating, and it cannot be modified or deleted by Labs or by any other person or entity.[21] Nor can Labs prevent any swaps from occurring on the Protocol or prevent users from accessing the Protocol. Although Labs employees wrote much of the code for different versions of the Protocol, each version is autonomous once launched. Labs

[20] In its rulemaking proposal, the Commission defined "Communication Protocol System" as "includ[ing] a system that offers protocols and the use of non-firm trading interest to bring together buyers and sellers of securities," *Securities Exchange Release No. 94062* (Jan. 26, 2022) at 15497 n.5, again demonstrating that the current rule does not reach the Protocol.

[21] There is a very limited set of attributes that may be modified on certain versions of the Protocol if and when a series of governance procedures and votes by holders of the UNI token have taken place. However, this decentralized power to make a limited number of modifications does not mean that UNI token holders are maintaining or providing the Protocol, and it certainly does not mean that Labs is doing so.

cannot be held liable for someone's use of the Protocol, just as Satoshi Nakomoto is not held liable for others' use of Bitcoin. To hold the developer of an autonomous protocol liable for how people use it is akin to holding the manufacturer of a self-driving car liable when someone uses it to commit a traffic violation, as one court wrote in analogizing to the Uniswap Protocol. In such a situation, "one would not sue the car company for facilitating the wrongdoing; they would sue the individual who committed the wrong." *Risley*, 2023 WL 5609200, at *14.

For all of these reasons, it would be a radical departure from the language of the statute and rules for the Commission to claim that the Protocol is an exchange.

2. The Interface Does Not Meet the Statutory Definition of an Exchange

The Interface likewise cannot be an exchange under the Exchange Act. The Interface functions like the online bulletin boards or connectivity providers that the Commission has repeatedly determined not to be exchanges, and the Commission cannot do an about-face on that position without notice.[22]

First, the Interface does not bring together the orders of multiple buyers and sellers. The Interface is software that enables users to connect their self-custodial wallets and better formulate their requests directed to the Protocol. The actual swapping of tokens does not occur on the Interface; the swap takes place in a direct interaction between the user's wallet and the blockchain. During this process, the user never relinquishes control of the crypto asset to the Interface. If a user elects to make a swap, it is the user's wallet that submits the code to the

[22] The Staff's allegation that the Interface operates as an exchange would contradict prior no-action letters from the Commission that considered similar activity. *See, e.g.*, Broker-to-Broker Networks Inc., SEC Staff No-Action Letter, 2000 WL 1886745 (Dec. 1, 2000) (system that allows "broker-dealers to communicate with each other and their respective settlement agents" regarding the "fulfillment of a customer's securities transaction order"); S3 Matching Technologies LP, SEC Staff No-Action Letter, 2012 WL 2948910 (July 19, 2012) (platform that "electronically link[s] registered broker-dealers to one another," permitting them to "send electronic messages that communicate buy and sell orders to other broker-dealers participating on the Platform").

blockchain, not the Interface—and the swap itself is not executed on the Interface but on the Protocol, which (as discussed above) does not qualify as an exchange.

Second, the Interface does not "[u]se[] established, non-discretionary methods . . . under which . . . orders interact with each other. . . ." 17 C.F.R. § 240.3b-16(a)(2). The Interface is not an order book and does not provide access to one. It also does not "receive or store orders from [u]sers in digital assets" or "provid[e] the means for [token swaps] to interact and execute." *In the Matter of Poloniex, LLC*, Exchange Act Release No. 92607, 2021 WL 3501307 (Aug. 9, 2021). The Interface does not execute any transactions or take any actions of an exchange. Rather, each individual user of the Interface controls all key aspects of their transaction, including selecting the input token, the output token, and their slippage tolerance.

Third, the Interface is not a "facility" of an exchange. Since Labs does not control the Protocol, the Interface cannot be considered a facility of the Protocol, even if the Protocol were an exchange. *See* 15 U.S.C. § 78c(a)(2) (defining facility to include a "system of communication to or from the exchange" only if (among other things) it is "maintained by or with the consent of the exchange"); *Intercontinental Exch.*, 23 F.4th at 1023 ("Communications systems that incidentally facilitate the trading of securities . . . do not owe their existence to the consent of any exchange, nor are they maintained by any exchange.").

3. The Autorouter Does Not Meet the Statutory Definition of an Exchange

The Autorouter function also does not meet the statutory definition of an exchange. Similar to the Protocol and the Interface, the Autorouter does not bring together orders of multiple buyers and sellers or use established non-discretionary methods. The Autorouter is an open-source tool that analyzes all of the potential paths for a swap to take place on the Protocol and then attempts to provide the Interface user with information about the most efficient swap

with the lowest fees available at that time. The user ultimately elects whether to take the identified path. If a user does elect to proceed, it is the user's own self-custodial wallet that submits the instructions to the blockchain to make the swap.

IV. Recent Precedent Establishes that Labs Does Not Meet the Definition of a Broker Under the Exchange Act

The Staff alleges that Labs is operating as an unregistered broker in violation of Section 15(a) of the Exchange Act. But Labs is not—and has never been—required to register as a broker. Choosing to litigate this issue will lead to yet another precedent narrowing the Commission's regulatory authority over technology services by definitively deeming them not to be brokers—precedent that may well cause leading service providers who operate trading platforms and order/execution management services in equity securities markets to reconsider their decisions to register as brokers.

The Exchange Act defines "broker" as "any person engaged in the business of effecting transactions in securities for the account of others." 15 U.S.C. § 78c(a)(4)(A). In evaluating whether a person acted as a broker, courts consider a list of non-exclusive factors, including whether that person is (1) helping an issuer identify potential purchasers of securities; (2) soliciting securities transactions (including advertising); (3) negotiating between issuers and investors; (4) providing advice, recommendations, or valuation as to the merit of an investment; (5) taking, routing, or matching orders, or facilitating the execution of securities transactions; or (6) handling investor funds or securities in connection with securities transactions. *SEC v. Hansen*, No. 83 CIV. 3692, 1984 WL 2413, at *10 (S.D.N.Y. Apr. 6, 1984); *SEC v. GEL Direct Tr.*, No. 22-cv-9803 (JSR), 2023 WL 3166421, at *2 (Apr. 28, 2023). The broker determination is fact-specific and based on the totality of the circumstances—meaning no one factor is dispositive. *See, e.g.*, *SEC v. RMR Asset Mgmt. Co.*, 479 F. Supp. 3d 923, 926 (S.D. Cal. 2020).

The Staff alleges that Labs operates as an unregistered broker on the ground that it participates regularly in securities transactions, including by soliciting customers for transacting crypto asset securities, routing customer orders, making evaluations as to the merits of investments, and providing advice. That allegation fails as a threshold matter because, as explained above, the underlying transactions on the Protocol are not securities transactions. But even assuming otherwise, the allegation does not stand up to scrutiny, as the decision in *Coinbase* illustrates. In *Coinbase*, the Commission alleged that Coinbase Wallet—a non-custodial wallet, with very similar functionality to the Labs wallet and legally indistinguishable from the Interface—allowed users to connect with external sources of liquidity to send, receive, or swap crypto assets. *Coinbase*, 2024 WL 1304037, at *6. The Commission also alleged that Coinbase had regularly solicited investors through advertisements on its website and social media, provided pricing information, routed user orders across platforms, and charged fees on certain digital asset swaps. *Id.* at *6, *34. The court in *Coinbase* held that the Commission's limited allegations, "alone or in combination," were "insufficient to establish 'brokerage activities' under the definition of broker and relevant case law." *Id.* at *34-35. The Staff's allegations against Labs similarly fail to establish brokerage activities—Labs does not solicit users to swap on the Protocol and does not provide investment advice, and Labs' receipt of certain fees does not render it a broker.

A. Labs Does Not Solicit Users to Swap on the Protocol

Labs does not solicit investors. Soliciting investors is defined as "any affirmative effort by a broker or dealer intended to induce transactional business for the broker-dealer or its affiliates," including "prepar[ing] letters . . . which extoll[] the virtues of [the investment]," "plac[ing] advertisements in newspapers," and "us[ing] gifts, bumper stickers and other promotional items to induce investors to purchase" the investment. *Registration Requirements*

for Foreign Broker-Dealers, Exch. Act Release No. 34-27017, 54 FR 30013-01, at * 30017 (July 18, 1989); *Hansen*, 1984 WL 2413, at *2. Labs' general public statements about the Protocol do not amount to solicitation of investments, and Labs and its employees do not direct users to purchase or swap specific tokens on the Protocol. The court in *Risley* found that Labs' conduct was "too attenuated to state a claim" for solicitation. *Risley*, 2023 WL 5609200 at *19.

B. Labs Does Not Evaluate the Merits of Investments or Provide Advice to Users of the Protocol or the Interface

The functions of the Interface and Autorouter do not amount to providing investment advice. Although the Autorouter is available to users of the Interface, it does not provide investment advice to those users. The Autorouter is software that analyzes possible paths to swap one token for another and informs the user which path likely has the lowest gas fees and smallest price impact. It therefore simply provides information about the most efficient path using the Protocol to execute a user's desired swap, not investment advice.

Such information sharing does not amount to effecting securities transactions. *See Rhee v. SHVMS, LLC*, No. 21-cv-4283, 2023 WL 3319532, at *8 (S.D.N.Y. May 8, 2023) ("[M]erely providing information . . . do[es] not implicate the objectives of investor protection under the Exchange Act and do[es] not constitute effecting a securities transaction"). In addition, the Commission has issued no-action letters to a variety of communication systems used to "facilitate the transmission of order information," which is extremely similar to what the Autorouter does.[23] In these no-action letters, the Commission emphasized that the subject company did not handle customer funds or assets and did not execute transactions—which is also

[23] *See* Quick America Corporation, SEC No-Action Letter, 1993 WL 241518, at *2 (June 18, 1993); *see also* Broker-to-Broker Networks, Inc., SEC No-Action Letter, 2000 WL 1886745 (Dec. 1, 2000); Charles Schwab & Co., Inc., SEC No-Action Letter, 1996 WL 762999 (Nov. 27, 1996); GlobalTec Solutions, LLP, SEC No-Action Letter, 2005 WL 3695276 (Dec. 28, 2005); Loffa Interactive Corp., Inc., SEC No-Action Letter, 2003 WL 22228634 (Sept. 12, 2003); NeptuneFI Fixed-Income System, SEC No-Action Letter, 2020 WL 1042613 (Mar. 4, 2020); S3 Matching Technologies LP, SEC No-Action Letter, 2012 WL 2948910 (Jul. 19, 2012).

the case here. The fact that the companies in question dealt with non-blockchain technologies whereas the Autorouter involves blockchain technology makes no difference to the analysis.

C. An Interface Fee is Not Sufficient to Support a Broker Claim

The small fee that Labs receives on swaps by Interface users is not evidence that Labs is acting as a broker. The Commission alleged that Coinbase operated as a broker because it charged a flat fee of 1% of the principal amount for any swap or trade executed in its wallet product. *Coinbase*, 2024 WL 1304037, at *34. In rejecting the Commission's assertion, the court in that case reasoned that the fact that "Coinbase has, at times, received a commission does not, on its own, turn Coinbase into a broker." *Id.* at *35. The fact that Labs receives Interface fees (which are significantly smaller than those charged by Coinbase) does not transform Labs into a broker.

V. Because Labs Does Not Take Custody of or Touch Users' Tokens, Labs Does Not Engage in Clearing Activity

The Staff's claim that Labs acts as an unregistered clearing agency in violation of Section 17A(b) of the Exchange Act, 15 U.S.C. § 78q-1(b), is also completely without merit. As a threshold matter, there can be no clearing-agency violations without security transactions. The Staff nevertheless contends that Labs is operating as an unregistered clearing agency based on the theory that (a) the Protocol's liquidity pools act as depositories for "crypto asset securities" contributed to those pools by LPs, and (b) Labs acts as an intermediary for the transfer of tokens by "moving" "crypto asset securities" to and from users who trade through the Protocol and the Interface. This characterization misunderstands the facts, as Labs does nothing to move these assets; the users themselves submit instructions executed by Ethereum miners.

A. Labs Does Not Act as a Depository Because it Does Not Take Custody of Users' Tokens

As the Commission has recognized in the context of investment advisers, a company "has custody if it holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them."[24] The Commission also has recognized that software platforms that link broker-dealers together but do not themselves engage in "execution, settlement or clearance of transactions, and will not hold or have access to customer funds or securities," are not violating the Exchange Act.[25]

Because Labs does not directly take custody of LPs' crypto assets, so the Staff has to suggest that Labs *indirectly holds and controls* these assets through the Protocol. The Staff alleges that the Protocol's smart contracts serve as depositories for crypto asset securities because LPs who deposit their assets into a pool relinquish possession and control of their assets to the smart contract. But Labs does not control the Protocol—indeed, *no one* controls the Protocol because it operates autonomously. Accordingly, neither Labs nor any other party can be said to have taken custody of any crypto assets in any liquidity pool on any version of the Protocol. Rather, LPs control their own assets and can withdraw them from (or maintain them in) liquidity pools at the LP's sole discretion.

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[24] Custody of Funds or Securities of Clients by Investment Advisers, SEC (Mar. 12, 2010), https://www.sec.gov/info/smallbus/secg/custody_rule-secg.htm#foot1; *see also* Frequently Asked Questions Concerning the July 30, 2013 Amendments to the Broker-Dealer Financial Reporting Rule, SEC (July 1, 2020), https://www.sec.gov/divisions/marketreg/amendments-to-broker-dealer-reporting-rule-faq ("Non-Covered Firm that limits its business activities exclusively to one or more of the following would be eligible to file an exemption report: […] (3) receiving transaction-based compensation for identifying potential merger and acquisition opportunities for clients, referring securities transactions to other broker-dealers, or *providing technology or platform services*") (emphasis added).

[25] S3 Matching Technologies LP, SEC Staff No-Action Letter, 2012 WL 2948910 (July 19, 2012).

B. Labs Does Not Act as an Intermediary that "Moves" Assets Because it Does Not Touch Users' Tokens

The Staff's strained argument that Labs acts as a clearing intermediary likewise fails. Labs is not involved "in making payments or deliveries or both" in connection with transactions of securities on the Protocol or the Interface. 15 U.S.C. § 78c(a)(23)(A).

1. Labs Plays No Role in Effecting or Settling Transactions

Labs never touches a user's input or output tokens. All swaps occur on-chain, through autonomous smart contracts that anyone can use. Labs plays no role in effecting or settling the swaps. And, as discussed above, at no time do users relinquish control and custody of their assets to Labs while tokens are being swapped through the on-chain smart contracts.

2. The Interface Does Not Take Custody of Users' Crypto Assets

The Interface also does not facilitate "payments or deliveries or both in connection with transactions in securities" or take custody of a user's assets. 15 U.S.C. § 78c(a)(23)(A). As noted previously, the Interface is software that offers one of many means through which users can interact with the Protocol. The Interface does not receive or store users' orders or hold their funds. At all times, a user of the Interface controls the key aspects of the transaction, and a user's crypto assets remain self-custodied in their own wallet until that user executes the swap on the Protocol and receives a different asset. As such, Labs does not act as a clearing intermediary through the Interface.

VI. Labs Did Not Engage in the Offer or Sale of Unregistered Securities

A. Labs' Distributions of UNI Either Did Not Involve an Investment of Money or Property or Were Exempt from Registration

The Staff alleges that Labs engaged in an unregistered offer and sale of UNI tokens in violation of Sections 5(a) and 5(c) of the Securities Act of 1933, which require that any offer or sale of securities be registered with the Commission or exempt from such registration. *See* 15

U.S.C. §§ 77e(a), (c). Labs has distributed UNI in four ways: (1) to institutional investors, through direct sales or pursuant to token warrants; (2) to historical users of the Protocol through a retroactive airdrop; (3) to employees; and (4) to LPs in four Uniswap pools for a limited period of time. None of these distributions could be unregistered securities offerings under the *Howey* test: either they did not involve the investment of money or, for sales to investors, Labs availed itself of established exemptions to registration out of an abundance of caution.

1. Distributions to Investors Were Exempt from Registration

Over the past several years, Labs has sold tokens in a handful of private transactions to sophisticated institutional investors. Although Labs is confident that the sale of UNI tokens does not involve an investment contract, *see infra* Section VI.B, Labs recognized the risk that the Commission—which has failed to clarify when it considers digital-asset distributions to be securities offerings—could assert a contrary view. Thus, Labs structured each UNI sale to ensure that it was exempt from registration under Section 4(a)(2). *See* 15 U.S.C. § 77d(a)(2). Labs did not engage in public solicitation or advertisement of these private UNI sales, and the tokens were sold only to sophisticated, accredited investors. Further, each investor purchased tokens for their own account and agreed to not transfer or sell their tokens for a defined period of time that removed the investors from the definition of underwriters. At any rate, these sales were made to sophisticated venture capital firms that often specialized in the blockchain space and were well positioned to "fend for themselves" within the meaning of *SEC v. Ralston Purina Co*, 346 U.S. 119, 125 (1953); *see Barrett v. Triangle Min. Corp.*, No. 72 CIV. 5111, 1976 WL 760, at *5-6 (S.D.N.Y. Feb. 2, 1976).

2. The Airdrop to Historical Users Did Not Involve an Investment of Money or Property

The retroactive airdrop to historical users of the Protocol, which occurred in September 2020, did not involve any investment of money. Notably, in the *Ripple* case, the Commission at first asserted that an initial distribution of XRP through giveaways to early adopters, developers, and programmers, for which the company received no compensation, could still be considered an investment of money if the "would-be gifts may be characterized as subterfuge to evade registration."[26] However, the Commission abandoned this position in its summary judgment reply brief in November 2022.[27] And it did so for good reason: giveaways, such as airdrops, do not even arguably involve the kind of "risk of loss" that is essential to *Howey*'s investment-of-money prong. *See, e.g.*, *Coinbase*, 2024 WL 1304037, at *30 (discussing the risk-of-loss requirement and citing *Marine Bank v. Weaver*, 455 U.S. 551, 558-59 (1982)).

3. Distributions to Employees Did Not Involve an Investment of Money or Property

The distributions to Labs' employees were also not investment contracts because there was no investment of money or property by employees in exchange for the tokens. Although the Commission has attempted to characterize similar distributions as consideration for services, Labs employees did not "pay money or some tangible and definable consideration to" Labs. *Ripple*, 682 F. Supp. 3d at 330 (internal quotation marks omitted).

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[26] SEC Mem. of Law in Opp'n to Def.'s Mot. for Summ. J. at 26 n.15, *SEC v. Ripple Labs Inc.*, No. 20 Civ. 10832 (S.D.N.Y. Oct. 18, 2022), ECF. No. 667 (quoting *SEC v. Sierra Brokerage Servs., Inc.*, 608 F. Supp. 2d 923, 941 (S.D. Ohio 2009)).

[27] SEC Reply Mem. of Law in Further Supp. of Its Mot. for Summ. J. at 5, *SEC v. Ripple Labs Inc.*, No. 20 Civ. 10832 (S.D.N.Y. Nov. 30, 2022), ECF. No. 726 ("Defendants bury in a footnote (at 17 n.7) their concession that they 'sometimes' sold XRP for money, but then attempt to distract the Court by arguing (at 8-9, 17-18) about giveaways, donations, and secondary market transactions. Those transactions are not part of the SEC's claims here.").

4. Liquidity Mining Did Not Involve an Investment of Money or Property

The distributions via liquidity mining similarly involved no investment of money by LPs. From September 18, 2020, until November 17, 2020, Labs initiated a liquidity mining rewards program for LPs in four specific pools on version 2 of the Protocol that consisted of Ethereum, wrapped Bitcoin, and two stablecoins.[28] Around 20 million UNI (approximately 2% of the total supply) were distributed during this period, divided among all qualifying LPs.[29] There was no investment of money involved in the distribution via liquidity mining—the recipients received the tokens without parting with anything of value. LPs retained ownership of all the tokens they provided to these pools. In fact, they earned a profit based on the fees from users swapping tokens with the respective pools, wholly apart from any UNI that was distributed to them for free.

B. These Four Distinct Distributions of UNI Cannot Constitute an Integrated Offering

The Staff has tried to characterize all of the distributions discussed above as an integrated offering. This offers no help to the Staff: because none of the distributions could amount to a Section 5(a) or 5(c) violation on their own, the distributions in combination cannot amount to such a violation either. But even if integration of the distributions into a single offering would make a difference, these distributions do not meet the criteria for integration.

Courts consider the following factors in determining whether offers and sales should be integrated for purposes of the exemptions under Regulation D: (a) whether the sales are part of a single plan of financing; (b) whether the sales involve issuance of the same class of securities; (c) whether the sales have been made at or about the same time; (d) whether the same type of

[28] *Introducing UNI*, Uniswap Labs Blog (Sept. 15, 2020), https://blog.uniswap.org/uni.

[29] *Uniswap's Year in Review: 2020*, Uniswap Labs Blog (Dec. 31, 2020), https://blog.uniswap.org/year-in-review.

consideration is being received; and (e) whether the sales are made for the same general purpose." *SEC v. Cavanagh*, 1 F. Supp. 2d 337, 364 (S.D.N.Y. 1998), *aff'd* 155 F.3d 129 (2d Cir. 1998). *Cavanagh* noted that "a review of the cases and no-action letters strongly suggests that the 'single plan of financing' and 'same general purpose' factors normally are given greater weight than the other factors." *Id.*

That test is not satisfied here. First, the UNI distributions were not made as part of a "single plan of financing." *Id.* Each distribution was made independently, and the distributions did not rely on one another. When Labs issued the UNI token, it had no plan to fund the development of a UNI ecosystem through the sale of tokens. Subsequent token sales to investors, months or years later, were made as part of fundraising for Labs' products, but were not specifically intended to fund development of the UNI token. And the airdrop and liquidity mining were not part of any plan of financing. Second, the UNI distributions were not "made for the same general purpose." *Id.* On the contrary, the distinct distributions met needs that arose at different times.[30] The remaining *Cavanagh* factors either favor Labs or are neutral. The UNI distributions were not "made at or about the same time." *Id.* Unlike in the *Kik* case, where distributions occurred over a period of days, the UNI distributions happened across a *multi-year period*. *See Kik*, 492 F. Supp. 3d at 181. Labs received varying amounts of consideration, or—for the overwhelming majority of UNI—no consideration at all, in exchange for the different UNI distributions. And although all UNI tokens are fungible with one another, the "same class" factor is less applicable to tokens (and digital assets broadly), which are generally fungible and not distinguished by classes. *See Cavanagh*, 1 F. Supp. 2d at 364.

[30] The mere fact that Labs contemplated using different sets of UNI tokens for different purposes in 2020 distinguishes this situation from the *Kik* circumstances, where the offeror put on a "Token Distribution Event" and a "Pre-Sale" that occurred one after the other and promoted them together as a collective fundraising effort. *Kik*, 492 F. Supp. 3d at 181 ("Both internally and in statements to the public, Kik . . . fail[ed] to differentiate between the $50 million raised in one sale and the $50 million raised in the other.").

C. The UNI Token Distributions Do Not Satisfy the Remaining Requirements of the *Howey* Test

Even if the distributions of UNI had not been exempt, could be integrated, or somehow involved the investment of money, they would not qualify as investment contracts under the other *Howey* factors.

1. There Was No Common Enterprise

Courts determine whether a common enterprise exists under *Howey* by analyzing whether offers and sales feature horizontal or vertical commonality. *Revak v. SEC Realty Corp.*, 18 F.3d 81, 87-88 (2d Cir. 1994). Only the former is even potentially relevant, and it does not exist here because "the fortunes of each investor" do not "depend upon the profitability of the enterprise as a whole." *Id.* at 87.[31] In prior digital-asset cases where horizontal commonality was found, there was a pooling of funds from the initial distribution of the asset used to improve the value of the asset in some way. *See, e.g.*, *Kik*, 492 F. Supp. 3d at 178-79; *Ripple*, 682 F. Supp. 3d at 325. Labs did not pool funds from the initial distribution of UNI because it received no funds. Labs launched two successful versions of its protocol before UNI was created by relying on equity financing, and equity financing has continued to be a major source of operational funding. Labs also has recently implemented ways to generate revenue through fees on its Interface and Wallet that do not involve the UNI token.

[31] Although the Second Circuit has not explicitly adopted the idea of vertical commonality, which requires that the investors' fortunes be "interwoven with and dependent upon the efforts and success of" the promoter's fortunes, that too is absent here. *See SEC v. Glenn W. Turner Enter., Inc.*, 474 F.2d 476, 482 n.7 (9th Cir. 1973), *cert. denied*, 414 U.S. 821 (1973). Labs' fortunes are not interwoven with those of UNI holders because Labs has multiple sources of revenue independent from its UNI holdings—money that would keep the company well-funded even if the price of UNI went to zero.

2. There Was No Expectation by UNI Purchasers of Profits Based on Labs' Efforts

Labs' distributions of UNI were not accompanied by an expectation of profits. First, unlike in other cases, there were no public statements made by Labs or its senior employees touting UNI as an investment or tying UNI's success to that of the company. *See, e.g.*, *SEC v. Ripple Labs, Inc.*, No. 20-CIV-10832, 2022 WL 762966, at *2, 10 (S.D.N.Y. Mar. 11, 2022); *SEC v. LBRY, Inc.*, 639 F. Supp. 3d 211 (2022); *SEC v. Telegram Grp. Inc.*, 448 F. Supp. 3d 352, 373-74 (S.D.N.Y. 2020). Labs merely described the UNI token as exactly what it is—a governance token[32]—and never touted a potential increase in its value.

Second, Labs made no promises to increase the price of UNI, and there was no other basis for holders to expect that the price of UNI would increase or that Labs would undertake efforts designed to increase its price. UNI tokens could have been purchased for various reasons, including shaping the future of the Protocol through Governance, showing support for the values of DeFi, or other purposes. UNI tokens also could have been purchased for potential returns from the crypto space in general, as the price of UNI is largely correlated with the performance of the overall crypto market and not Labs' financial performance as a company.

Finally, although Labs retained some UNI for itself following the initial distribution, UNI is not Labs' primary means of funding its operations. Labs has raised multiple equity rounds—including a $165 million Series B round following the initial distribution of UNI—and it has implemented a number of different ways to generate revenue that do not rely on its UNI holdings or UNI sales, such as fees assessed on the Interface.

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[32] *Introducing UNI*, Uniswap Labs Blog (Sept. 15, 2020), https://blog.uniswap.org/uni ("Having proven product-market fit for highly decentralized financial infrastructure with a platform that has thrived independently, Uniswap is now particularly well positioned for community-led growth, development, and self-sustainability. The introduction of UNI (ERC-20) serves this purpose, enabling shared community ownership and a vibrant, diverse, and dedicated governance system, which will actively guide the protocol towards the future.").

D. LP Tokens Are Not Securities

The Staff alleges that LP Tokens are investment contracts and that their distribution amounts to Section 5(a) and (c) violations by Labs.

As an initial matter, Labs does not offer or sell LP Tokens, and the Staff cannot show that Labs is a counterparty to any transaction with LP Token holders. LP Tokens are generated automatically by the Protocol, which Labs does not operate or control.

Equally fundamentally, "the economic reality" is that LP Tokens are not issued (or sought) for investment purposes. *Foxfield Villa Assocs., LLC v. Robben*, 967 F.3d 1082, 1100-01 (10th Cir. 2020) (finding that a plaintiff's shared interest in an LLC was not a security, "even if [the plaintiff's] interests could be characterized as certificates of interest or participation in a profit-sharing agreement in theory"); *see also Marine Bank v. Weaver*, 455 U.S. 551, 558 (1982). Instead, the LP Token is used as a bookkeeping device to keep track of which assets the user provided to the smart contract and any fees earned on the user's liquidity. In other words, the LP Tokens are issued not for investment purposes, but instead as accounting tools, and they are therefore not securities. *See Kirschner v. JP Morgan Chase Bank, N.A.*, 79 F.4th 290, 304 (2d Cir. 2023) ("only 'notes issued in an investment context' are 'securities[]'" and "notes 'issued in a commercial or consumer context' are not") (quoting *Reves v. Ernst & Young*, 494 U.S. 56, 63 (1990)).

Finally, the individualized nature of LP Tokens means they cannot be considered profit-sharing agreements or certificates of interest. In *Tcherepnin v. Knight*, the Supreme Court held that withdrawable capital shares in an Illinois savings and loan institution were securities because they were "evidenced by a certificate . . . [and] contingent upon an apportionment of profits." 389 U.S. 332, 339 (1967). LP Tokens are different. When an LP deposits liquidity into a

pool, the smart contract generates an LP Token corresponding to the LP's liquidity position.[33] These tokens simply memorialize the portion of the pool owned by the LP and fees it has earned, akin to a voucher or receipt, and the LP Token can be redeemed for those at any time. The Protocol applies a fee to swaps, which is paid proportionally to all LPs who have an active liquidity position within the price range at that point in time. In addition, these fees are provided to users when they redeem their LP Tokens (and users also can remove earned fees without modifying their liquidity positions).

LP returns also are highly individualized. Their actual return is based upon their holders' overall position in a pool. This depends on a number of factors, including how long LPs leave their liquidity in the pool, at which prices the liquidity is placed, and the size of the price movement in the pool over time. Put simply, unlike in *Tcherepnin*, where investors received discretionary dividends based on the entity's profits, here LPs receive fees connected only to the performance of their own liquidity. *Tcherepnin*, 389 U.S. at 337.

II. An Enforcement Action Would Violate the Major Questions Doctrine and Labs' Due Process Rights

A. The Commission Lacks Congressional Authority to Regulate the Protocol as an Exchange

For all the reasons explained above, the contemplated enforcement action rests on untenable interpretations of the Commission's statutory mandate. But even if the Commission's reading of the Exchange Act were not unreasonable on its face, that reading would still run afoul of the major questions doctrine, which precludes the Commission (or any agency) from regulating in an area of major economic significance without clear congressional authority. *West Virginia v. EPA*, 597 U.S. 697, 723 (2022). This doctrine applies with special force where, as

[33] On version 2 of the Protocol, the liquidity position is represented by a UNI-V2 token; on version 3 of the Protocol, that position is represented by an NFT.

here, an agency "claims to discover in a long-extant statute an unheralded power to regulate a significant portion of the American economy." *Util. Air Regul. Grp. v. EPA*, 573 U.S. 302, 324 (2014) (citations omitted).

The Commission's lack of regulatory authority over the multi-billion-dollar crypto industry falls squarely within the Supreme Court's recent jurisprudence on the major questions doctrine—especially given that the Commission did not assert the authority it now claims to possess for many years and Congress is actively debating enacting a new regulatory regime. *See West Virginia*, 597 U.S. at 723; *Nat'l Fed'n of Indep. Bus. v. Occupational Safety and Health Admin.*, 595 U.S. 109 (2022); *Alabama Assn. of Realtors v. Dep't of Health and Human Servs.*, 594 U.S. 758 (2021). No appellate court has yet weighed in on this issue. And the Supreme Court's rulings suggest that the Commission should take little comfort in the fact that a few district courts have so far ruled in the Commission's favor on issues presented here.

There are multiple major questions implicated by the Commission's potential enforcement action against Labs. First, the Commission's assertion of authority over all assets using a new digital file type affects the $100 trillion traditional financial markets by protecting those markets from new competition. In an amicus brief filed in the Commission's case against Kraken, Senator Lummis has argued that crypto asset markets and the technology underlying these markets "will impact every quarter of finance." Amicus Curiae Brief of United States Senator Cynthia M. Lummis in Support of Defendants' Motion to Dismiss at 9, *SEC v. Kraken*, ECF No. 41, Case No. 23-cv-06003-WHO (N.D. Cal. Feb. 27, 2024). For example, the blockchain technology stack underlying the Protocol could disrupt custodians such as banks (through self-custodial technology), law firms that help issue assets (through simplifying the asset-production process), centralized markets makers, traditional central-limit order books,

trading for the large number of relatively illiquid assets, and clearing agencies and transfer agents. Senator Lummis also notes the risk of the Commission claiming jurisdiction over non-securities in other asset classes. *Id.* at 10.

Second, the crypto industry is valued at over $2.5 *trillion*,[34] and eliminating it and causing consumer and institutional investor losses as a result—which is what the Commission is attempting to do, since it provides no path to registration—clearly makes this a major question under recent Supreme Court precedent. *See Biden v. Nebraska*, 143 S. Ct. 2355, 2372 (finding release of $430 billion in student debt to be a matter of "economic and political significance" that should give judicial pause "before concluding Congress meant to confer such authority"). Nearly twenty percent of all Americans now hold crypto assets[35]—more than the 13% who have student loan debt[36]—and their holdings would be wiped out by the Commission's approach. And the Commission's attempt to reinterpret the statutory language "investment contract" to eliminate the word "contract," contrary to all appellate and Supreme Court precedent, would effectively ban digital assets and have larger repercussions beyond the crypto industry as well.

B. The Commission Did Not Provide Fair Notice that It Considered Labs' Conduct Unlawful

"A fundamental principle in our legal system is that laws which regulate persons or entities must give fair notice of conduct that is forbidden or required," which means the statute at issue must "provide a person of ordinary intelligence fair notice of what is prohibited." *FCC v. Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012). An entity being regulated should not be

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[34] *See Cryptocurrency Prices Today By Market Cap*, Forbes, https://www.forbes.com/digital-assets/crypto-prices (last visited Apr. 23, 2024).

[35] Casey Wagner, *A fifth of US voters have bought crypto, Paradigm survey finds*, Blockworks (Mar. 14, 2024), https://blockworks.co/news/us-voters-holding-cryptohttps://blockworks.co/news/us-voters-holding-crypto.

[36] Eliza Haverstock and Anna Helhoski, *Student Loan Debt Statistics: 2024*, Nerd Wallet (Feb. 5, 2024), https://www.nerdwallet.com/article/loans/student-loans/student-loan-debt.

"held liable when [an] agency announces its interpretations for the first time in an enforcement proceeding." *Christopher v. SmithKline Beecham Corp.*, 567 U.S. 142, 159 (2012).

The lack of clarity in the statutes being used by the SEC and other federal agencies in enforcement actions against the crypto industry is now obvious to courts. For example, Judge Wiles noted that "regulators themselves cannot seem to agree as to whether cryptocurrencies are commodities that may be subject to regulation by the CFTC, or whether they are securities that are subject to securities laws, or neither, or even on what criteria should be applied in making the decision." *In re Voyager Dig. Holdings, Inc.*, 649 B.R. 111, 119 (Bankr. S.D.N.Y. Mar. 11, 2023). This commentary is not surprising given the state of the industry, with the CFTC labeling at least one token (BUSD) as a commodity,[37] and the SEC later claiming it is a security.[38]

In light of this lack of clarity, an enforcement action would violate Labs' due process right to fair notice. In November 2018, when Hayden Adams announced the first version of the Protocol, no court had ruled that any crypto asset transaction was an investment contract—let alone that any asset using a new file format automatically became an investment contract or that designing the world's first successful protocol for automated market-making entailed running a securities exchange. To the contrary, a top official at the Commission had announced just months earlier that the token paired with all other tokens in version 1 of the Protocol, Ether, was specifically *not* a security.[39] When the UNI token was launched, it was listed on major centralized exchanges, such as Coinbase, within mere days, and subsequently Coinbase was allowed by the Commission to go public while listing UNI in 2021, now more than three years

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[37] Compl. at ¶ 24, *CFTC v. Zhao*, No. 23-cv-01887 (N.D. Ill. Mar. 27, 2023), ECF No. 1.

[38] *Paxos Issues Statement*, Paxos (Feb. 13, 2023), https://paxos.com/2023/02/13/paxos-issues-statement/.

[39] William Hinman, Dir., Div. of Corp. Fin., SEC, *Digital Asset Transactions: When Howey Met Gary (Plastic)*, U.S. Sec. & Exch. Comm'n (June 14, 2018), https://www.sec.gov/news/speech/speech-hinman-061418.

ago.[40] Thus, any reasonable person would have had no reason to believe that the SEC might change its mind and later take the position that creating and deploying the Protocol, operating the Interface, or deploying the UNI token would violate federal securities laws.[41]

III. An Enforcement Action Would Harm the Public Interest and Undermine the Commission's Goals

If the Commission files a lawsuit against Labs, the Commission would harm an important, emerging industry that can help achieve many of the Commission's stated goals, such as creating efficient markets and protecting investors. An action against Labs would not just affect Labs; rather, it would affect all crypto companies that offer similar services, including myriad companies that offer access to the Uniswap Protocol and create innovative ways to use it. And it would chill the kind of innovation on US soil that benefits individual consumers who seek and deserve fair access to the global economy.

First, the Commission's theory of liability, if adopted by a court, would effectively ban all AMMs. The Commission thus would violate its own mandate and make U.S. markets *less efficient* by benefiting some incumbents at the expense of AMMs. Research also estimates that the use of AMMs like the Protocol could save American investors *billions* of dollars in transaction costs per year by removing unnecessary costs of traditional middle men.[42] These savings stem from liquidity providers on AMMs also being longer term holders of the underlying assets and therefore needing less compensation for the smaller intraday risk they take.[43] This means traders get better prices and sellers get the return commensurate with their risk.

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40 *Uniswap (UNI) is launching on Coinbase Pro*, Coinbase (Sept. 16, 2020), https://www.coinbase.com/blog/uniswap-uni-is-launching-on-coinbase-pro.

41 Compl. at ¶¶ 82–85, *Consensys Software Inc. v. SEC*, No. 24-cv-00369-Y (N.D. Tex. Apr. 25, 2024), ECF. No. 1.

42 Katya Malinova and Andreas Park, *Learning from DeFi: Would Automated Market Makers Improve Equity Trading?*, 5 (Nov. 18, 2023), https://ssrn.com/abstract=4531670.

43 *Id.* at 10.

Additionally, the 24/7 liquidity available on crypto asset platforms promotes efficiency by allowing consumers to engage in transactions at the moment they need or want to, without waiting for the market to "open" or for the last hour before "close" to have sufficient liquidity for a fair trade.[44] In fact, traditional financial markets are now seriously considering implementing this popular feature of DeFi platforms.[45] Finally, AMMs provide more liquidity—reflected in lower spreads and higher depth of pricing—for both fat-tail and long-tail assets.[46] As a result, an AMM can solve a long-standing problem in traditional markets, which is that most assets are illiquid. The Commission has recognized this problem and tried to address it with years of written reports and Wall Street industry roundtables.[47] Those efforts have failed, and this technology, which the Commission is trying to ban, can solve this important consumer problem. And it can do so for securities markets as well as the much larger non-securities markets.

Second, the Commission's actions have already forced many companies in the crypto industry offshore,[48] and bringing an action against Labs would only accelerate the offshoring of this emerging financial sector. That trend deprives the American public of access to intermediary-free platforms, takes jobs away from the American economy, and poses security risks. Nearly one million jobs could be created in the DeFi industry by 2030, but a large portion of those will not be in the United States if the Commission continues to pursue its current

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44 Austin Adams et al., *On-Chain Foreign Exchange and Cross-Border Payments* (January 18, 2023), https://ssrn.com/abstract=4328948.

45 Jennifer Hughes, *New York Stock Exchange tests views on round-the-clock trading*, Financial Times (Apr. 22, 2024), https://www.ft.com/content/31c3a55b-9af9-4158-8a49-4397540571bf.

46 *The Dominance of Uniswap v3 Liquidity*, Uniswap Labs Blog (May 5, 2022), https://blog.uniswap.org/uniswap-v3-dominance.

47 *SEC Staff to Host Roundtable on Market Structure for Thinly-Traded Securities*, SEC (Apr. 13, 2018), https://www.sec.gov/news/press-release/2018-65.

48 *See, e.g.*, Electric Capital, *U.S. Share of Blockchain Developers is Shrinking*, Crypto Council for Information (Apr. 24, 2023), https://cryptoforinnovation.org/u-s-share-of-blockchain-developers-is-shrinking/.

strategy.[49] Moreover, offshoring forces companies beyond the direct jurisdiction of U.S. regulators and law enforcement, allowing riskier behaviors to thrive. The cases of FTX and Terra (Luna) show exactly how offshoring crypto companies can breed the type of fraud from which the Commission should be protecting investors.

Third, Uniswap has already benefitted a significant number of consumers, creating innovative products (with more to come) and saving consumers significant transaction costs. An action against Uniswap would put all of that at risk, with no legal basis.

IV. Conclusion[50]

For all of these reasons, Labs urges the Staff not to recommend an enforcement action in this matter.

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[49] *Id.*

[50] If after reviewing this submission the Staff still intends to proceed with its enforcement action recommendation, we request a meeting with the Director and Deputy Director of Enforcement to discuss the matter before any recommendation is made to the Commission.

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

CONSENSYS SOFTWARE INC.,

Plaintiff,

v.

GARY GENSLER, Chair of the U.S. Securities and Exchange Commission; CAROLINE A. CRENSHAW, JAIME LIZÁRRAGA, MARK T. UYEDA, AND HESTER M. PEIRCE, each a Commissioner of the U.S. Securities and Exchange Commission; and U.S. SECURITIES AND EXCHANGE COMMISSION,

Defendants.

No. _____

JURY TRIAL DEMANDED

COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF

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Dated: April 25, 2024

INTRODUCTION

1. This action is about regulatory overreach, the ambition of the administrative state to control innovative technologies, and elementary principles of fairness and due process.

2. Plaintiff Consensys Software Inc. ("Consensys") is a software developer whose business centers on a blockchain network called Ethereum. Users of the Ethereum network pay fees with a digital asset called "ether" or "ETH."

3. The U.S. Securities and Exchange Commission (the "SEC" or the "Commission") seeks to regulate ETH as a security, even though ETH bears none of the attributes of a security — and even though the SEC has previously told the world that ETH is not a security, and not within the SEC's statutory jurisdiction. This is the latest step in the SEC's recent campaign to seize control over the future of cryptocurrency, one of the fastest-growing and most innovative technologies in the world. The SEC seeks to achieve this regulatory dominion through ad hoc enforcement actions against Consensys and others — enforcement actions that would punish Consensys for accepting and acting in reliance on years of government assurance that ETH is not a security. There is nothing right about this picture.

4. Developed in 2014, Ethereum is a revolutionary network that permits individual users to transact directly and securely with one another through automated software programs. For example: borrowers now can complete loan transactions, settled in ETH or other crypto, by satisfying the requirements of a software application on the Ethereum network that facilitates borrowing and lending — without the intermediary of a traditional banking institution. Artists, writers, and musicians now can sell their work to customers in transactions settled in ETH — without the intermediary of a publisher, gallery, or record label. All these transactions are immutably recorded on the Ethereum network's ledger — called the blockchain — ensuring that the transactions are secure and transparent.

5. The Ethereum network is decentralized. No individual or group of individuals manages Ethereum or directs its affairs. Ethereum has no management team, no board of directors, no constitutive body of any kind. Rather, as detailed below, Ethereum is organized and develops democratically through the voluntary participation of a shifting mass of thousands of users, code developers, and other stakeholders.

6. ETH is the currency that permits users to transact and interact on the Ethereum network. ETH has none of the features of a security. ETH represents no claim on the proceeds or revenues of the Ethereum network. ETH provides no interest in the profits or assets of any enterprise. Nor is the value of ETH driven by the efforts of any promoter or organization. No governing board manages ETH or defines its characteristics or terms of use.

7. In 2018, the SEC definitively declared that ETH is not a security. Recognizing Ethereum's lack of any centralized managing authority, the SEC's Director of Corporation Finance stated that "current offers and sales of Ether are not securities transactions." The following year, the Chair of the Commodity Futures Trading Commission (the "CFTC") announced the determination "that ether is a commodity and therefore would fall under our jurisdiction." His successor reaffirmed: ETH falls "within the commodity regime," not the "security regime." Throughout this period, the SEC and CFTC have repeatedly affirmed that position — in public statements, testimony to Congress, agency enforcement actions, and regulatory actions. The regulatory consensus was clear: ETH is not a security.

8. Consensys built its business against the backdrop of this regulatory consensus. Its products include "MetaMask" wallet software that allows individuals to self-custody their ETH and other digital assets and to direct those assets for use on third-party exchanges and other decentralized applications on Ethereum and other blockchains. Consensys's software products are

primarily built for Ethereum. Its business is driven by the broad-scale adoption of the Ethereum network and, in turn, the ability of individuals to use ETH. Consensys itself acquires, holds, and sells ETH in the ordinary course of its business.

9. In 2021, a new Administration took power and brought with it a new regulatory agenda. At first, new SEC leadership asked Congress for more power to regulate crypto. When Congress declined, the SEC decided to assert that power anyway. Over the past three years, with no further statutory basis, the SEC has arrogated to itself new powers to regulate cryptocurrencies and the exchanges on which they trade. Years into its self-appointed campaign of regulatory escalation — and completely contrary to its conclusion six years ago — the SEC now has decided to claim the right to regulate ETH as a security.

10. The SEC's self-aggrandizing about-face on ETH is notable for its lack of transparency. In April 2023, Gary Gensler, the Biden Administration's crusading SEC Chair, appeared before the House Financial Services Committee. The Committee Chairman repeatedly asked Gensler: does the SEC now think ETH is a security? Gensler refused to answer this direct question from the Chairman of the Congressional committee charged with overseeing his agency. He did not want to admit that his SEC had already secretly cemented its power-grab by issuing an [redacted].*

11. This action challenges the SEC's determination that ETH is a security, subject to SEC jurisdiction. The SEC is only authorized to regulate securities. It claims the power to regulate transactions in ETH and other digital asset tokens on the ground that they are "investment contracts" — one of the many enumerated securities identified in the Securities Act of 1933 (the

* References to a document the SEC has designated non-public have been redacted, subject to the SEC's position on whether the unredacted Complaint should be filed under seal.

"Securities Act"). But all "investment contracts" involve a contractual undertaking in which a person invests in an enterprise in exchange for a promise to deliver value from the profits, income, or assets of the business at a future date. Transactions in ETH involve none of these things: no ongoing contractual undertakings, no interest in any enterprise, and no profits derived from the efforts of a centralized promoter. In these respects, ETH is indistinguishable from bitcoin, the sole digital asset that Chairman Gensler remains willing to concede is a commodity and not a security.

12. Even if the SEC's construction of "investment contract" to include ETH and other digital assets were colorable, the major questions doctrine would require its rejection. Where, as here, an agency claims "to discover in a long-extant statute an unheralded power to regulate a significant portion of the American economy," it must have "clear congressional authorization." The SEC does not.

13. The SEC's assertion of jurisdiction over ETH, and the specter of an enforcement action against Consensys for its transactions in ETH, also violate the Constitutional requirement of fair notice under the Due Process Clause. The SEC and the CFTC for years took the position — openly, consistently, and repeatedly — that ETH *is not a security.* Just last month, the CFTC reaffirmed this position in an enforcement action concerning transactions in "digital assets that are commodities, including . . . ether." The SEC's about-face on ETH is the antithesis of fair notice, with businesses — including Consensys — built on the basis of the SEC's previous position (and the CFTC's ongoing insistence) now facing the threat of punitive, even existential, enforcement actions.

14. The SEC's unlawful seizure of authority over ETH would spell disaster for the Ethereum network, and for Consensys. Every holder of ETH, including Consensys, would fear violating the securities laws if he or she were to transfer ETH on the network. And the ability of

anyone new to acquire ETH to use Ethereum's repository of decentralized applications and services would be extinguished. This would bring use of the Ethereum blockchain in the United States to a halt, crippling one of the internet's greatest innovations.

15. The SEC has now also trained its sights on Consensys's MetaMask wallet software. The SEC claims that by offering this wallet software, Consensys acts as a broker and offers and sells securities. But MetaMask is simply an interface — like a web browser — that allows digital asset holders to seamlessly interact with the Ethereum network, including all other users and applications participating on the network. MetaMask neither holds customers' digital assets nor carries out any transaction functions. No court has found anything like the MetaMask wallet software to be a securities broker.

16. Consensys is built on creating software products that allow people around the world to use and build on top of the Ethereum network, and it is entitled to run its business without the cost, burden, and uncertainty of an unlawful enforcement action. Consensys therefore brings this action seeking declarations that (i) ETH is not a security and Consensys's sales of ETH are not securities transactions; (ii) any investigation or enforcement action against Consensys premised on ETH being a security or ETH transactions being securities transactions would exceed the SEC's regulatory authority and violate the fair notice requirement of the Due Process Clause; (iii) Consensys neither acts as a broker, nor offers or sells securities, through the Swaps and Staking functionality of its MetaMask wallet software; and (iv) any investigation or enforcement action against Consensys premised on it acting as a broker or offering and selling securities through its MetaMask software would exceed the SEC's authority. Consensys further seeks an order enjoining the SEC from investigating or bringing an enforcement action either with respect to its sales of ETH or as to MetaMask.

PARTIES

17. Plaintiff Consensys is a corporation organized under the laws of Delaware and headquartered in Fort Worth, Texas. Consensys is a leading developer of blockchain and web3 software solutions. Its software products include MetaMask, a popular non-custodial wallet application that allows users to manage their digital assets, interact with decentralized applications, and securely store their private keys.

18. Defendant Gary Gensler is the Chair of the SEC. Chair Gensler is named in his official capacity only.

19. Defendant Caroline A. Crenshaw is a Commissioner of the SEC. Commissioner Crenshaw is named in her official capacity only.

20. Defendant Jaime Lizárraga is a Commissioner of the SEC. Commissioner Lizárraga is named in his official capacity only.

21. Defendant Mark T. Uyeda is a Commissioner of the SEC. Commissioner Uyeda is named in his official capacity only.

22. Defendant Hester M. Peirce is a Commissioner of the SEC. Commissioner Peirce is named in her official capacity only.

23. Defendant the U.S. Securities and Exchange Commission is an agency of the U.S. federal government.

JURISDICTION AND VENUE

24. This action arises under the Constitution, the federal courts' equitable powers, the Declaratory Judgment Act, 28 U.S.C. § 2201 *et seq.*, the Administrative Procedure Act, 5 U.S.C. § 500 *et seq.*, the Securities Act, 15 U.S.C. § 77a *et seq.*, and the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* (the "Exchange Act"). This Court therefore has jurisdiction pursuant to 28 U.S.C. § 1331.

25. Venue is proper in this district because Plaintiff Consensys maintains its principal place of business in this district and division at 5049 Edwards Ranch Road, Fort Worth, TX 76109, and no real property is involved in this action.

BACKGROUND

A. Blockchains and digital assets

26. A blockchain is a distributed peer-to-peer electronic ledger or database maintained on a decentralized basis by numerous computers within a network. Unlike traditional ledgers that record transactions, a blockchain "ledger" is "distributed" in the sense that it is shared and instantly synchronized across multiple computers, with public copies of the ledger accessible by multiple users at the same time. The ledger is "peer-to-peer" in the sense that no central authority controls the network. When a user submits a transaction to the ledger, the entry is immediately available to all other users without any central organizing function or administrator.

27. These attributes distinguish blockchain technology from all previous forms of transactional recordkeeping. Because it is distributed across computers globally, with no centralized organizing function, the blockchain is vulnerable to no one point of malicious cyberattack or failure. Because all transactions are recorded publicly, the blockchain is far more transparent than traditional forms of transactional recordkeeping. Because it is peer-to-peer, the blockchain is far more accessible than traditional forms of transactional recordkeeping. Because the blockchain software is publicly available and can be used by anyone to build new applications on the network, third-party decentralized applications on the blockchain are proliferating around the world. Blockchain technology has been utilized by individuals and enterprises to secure financial transactions, manage supply chains, issue stablecoins, store data, and verify identities, among other applications.

28. Every blockchain has its own "native" or "base" "token" — also referred to as a "digital asset," "cryptoasset," or "cryptocurrency." These tokens give their holders the ability to access an application or service on the blockchain. The blockchain records ownership of tokens through public alphanumeric addresses. The owner holds a unique "private key" to that public address that allows them to transact in the tokens held at that address. Token holders are accordingly able to use their tokens to participate in activities on the blockchain.

29. The transactions on a public blockchain are confirmed by the participants in that blockchain's transaction verification process or "consensus mechanism." The job of these validators is to ensure that transactions undertaken on the blockchain are accurately and securely recorded on the ledger. Before a transaction is entered on the blockchain, validators must reach a consensus on the transactions to add to the ledger. Blockchains generally employ one of two consensus mechanisms: "proof of work" or "proof of stake."

30. In a proof-of-work network, for each "block" of transactions to be validated, "miners" race with one another to solve a computational puzzle for the right to validate a given transaction proposed for addition to the blockchain and earn rewards. In a proof-of-stake network, validators "stake" some of their blockchain tokens — posting the tokens as a bond — while they verify new transactions proposed to be added to the blockchain. If a validator violates the rules of the network, for example by proposing the addition to the blockchain of a fake transaction or one that lacks the requisite valid digital signature from each party, that validator risks losing some or all of its staked assets — a way to deter bad actors. Under both proof-of-work and proof-of-stake programs, validators can earn additional tokens as a fee for validating other users' transactions and maintaining consensus as to the history of transactions on the blockchain.

31. The first major blockchain network, Bitcoin, was invented in 2008. Until recently, the sole function of the Bitcoin blockchain was to record transactions in its native token, bitcoin, allowing holders of the bitcoin token to use it as a medium of exchange and store of value. Another major digital asset network, Ethereum, was launched in 2015.

32. In the years since the launch of Bitcoin and Ethereum along with their native tokens, thousands of other crypto tokens have been developed, with a variety of functions and uses. Many, like bitcoin, function primarily as digital currency, providing means to transfer funds, pay for products and services, and store value — all without an intermediary like a bank. Others provide their owners with utility linked to a specific network, making possible the use of various products and services offered on the network. And other tokens with so-called "governance" attributes can be used to cast votes on proposed changes to a network's code and thus its functionality.

33. The digital asset industry has become a significant economic force. At least one in five adults in the United States owns crypto today. Digital assets have achieved a market capitalization of over $2 trillion. Hundreds of millions of people globally use cryptoassets for financial and non-financial purposes. Ethereum is used by tens of millions of people to complete over a million transactions daily, and ETH alone has a market value of almost $400 billion. Participation in Ethereum is expanding rapidly, as innovators continue to build new applications on Ethereum, including traditional financial institutions like BlackRock, which launched its first digital asset product on Ethereum last month.

B. The Ethereum Network

34. Ethereum was developed to expand the distributed ledger concept of Bitcoin and other blockchains to applications beyond money. Ethereum enables anyone to develop and run automated software programs stored on the blockchain — known as "smart contracts" — while maintaining a permanent record of all transactions on the network. Smart contracts automatically

perform predetermined actions when their conditions are met, without human intervention. The execution of a smart contract's if/then logic is often analogized to the operation of a vending machine: when a user inserts a dollar and pushes B4, a Snickers bar drops into the bin. In the same way, users of the Ethereum network can commit their ETH, enter a computer instruction, and receive a product or service in automatic response. Ethereum thus permits developers to create countless applications — from games to marketplaces — that, unlike traditional transactions, require no intermediation and, unlike traditional computer applications, do not sit on centralized servers. So, for example, individuals can use ETH to buy distributed data storage from a decentralized application sitting on Ethereum, with buyers and sellers interacting with no human intermediary — only smart contracts.

35. At the heart of Ethereum's design is its native token, ether or ETH. To conduct a transaction on the Ethereum blockchain, users pay a fee in fractions of ETH. Validators are paid in ETH to process and verify user transactions. The imposition of fees in ETH for transactions on Ethereum is critical to the network's security and long-term viability: if Ethereum transactions were free, there would be no cost to transmitting an inordinate number of transactions, leading to denial-of-service attacks where attackers cheaply overload the network and make it unusable.

36. The Ethereum network operates without a formal governance structure or governing body. Instead, decisions are made through rough consensus among the network's stakeholders, including ETH holders and application users and developers. Anyone can propose changes to Ethereum's operating protocol through a process called "Ethereum Improvement Proposals." Proposals to change the network are debated in public forums, including open internet forums and in-person conferences, with the goal of achieving broad consensus. The process operates in stages and is democratic: a proposal may be revised and re-submitted over time by its

"champion" to incorporate Ethereum community feedback. If a proposal fails to capture community interest, as many do, it will be abandoned. But if an idea commands broad consensus within the Ethereum community, then dispersed Ethereum code developers volunteer to participate in preparing and testing the code needed to implement the proposal. If the proposal proves viable, the Ethereum network will be updated and then all Ethereum network participants have the option to implement the update in running their nodes or their decentralized applications.

37. An illustration of Ethereum's decentralized governance process involved its migration in 2022 from a proof-of-work to a proof-of-stake validation mechanism — a change referred to as "the Merge." This complex technical shift was years in the making. It began as an Ethereum Improvement Proposal and, after extensive debate, generated widespread consensus among Ethereum stakeholders — ranging from leading code developers to ETH token holders — to implement a roadmap of changes to the network's protocols. No single person or body had central authority or was designated as a decision-maker to plan or implement the Merge. By eliminating the use of intense computational exercises to validate transactions, the Merge decreased Ethereum's electricity use by 99.9%.

C. Consensys's business

38. Consensys develops software for blockchains. It employs over 800 people globally, including over 340 in the United States. Consensys's products help individual users and enterprises build and use next-generation web applications and participate in the decentralized web.

39. Many of Consensys's software products are built for Ethereum; Ethereum is therefore critical to Consensys's mission. So is ETH. The consumers and developers that use Consensys's software for Ethereum must use ETH to transact on the blockchain. Consensys holds ETH in the ordinary course of its business, including ETH received from customers as payment

for its offerings. Consensys sells ETH as a normal part of its treasury operations, to maintain sufficient cash and cash equivalents on its balance sheet.

40. Consensys's software products include MetaMask. MetaMask is free "wallet" software — in the form of a browser extension or mobile application — that facilitates access to users' self-custodied digital assets (technically, it enables users to hold the "private keys" for tokens that are recorded on the blockchain). The MetaMask wallet software is "self-hosted" or "non-custodial," which means that the software provides a user with a means to store, manage, and secure private keys locally — entirely on the user's own device. Consensys never holds and cannot access a user's private keys and other data.

41. MetaMask provides a user-friendly software interface to Ethereum and other blockchain networks. Transacting on Ethereum requires composing and encrypting instructions in computer-readable language. The wallet software enables users to avoid having to manually compose those instructions and instead provides users with an intuitive interface through which they can input commands that are then used to generate the appropriate code for submitting transactions to the blockchains. MetaMask thus provides users a seamless and simple way to read blockchain data, send ETH from one address to another, and interact with third-party decentralized applications, much like a web browser allows one to surf the internet without having to know command-line computer instructions.

42. Two core features of this wallet platform are MetaMask Swaps and MetaMask Staking.

43. ***MetaMask Swaps*** is an application that allows users to communicate with third-party decentralized exchanges ("DEXs") where they can buy, sell, or exchange tokens. MetaMask

Swaps allows a user to see pricing information for tokens from DEXs and third-party aggregators and communicates the user's commands to DEXs to carry out transactions.

44. MetaMask Swaps software itself does not execute transactions and never comes into possession of users' digital assets. It simply displays pricing information collected from third-party aggregators and sends user commands to DEXs, which execute the transactions.

45. Consensys charges a 0.875% service fee in connection with certain successful transactions for use of the Swaps software.

46. ***MetaMask Staking*** is an application that allows users to communicate with certain third-party protocols called Lido and Rocket Pool, each of which offers a "liquid staking service" for validating transactions on the Ethereum blockchain. Lido and Rocket Pool allow users to deposit ETH into a pool and, through a series of smart contracts, Lido and Rocket Pool will automatically stake users' assets and allow them to earn Ethereum network rewards and transaction fees in return for participating in this blockchain validation service. While their digital assets are staked, users receive from Lido or Rocket Pool a tokenized version of the staked tokens. These tokens, like any other token, can be swapped for other crypto or money, and also give the holder the right to withdraw ETH from the liquid staking protocol.

47. MetaMask Staking is thus an interface to facilitate users' communications with these third-party protocols, which in turn allow users to deposit ETH for staking and receive a tokenized version of the staked digital asset in return. Like the rest of the MetaMask wallet software, the MetaMask Staking feature is entirely non-custodial; at no point does Consensys come into possession, custody, or control of a user's tokens, nor can it alter in any way the user's transaction instructions to the protocol.

D. The SEC's authority and its limits

48. The SEC is a federal agency whose authority to regulate is limited to transactions in "securities." The term "securities" is statutorily defined to embrace an enumerated set of financial instruments, including "stocks," "bonds," and similar investments. Most economic transactions are not transactions in securities. Nor are most investments necessarily investments in securities. Commodities, like gold or soybeans, are fundamentally distinguishable from securities even though, like securities, they are traded by investors on public markets. Commodities markets and products are regulated by the CFTC, not by the SEC. As the CFTC Chair put it, the question is whether the product "fall[s] within the commodity regime or the security regime" — they are mutually exclusive.

49. Securities are investments in a business enterprise backed by a managerial commitment. Securities offer their holders the prospect of a return derived from the income, profits, or assets of the enterprise. Commodities, by contrast, are not investments in an enterprise backed by a managerial commitment, and do not offer a return derived from the operations of the enterprise. Their value is derived from the trading price available in the market, by the forces of supply and demand, not the performance or commitments of management.

E. The SEC acknowledges that ETH is not a security

50. For years following the first cryptocurrency's introduction, the SEC claimed no authority to regulate cryptoassets. Many cryptocurrencies were in broad circulation before the SEC suggested it might have regulatory authority over any transactions in any of them. And even then, both the SEC and CFTC repeatedly affirmed that ETH, specifically, is *not* a security.

51. The SEC confirmed that ETH is not a security in June 2018 in a speech delivered by William Hinman, the Director of the SEC's Division of Corporation Finance, the division responsible for regulatory activities concerning issues relating to the definition of a "security" and

for advising the Commission on these issues. Hinman declared that while a digital asset representing a "financial interest in an enterprise" might be "a digital asset offered as a security," a token "can, over time, become something other than a security." Specifically, Hinman said a digital token used to purchase goods and services within a "sufficiently decentralized" network would cease to be a security. He went on to explain that a sufficiently decentralized network was one "where purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts." In that situation, Hinman said, "the ability to identify an issuer or promoter to make the requisite disclosures becomes difficult, and less meaningful." The SEC's regulatory authority would in that circumstance fall away.

52. In his speech, Hinman confirmed the SEC's conclusion that ETH is not a security. He explained: "[B]ased on my understanding of the present state of Ether, the Ethereum network and its decentralized structure, current offers and sales of Ether are not securities transactions."

53. In an interview on CNBC the next day, Hinman reemphasized that ETH is not a security: "When we look . . . at ether and the highly decentralized nature of the network[] we don't see a third-party promoter where applying the disclosure regime would make a lot of sense. So we're comfortable . . . viewing these as items that don't have to be regulated as securities."

54. Hinman's representations about ETH reflected the considered judgment of the SEC and its leadership. As internal Commission documents made public have revealed, Hinman's use of the plural "we" reflected the approval Hinman received from the highest ranks of SEC officials — including then-Chair Jay Clayton — before he publicly declared ETH not to be a security. When Hinman circulated the speech draft, he bracketed the portion about Ethereum and ETH and said he would only keep the language "if we [at the SEC] all are in agreement."

55. In the wake of this announcement, then-Chair Clayton endorsed Hinman's speech as "the approach [the SEC] staff takes to evaluate whether a digital asset is a security" and encouraged people "to take a look at Bill [Hinman]'s speech." SEC Commissioner Peirce, too, embraced Hinman's framework, noting that "[o]nce 'a network becomes truly decentralized, the ability to identify an issuer or promoter to make the requisite disclosure becomes less meaningful' and offers and sales of tokens are no longer subject to the securities laws."

56. In 2019, the SEC staff published a "Framework for 'Investment Contract' Analysis of Digital Assets" (the "Framework"). The Framework memorialized many of the key points outlined in Hinman's speech, including his emphasis on whether the network is "decentralized." In particular, the Framework noted that a digital asset was not likely to be a security if it was governed by "an unaffiliated, dispersed community of network users (commonly known as a 'decentralized' network)."

57. The SEC's 2018 declaration that ETH is not a security, and therefore not subject to SEC jurisdiction, was widely understood and uncontroversial. Chair Gensler, then a professor at the Massachusetts Institute of Technology, told a gathering of investors in 2018 that "Bitcoin, ether, Litecoin and Bitcoin Cash" are "not securities." Similarly, then-Professor Gensler told his students in a course on blockchains and digital assets that "in 2018 the Securities and Exchange Commission has said that regardless of what [ether] might have been in '14, it's now sufficiently decentralized that we'll consider it not a security."

58. And just last fall, the SEC declared effective registration statements for nine Exchange Traded Funds intended to hold ETH futures contracts that are traded on commodities exchanges. The CFTC approved those ETH futures contracts to trade on commodities exchanges on the basis that they were futures contracts based on a commodity, not a security. By approving

the Exchange Traded Funds that hold those contracts, the SEC explicitly endorsed the CFTC's view that ETH is a commodity, not a security.

F. The CFTC agrees that ETH is a commodity, not a security

59. Like the SEC, the CFTC also has consistently concluded that ETH is a commodity, not a security. In 2019, then-Chair of the CFTC, Heath Tarbert, stated: "Ether is a commodity, and therefore it will be regulated under the [Commodity Exchange Act]." Based on that position, since February 2021, the CFTC has permitted futures contracts for ETH to trade on the Chicago Mercantile Exchange.

60. The CFTC has repeatedly reaffirmed its determination that ETH is a commodity and not a security, including through approval of additional ETH commodity futures contracts, in CFTC enforcement actions, and in statements by Commissioners. Testifying in oversight hearings, CFTC Chair Rostin Behnam told the Senate that "when ether futures were listed . . . both the exchange and the [CFTC] thought very deeply and thoughtfully about 'what is the product?' and 'does it fall within the commodity regime or the security regime?" — concluding, "We would not have allowed the ether futures product to be listed on a CFTC exchange if we did not feel strongly that it was a commodity asset." In further testimony last month, Chair Behnam observed that the "conclusion that Ether is a commodity" was a "years-old decision" that has served markets well. CFTC Commissioner Caroline Pham has similarly stated publicly that ETH is a "digital asset commodit[y]."

61. CFTC Director of Enforcement Ian McGinley told leading practitioners in a widely reported keynote address on September 11, 2023, that ETH would be regulated as a commodity, just like "gold, wheat or oil futures and options."

62. Acting on its determination that ETH is a commodity, subject to CFTC rather than SEC regulation, the CFTC has launched multiple enforcement actions concerning the sale of ETH.

In a proceeding before a federal judge in this State, the CFTC procured an order declaring that "ether . . . [is a] 'commodit[y]' pursuant to 7 U.S.C. § 1a(9)" — the Commodity Exchange Act. Order of Final Judgment by Default, *CFTC* v. *Laino Grp. Ltd. d/b/a PaxForex*, Case No. 4:20-cv-03317, ECF No. 21 at ¶ 43 (S.D. Tex. June 30, 2021). In each of the cases cited in the margin, the CFTC has similarly told federal judges that ETH is a commodity (not a security), subject to CFTC jurisdiction.[1]

G. The SEC makes a crypto regulatory power grab

63. In early 2021, shortly after assuming office, President Biden nominated Gary Gensler as Chair of the SEC. In May 2021, immediately following his confirmation, Gensler told Congress that the SEC lacked regulatory authority over crypto exchanges and called on the legislature to supply his agency with a broad regulatory mandate. Congress declined. But the SEC under Gensler decided to take the authority anyway. In August 2021, within months of becoming the SEC's Chair, Gensler vowed to "take [the agency's] authorities as far as they go" in pursuit of crypto. Soon thereafter, the SEC doubled the size of its crypto enforcement unit and ramped up investigations of participants in the digital asset market.

[1] *See* Amended Complaint, *CFTC* v. *Bankman-Fried*, Case No. 1:22-cv-10503, ECF No. 13 at ¶ 23 (S.D.N.Y. Dec. 21, 2022) ("Digital assets such as including bitcoin (BTC), ether (ETH), tether (USDT) and others are 'commodities' as defined under Section 1a(9) of the Act, 7 U.S.C. § 1a(9)"); Complaint, *CFTC* v. *Temurian*, Case No. 1:23-cv-01235, ECF No. 1 at ¶ 1 (E.D.N.Y. Feb. 15, 2023) (charging defendants with fraud "in connection with the sale of digital assets that are commodities, such as Bitcoin and Ether"); Complaint, *CFTC* v. *Zhao*, No. 1:23-cv-01887, ECF No. 1 at ¶¶ 2, 24 (N.D. Ill. Mar. 27, 2023) (alleging that bitcoin, ether, Litecoin, Tether, and some "other virtual currencies" are "commodities" under the Commodity Exchange Act); Complaint, *CFTC* v. *Russell*, No. 23-cv-2691, ECF No. 1 at ¶ 12 (E.D.N.Y. Apr. 11, 2023) (alleging that "[c]ertain digital assets, including bitcoin, ether and USDC, are 'commodities'" under the Commodity Exchange Act); Complaint, *CFTC* v. *MEK Global Ltd.*, Case No. 24-cv-2255, ECF No. 1 at ¶ 2 (S.D.N.Y. Mar. 26, 2024) (alleging that exchange transactions involved "digital assets that are commodities, including . . . ether (ETH)").

64. Instead of regulating by rulemaking, the SEC has chosen to bring dozens of cryptocurrency-related enforcement actions in assorted jurisdictions, many against smaller-scale or under-capitalized defendants unable to defend against the SEC's aggressive litigation stance. As the actions mounted, SEC Commissioner Peirce noted the unfairness of regulating by enforcement rather than rulemaking: "Using enforcement actions to tell people what the law is in an emerging industry," she observed, is not a "fair way of regulating" — "one-off enforcement actions and cookie-cutter analysis does not cut it." She has also stated that "if we seriously grappled with the legal analysis and our statutory authority, as we would have to do in a rulemaking, we would have to admit that we likely need more, or at least more clearly delineated, statutory authority to regulate certain crypto tokens and to require crypto trading platforms to register with us." Most recently, Commissioner Peirce joined Commissioner Uyeda to criticize as "fiction" the SEC's claim to have provided "clarity on which crypto assets are securities" with standards that "are so opaque and arbitrary that the Commission itself is unwilling to stand by its own analysis."

65. Chair Gensler's SEC has little interest in public comment or forward-looking rulemaking addressing the crypto industry. The agency denied a recent petition for rulemaking asking it to spell out its position and accompanying guidance, and has ignored comments seeking clarification about how recent regulations apply to firms operating in the crypto space. The agency is determined to answer to no one.

H. Consensys becomes a target

66. On April 4, 2022, Consensys received a letter from the SEC's Division of Enforcement staff advising it that the staff was "conducting an investigation" of MetaMask. The SEC requested that Consensys voluntarily provide answers to a number of broad requests for information regarding MetaMask, including MetaMask Swaps. The SEC made additional requests

for information by letter and on calls. Consensys diligently cooperated throughout this period, at significant effort and expense, providing a detailed account of certain of its software products and operations.

67. While that investigation was ongoing, on September 21, 2022, Consensys received another letter from the SEC staff advising that the agency was conducting an investigation into certain staking protocols on the Ethereum network and requesting voluntary responses to its questions. Although the SEC did not initially indicate that Consensys was a target of this investigation, through subsequent letters and communications the SEC staff came to focus its requests for information and documents on MetaMask Staking. As with the SEC staff's investigation into MetaMask Swaps, Consensys diligently cooperated at significant expense.

68. On April 10, 2024, the SEC staff sent Consensys a "Wells Notice" stating its intent to imminently recommend that the Commission bring an enforcement action against Consensys for violating the federal securities laws through its MetaMask Swaps and MetaMask Staking products. In a telephone conference that same day, the SEC staff stated its view that Consensys, by operating the MetaMask Swaps software, is an unregistered broker-dealer in violation of Section 15(a) of the Exchange Act. The SEC staff also stated its view that Consensys, in connection with its MetaMask Staking program, violates both Sections 5(a) and 5(c) of the Securities Act by engaging in the offer and sale of unregistered securities and violates Section 15(a) of the Exchange Act by acting as an unregistered broker-dealer.

I. The SEC puts ETH and Consensys in its crosshairs

69. The SEC, meanwhile, has also sought to appoint itself regulator of ETH: a digital asset the SEC, the CFTC, and the public at large had long understood fell outside the SEC's grasp.

70. Beginning in early 2023, Chair Gensler backtracked from the SEC's prior statement that ETH is not a security, stating in February that among cryptocurrencies "everything but Bitcoin" could be a security. Chair Gensler sowed further confusion a few weeks later when he asserted that any developers "promoting" proof-of-stake protocols, like Ethereum's, would need "to come into compliance" with securities regulation. And the following month, when testifying before the House Financial Services Committee, Gensler pointedly refused to answer — even in the face of repeated questioning by the Committee's chair — whether he considered ETH to be a security.

71. Unwilling to state its position publicly, by early 2023 the SEC had already made what it knew would be a destabilizing reversal of its declaration that ETH was not a security. On March 28, 2023, Gurbir Grewal, Director of the Division of Enforcement, approved [redacted]. The Commission affirmed the issuance of [redacted] shortly thereafter on April 13, 2023. [redacted]

72. Over the last year, the SEC has issued numerous subpoenas [redacted]. Consensys itself received three subpoenas in 2023 containing two dozen distinct requests for information, many comprising several detailed sub-requests. The subpoenas do not just seek information on Consensys's acquisitions, holdings, and sales of ETH. They also seek detailed information concerning the role of Consensys, including its software developers, in a host of

Ethereum Improvement Proposals related to the Ethereum Merge, the transition from a proof-of-work to a proof-of-stake validation mechanism. These subpoena categories include information on Consensys meetings with third parties, communications with all Consensys customers, a list of the names of any Consensys developers who contributed to any coding related to the proposals, and the identity of all public and private repositories that Consensys developers contributed to in connection with their coding. As with the SEC staff's investigation into MetaMask, Consensys again diligently cooperated at significant expense. Consensys has made at least eight document productions, totaling over 88,000 pages. The SEC has also requested testimony from at least one senior officer of Consensys concerning the company's sales of ETH.

73. The SEC staff has communicated to Consensys that the agency is investigating whether Consensys's current offers and sales of ETH — transactions carried out from its own holdings as part of its normal treasury operations — are securities transactions. And the staff recently requested that Consensys make a "proffer" to the SEC to state why Consensys believes its ETH sales are not securities transactions.

74. Despite requests for clarification, the staff has declined to explain why the SEC believes Consensys's sales of ETH may violate securities law or why the agency believes it now has jurisdiction over ETH. Instead, the SEC has elected to shroud the reversal of its position in secrecy, seeking to maintain a tactical advantage as it moves forward with its unprecedented land grab.

75. The SEC's "Ethereum 2.0" investigation has only escalated in the year since [redacted]. Just last month, the SEC served yet another document subpoena on Consensys. The subpoena categories include all documents and communications between Consensys and any secondary trading platforms as well as other third parties concerning the

Merge, the ongoing development of the Ethereum blockchain, and Consensys's role as a validator for Ethereum. And in requesting an interview with the company's acting chief financial officer, the staff indicated that it will serve a testimonial subpoena if the executive does not submit voluntarily and promptly. There can be no doubt, then, that the SEC's review of the tens of thousands of pages of documents already produced by Consensys and of the voluminous publicly available information about Ethereum has not dissuaded the SEC from its unlawful investigation. In fact, the opposite: the SEC's investigation has entered a new, broader phase in recent weeks.

76. According to widespread news coverage, the SEC recently unleashed a series of additional subpoenas to other crypto companies as part of the "Ethereum 2.0" investigation. As one news report warned, "If the SEC goes ahead with its plan to declare that all of Ethereum is subject to its securities laws, it will have broad and unpredictable consequences."

J. The SEC assertion of jurisdiction over ETH is unlawful

77. Contrary to its previously confirmed position, the SEC now claims that ETH is a security subject to SEC regulation. The SEC's claim of jurisdiction rests on the claim that transactions in ETH involve an "investment contract" as that term appears in the securities laws. That position is not supported by the facts and not permitted under the law. And the SEC's determination to carry out its agenda through burdensome investigations and punitive retroactive enforcement actions after years of assurances that ETH was not a security violates the Constitution.

1. Ether transactions are not "investment contracts"

78. For an investment to constitute an "investment contract" it must include a contractual undertaking to deliver value at a later date.

79. Consensys's sales of ETH lack any such contractual undertaking. There are no commitments made to the buyer — whether by Consensys or anyone else — to deliver any future

value. And unlike traditional debt or equity securities, ETH holders have no expectation in the income, profits, or assets of any business.

80. Moreover, investment contracts, like all securities, involve passive investments in which holders rely on the efforts of a centralized manager or promoter for their investment profit. But in the case of ETH, no such central manager or promoter even exists. Indeed, it is the Ethereum blockchain's decentralization that the SEC rightly cited in concluding that ETH fell outside its jurisdiction. The Ethereum network has since grown more decentralized. By the end of 2023, nearly 8,000 individuals from around the world were actively involved on a monthly basis in developing code for this global computing platform.

81. Even were there doubt whether ETH qualified as an "investment contract," the SEC's claim to authority would still fail. Digital assets are a trillion-dollar market, with one in five American adults holding crypto. The market value of ETH alone is almost $400 billion, and the economic scale of the decentralized internet, built on the foundation of Ethereum, is even greater. The SEC lacks the "clear congressional authorization" required under the major questions doctrine to regulate this industry of "vast 'economic and political significance,'" let alone to regulate all investments accompanied only by a hope of gain but no contractual undertaking, which the SEC claims authority to sweep within its jurisdiction.

2. Consensys did not have fair notice

82. The SEC's land grab also violates core principles of due process and fair notice. Essential to due process is the "fundamental principle . . . that laws which regulate persons or entities must give fair notice of conduct that is forbidden or required." *FCC* v. *Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012).

83. The SEC's position on ETH is the antithesis of fair notice, reversing years of public statements and regulatory actions in which both the SEC and CFTC have taken the *exact opposite*

position. In reliance on the SEC's and CFTC's assurances that ETH is not a security, the Ethereum blockchain has grown to be the backbone of the digital assets industry. Many of the most significant utilizations of blockchain technology have been built on Ethereum, from large-scale DEXs, like Uniswap, to popular stablecoins, such as USDC. Even traditional financial institutions like BlackRock and UBS have launched digital asset products on the Ethereum network.

84. Consensys, in particular, has built its business around the Ethereum blockchain, launching features like MetaMask Swaps in 2020 and MetaMask Staking in 2023 — that is, years after the SEC assured the public it viewed ETH as outside its domain — aimed at reaching the growing number of Ethereum users. Consensys has done so in reliance on the SEC's and CFTC's repeated statements that ETH is not a security.

85. Consensys and other industry actors were entirely justified to and did rely in good faith upon the SEC's and CFTC's actions and words. The SEC's efforts to pull the rug out now by deeming ETH a security violate the requirement of fair notice.

K. MetaMask Swaps and Staking do not violate securities law

86. Consistent with its broader anti-crypto crusade, the SEC also contends that Consensys has violated the securities laws merely by offering its MetaMask software — an interface for users to interact with Ethereum's decentralized network — to the public. Specifically, as to both the Swaps and Staking feature of the MetaMask wallet, the SEC contends that Consensys operates as an unregistered "broker" in violation of Section 15 of the Exchange Act. Additionally, as to MetaMask Staking alone, the SEC contends that Consensys has sold or offered to sell an unregistered security in violation of Section 5 of the Securities Act.

87. These accusations fail because the digital asset transactions at issue are, like the ETH transactions described above, not securities transactions falling within the purview of the federal securities laws. But even setting this objection aside, the charges are absurd — and for a

simple reason: Both MetaMask Swaps and Staking are software that help users interact directly with third-party protocols on the Ethereum blockchain. Nothing more, nothing less. The notion that they could cause Consensys to operate as either a broker or seller of securities is contrary to precedent and common sense.

88. As to Swaps, the software simply provides a convenient and user-friendly interface for interacting with third-party DEXs. While MetaMask helps users search and compare prices by aggregating quotes from different third-party liquidity providers, "providing pricing comparisons does not rise to the level of routing or making investment recommendations." *SEC* v. *Coinbase, Inc.*, 2024 WL 1304037, at *35 (S.D.N.Y. Mar. 27, 2024). In other words, "merely providing information or bringing two sophisticated parties together" is not broker activity. *Rhee* v. *SHVMS, LLC*, 2023 WL 3319532, at *8 (S.D.N.Y. May 8, 2023).

89. The same applies to MetaMask Staking. As with Swaps, Staking is an interface for interacting with third-party liquid staking platforms. It does not direct how trades should be executed or engage in any of the other routing activities courts have recognized as traditionally carried out by brokers.

90. The SEC's charge that the MetaMask Staking software offers or sells unregistered securities is similarly baseless. Even assuming for the sake of argument that liquid staking involves a transaction in a security — and it does not — MetaMask Staking plays no significant role in the sale of liquid staking services. Nor does Consensys ever hold or otherwise control ETH or liquid staking tokens as part of any user transaction. All MetaMask Staking does is provide the equivalent of a webpage through which users can learn about and link to these third-party services. The SEC's accusations to the contrary only further illustrate what little regard the SEC gives to the limits of its statutory purview.

GROUNDS FOR RELIEF

Count One
(Agency Action in Excess of Statutory Authority)

91. Consensys incorporates by reference all allegations above.

92. A plaintiff may "institute a non-statutory review action" against an agency head "for allegedly exceeding his statutory authority." *Chamber of Com. of U.S.* v. *Reich*, 74 F.3d 1322, 1327-28 (D.C. Cir. 1996).

93. The Commission's authority to empower its staff to conduct an investigation, including to subpoena witnesses and take evidence, is limited to those "necessary and proper for the enforcement of" the Securities Act. 15 U.S.C. § 77s(c).

94. ETH is not a security under the Securities Act and transactions in ETH are not securities transactions.

95. The issuance of [redacted] was predicated on the Commission's unlawful determination that ETH is a security and there may have been sales of unregistered securities, including ETH, within the meaning of the Securities Act.

96. Consensys has been subject to a coercive investigation by the Commission's staff [redacted]. Being subject to an unlawful "formal investigation" is a "'here-and-now' injury that can be remedied by a court." *Free Enter. Fund* v. *Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 487, 513 (2010). That injury will continue so long as [redacted] or the investigation into Consensys's ETH sales continues. *See Blinder, Robinson & Co.* v. *S.E.C.*, 692 F.2d 102, 106 (10th Cir. 1982).

97. [redacted] confirms that the SEC now believes ETH is a security. The SEC's position poses a genuine threat to Consensys of an enforcement action regarding its past

and future business operations and the further risk of attendant liability. Moreover, on information and belief, the SEC has determined to pursue enforcement actions against market participants, including Consensys, alleging that their transactions in ETH violate the securities laws. There exists between the parties an actual controversy regarding whether ETH is a security.

98. Actions taken by an agency or official that are "*ultra vires*" may appropriately "be made the object of specific relief." *Apter* v. *Dep't of Health & Human Servs.*, 80 F.4th 579, 587 (5th Cir. 2023).

99. Accordingly, Consensys is entitled to declaratory and injunctive relief preventing the SEC from continuing any investigation or commencing an enforcement action against Consensys based on the premise that Consensys's transactions in ETH are securities transactions.

100. Consensys has no adequate remedy at law.

Count Two
(Agency Action in Violation of the Due Process Clause)

101. Consensys incorporates by reference all allegations above.

102. A court may order injunctive relief to "prevent[] [an] entit[y] from acting unconstitutionally." *Corr. Servs. Corp.* v. *Malesko*, 534 U.S. 61, 74 (2001). Similarly, courts, in their equitable authority, may declare invalid agency actions found not to be "rationally based." *Texas Rural Legal Aid, Inc.* v. *Legal Servs. Corp.*, 940 F.2d 685, 697 (D.C. Cir. 1991).

103. The SEC's investigation into transactions in ETH is predicated on a determination that ETH is a security, in contradiction to the long-held position set out by both the SEC and CFTC that ETH is a commodity falling within the jurisdiction of the CFTC, and not a security regulated by the SEC. Consensys has relied in good faith on the previously established position. Accordingly, the SEC's investigation is, and any enforcement action premised on that

investigation would be, unlawful and in violation of the requirement of fair notice under the Constitution's Due Process Clause.

104. Because the SEC's characterization of ETH as a security and ETH transactions as securities transactions violates the requirement of fair notice, Consensys is entitled to declaratory and injunctive relief preventing the SEC from continuing any investigation or commencing an enforcement action based on the premise that Consensys's transactions in ETH are securities transactions.

105. Consensys has no adequate remedy at law.

Count Three
(Agency Action in Violation of the Administrative Procedure Act, 5 U.S.C. §§ 701-706)

106. Consensys incorporates by reference all allegations above.

107. The APA prohibits agency action that is "arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law," "contrary to constitutional right," or "in excess of statutory jurisdiction, authority, or limitation, or short of statutory right." 5 U.S.C. § 706(2)(A)-(C).

108. [redacted] constitutes final agency action reviewable under the APA. *See* 5 U.S.C. § 701. It possesses statutory "[f]inality," 15 U.S.C. § 78d–1(c), and bears "legal consequences" insofar as it [redacted] *Bennett* v. *Spear*, 520 U.S. 154, 178 (1997).

109. Federal administrative agencies are required to engage in "reasoned decision-making." *Allentown Mack Sales & Serv., Inc.* v. *NLRB*, 522 U.S. 359, 374 (1998).

110. ETH is not a security under the Securities Act, and therefore [redacted] exceeds the SEC's statutory authority.

111. The SEC and the CFTC have previously recognized that ETH is a commodity that falls within the CFTC's authority. [redacted], which is predicated on a characterization of ETH as a security, represents a sharp departure from that previous position and reflects the SEC's efforts to treat ETH transactions as securities transactions in future enforcement proceedings. This constitutes arbitrary and capricious agency action insofar as the SEC is invoking its investigatory authority to create new policy, in contravention of well-settled expectations, without fair warning. Moreover, invocation of the agency's investigatory authority in this manner violates due process.

112. Each of these flaws renders [redacted] and the coercive authority exercised by the SEC staff [redacted] legally invalid.

113. Consensys is therefore entitled to declaratory and injunctive relief preventing any further investigation [redacted] or any enforcement action arising out of such investigation against Consensys.

114. Consensys has no adequate remedy at law.

Count Four
(Agency Action in Excess of Statutory Authority)

115. Consensys incorporates by reference all allegations above.

116. The Declaratory Judgment Act, 28 U.S.C. § 2201, allows a party faced with a "genuine threat of enforcement" to bring suit to seek a declaration to determine the legality of an expected government enforcement action. *MedImmune, Inc.* v. *Genentech, Inc.*, 549 U.S. 118, 129 (2007). Consensys faces such a genuine threat here.

117. The SEC staff told Consensys that it views the Swaps and Staking features of the MetaMask software as violative of the federal securities law. Moreover, the staff stated that unless Consensys agrees to settle the threatened charges, it will pursue an enforcement action against Consensys. Given the SEC's aggressive campaign of regulation-through-enforcement, there is no

question that these threats are genuine. Accordingly, Consensys faces a genuine threat that the SEC will bring an enforcement action related to Consensys's MetaMask Swaps and Staking products.

118. The SEC's position is contrary to the statute, precedent, and common sense. A declaratory judgment action is therefore appropriate to allow Consensys to clear the considerable uncertainty and risk to its business generated by the SEC's threatened enforcement action.

119. Consensys accordingly seeks declaratory and injunctive relief to prevent the SEC from subjecting Consensys to any unlawful investigation or enforcement action as to MetaMask.

120. Consensys has no adequate remedy at law.

PRAYER FOR RELIEF

121. Consensys prays for an order and judgment:

A. Declaring that ETH is not a security under the Securities Act and that Consensys's sales of ETH are not sales of securities under the Securities Act, and therefore that any investigation or enforcement action against Consensys premised on ETH transactions being securities transactions would exceed the SEC's authority;

B. Declaring that an investigation or enforcement action against Consensys premised on ETH transactions being securities transactions would violate the requirement of fair notice under the Fifth Amendment's Due Process Clause of the United States Constitution;

C. Declaring that the Commission's [redacted] violates the Administrative Procedure Act, and therefore that any investigation [redacted] is invalid and any enforcement action arising from such investigation would be invalid;

D. Declaring that, by offering MetaMask Swaps and MetaMask Staking through its MetaMask wallet software, Consensys does not operate as a "broker" under the Exchange Act, and therefore that any investigation or enforcement action premised on Consensys operating as a "broker" under the Exchange Act through its MetaMask wallet software would exceed the SEC's authority;

E. Declaring that Consensys does not, through MetaMask Staking, participate in the offering or sale of securities within the meaning of the Securities Act, and therefore any investigation or enforcement action premised on Consensys participating in the offering or sale of securities through MetaMask Staking would exceed the SEC's authority;

F. Granting permanent injunctive relief prohibiting the SEC and its officers and agents from pursuing any investigation or enforcement action premised on ETH transactions being securities transactions, as exceeding the agency's statutory authority and violating the requirement of fair notice;

G. Granting permanent injunctive relief prohibiting the SEC and its officers and agents from pursuing any investigation [redacted] and any enforcement action arising out of such investigation, as violating the Administrative Procedure Act;

H. Granting permanent injunctive relief prohibiting the SEC and its officers and agents from bringing or maintaining any investigation or enforcement action related to the Swaps or Staking features of its MetaMask software, as doing so would exceed the agency's statutory authority;

I. Awarding Consensys its reasonable costs, including attorneys' fees, incurred in bringing this action under 28 U.S.C. § 2412, or other applicable law; and

J. Granting such other and further relief as this Court deems just and proper.

Dated: April 25, 2024

Respectfully submitted,

/s/ Brant C. Martin

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96 F.4th 129
United States Court of Appeals, Second Circuit.

Chase WILLIAMS, individually and on behalf of all others similarly situated, Plaintiff-Appellant, JD Anderson, Corey Hardin, Eric Lee, individually and on behalf of all others similarly situated, Brett Messieh, David Muhammad, Ranjith Thiagarajan, Token Fund I LLC, Lead-Plaintiffs-Appellants,
v.
BINANCE, Changpeng Zhao, Defendants-Appellees, Yi He, Roger Wang, Defendants.

No. 22-972
|
August Term 2022
|
Argued: April 12, 2023
|
Decided: March 8, 2024

Synopsis

Background: Purchasers of crypto-asset "tokens" on international electronic exchange brought putative class action against exchange and its chief executive officer (CEO) for allegedly promoting, offering, and selling unregistered securities in violation of Securities Act of 1933, for alleged failure to register as securities exchange or broker-dealer in violation of Securities Exchange Act of 1934, and for violations of state "Blue Sky" statutes, seeking damages and rescission of contracts. The United States District Court for the Southern District of New York, Andrew L. Carter, Jr., J., 2022 WL 976824, granted defendants' motion to dismiss, and purchasers appealed.

Holdings: The Court of Appeals, Nathan, Circuit Judge, held that:

[1] purchasers adequately alleged domestic transactions occurred when transactions were matched on exchange's servers;

[2] purchasers adequately alleged domestic transactions occurred when they agreed to terms of use, placed purchase orders, and sent payments;

[3] claim for solicitation of unregistered securities accrued when purchasers acquired tokens at issue;

[4] claims for rescission of terms-of-use contracts was subject to Exchange Act's one-year statute of limitations for fraud-based claims;

[5] rescission claims accrued when purchasers executed trades governed by terms of use; and

[6] question of whether to dismiss state-law claims of unnamed class members outside named plaintiffs' home states could not be resolved on motion to dismiss.

Reversed and remanded.

Procedural Posture(s): Motion to Dismiss.

West Headnotes (18)

[1] International Law Federal acts and laws in general

Legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.

[2] International Law Federal acts and laws in general

When a federal statute gives no clear indication of an extraterritorial application, it has none.

[3] Securities Regulation Foreign securities

Irrevocable liability attaches, for purposes of determining whether a domestic transaction in securities not listed on domestic exchanges has occurred such that domestic securities statutes may be applied to a claim, when parties become bound to effectuate the transaction or enter into a binding contract to purchase or sell securities; in other words, irrevocable liability attaches when the parties to the transaction are committed to one another, or when in the classic contractual sense, there was a meeting of the minds of the parties.

3 Cases that cite this headnote

[4] **Securities Regulation** Foreign Transactions or Securities

To determine whether a transaction is domestic, such that domestic securities statutes may apply, courts must consider both when and where the transaction became irrevocable.

1 Case that cites this headnote

[5] **Securities Regulation** Foreign Transactions or Securities

Securities Regulation Foreign Transactions or Securities

Purchasers of crypto-asset "tokens," who brought action against cryptocurrency exchange, which purportedly lacked physical locus in any country, for promoting, offering, and selling unregistered securities and failing to register as securities exchange or broker-dealer, adequately alleged that irrevocable liability for such transactions was incurred when transactions were matched on servers in United States, as necessary to plead that purchasers made domestic transactions subject to federal securities statutes; purchasers alleged that exchange served similar function to traditional exchanges by matching buyers and sellers on its servers and other infrastructure, most or all of which was located in United States. Securities Act of 1933 § 12, 15 U.S.C.A. § 77*l*(a)(1); Securities Exchange Act of 1934 § 29, 15 U.S.C.A. § 78cc(b).

2 Cases that cite this headnote

[6] **Securities Regulation** Foreign Transactions or Securities

Securities Regulation Foreign Transactions or Securities

Purchasers of crypto-asset "tokens," who brought action against cryptocurrency exchange, which purportedly lacked physical locus in any country, for promoting, offering, and selling unregistered securities and failing to register as securities exchange or broker-dealer, adequately alleged that irrevocable liability for such transactions was incurred when purchasers agreed to exchange's terms of use, placed purchase orders, and sent payments while in United States, as necessary to plead that purchasers made domestic transactions subject to federal securities statutes; purchasers alleged that once they sent buy orders and payments on exchange's platform, they could not revoke such trades pursuant to terms of use. Securities Act of 1933 § 12, 15 U.S.C.A. § 77*l*(a)(1); Securities Exchange Act of 1934 § 29, 15 U.S.C.A. § 78cc(b).

1 Case that cites this headnote

[7] **Limitation of Actions** Securities regulation

Crypto-asset token purchasers' claims against cryptocurrency exchange and its CEO for solicitation of unregistered securities in violation of Securities Act of 1933 accrued, and one-year statute of limitations began to run, when purchasers acquired tokens at issue, not when exchange allegedly solicited purchases; it would make little sense for limitations period to begin running before purchasers executed transactions that allowed them to file suit and obtain relief, such an interpretation would undermine Congress's purpose of protecting all investors who fell victim to illegal solicitations rather than just those who happened to make their purchases within a year of such solicitations, and statute of limitations on such claim was distinct from Securities Act's statute of repose. Securities Act of 1933 §§ 12, 13, 15 U.S.C.A. §§ 77*l*(a)(1), 77m.

[8] **Limitation of Actions** Nature of statutory limitation

As opposed to statutes of repose, statutes of limitations are designed to encourage plaintiffs to pursue diligent prosecution of known claims.

[9] **Limitation of Actions** Causes of action in general

Limitations periods begin to run when a cause of action accrues, that is, when the plaintiff can file suit and obtain relief.

[10] **Securities Regulation** Persons entitled to sue or recover

A prospective buyer has no recourse under the Securities Act of 1933 against a person who touts unregistered securities to him if he does not purchase the securities. Securities Act of 1933 § 12, 15 U.S.C.A. § 77*l*(a)(1).

[11] **Limitation of Actions** Causes of action in general

A statute of repose begins to run from the defendant's violation.

[12] **Limitation of Actions** Nature of statutory limitation

Limitation of Actions Causes of action in general

Unlike statutes of limitations, statutes of repose are enacted to give more explicit and certain protection to defendants, and thus run from the date of the last culpable act or omission of the defendant.

[13] **Securities Regulation** Time to sue and limitations

Crypto-asset token purchasers' claims against cryptocurrency exchange for rescission of contracts under Securities Exchange Act, which were premised on allegations that contracts, namely exchange's terms of use as agreed to by purchasers, were voidable due to exchange's violations of Exchange Act by operating as unregistered securities exchange and unregistered broker-dealer, were subject to Exchange Act's one-year express statute of limitations for fraud-based claims. Securities Exchange Act of 1934 §§ 5, 15, 29, 15 U.S.C.A. §§ 78e, 78*o*(a)(1), 78cc(b).

[14] **Limitation of Actions** Fraud in the purchase, sale, or acquisition of property

Crypto-asset token purchasers' claims against cryptocurrency exchange for rescission of contracts under Securities Exchange Act, which were premised on allegations that contracts, namely exchange's terms of use as agreed to by purchasers, were voidable due to exchange's violations of Exchange Act by operating as unregistered securities exchange and unregistered broker-dealer, accrued, and Exchange Act's one-year statute of limitations for fraud-based claims began to run, on date of each transaction involving such alleged violations, not on date purchasers agreed to terms of use, even though terms of use precluded purchasers from unilaterally revoking trades once made; terms of use did not commit purchasers to making any trades through exchange, and both claims required transactions. Securities Exchange Act of 1934 §§ 5, 15, 29, 15 U.S.C.A. §§ 78e, 78*o*(a)(1), 78cc(b).

[15] **Limitation of Actions** Liabilities Created by Statute

Where the claim asserted is one implied under a statute that also contains an express cause of action with its own time limitation, a court should look first to the statute of origin to ascertain the proper limitations period.

[16] **Securities Regulation** Contracts in violation of regulations

A claim for rescission of a contract under the Securities Exchange Act must be predicated on an underlying violation of such Act. Securities Exchange Act of 1934 § 29, 15 U.S.C.A. § 78cc(b).

1 Case that cites this headnote

[17] **Federal Civil Procedure** Time for proceeding and determination

Federal Civil Procedure Time of determination; reserving decision

Question of whether putative class of crypto-asset token purchasers bringing claims against cryptocurrency exchange for violations of Securities Act, Securities Exchange Act, and various states' "Blue Sky" laws properly included unnamed class members asserting Blue Sky claims under laws of states where no named class members were located could not be resolved on exchange's motion to dismiss, but rather, raised question of predominance to be decided at class certification stage of litigation. Securities Act of 1933 § 12, 15 U.S.C.A. § 77*l*(a)(1); Securities Exchange Act of 1934 § 29, 15 U.S.C.A. § 78cc(b); Fed. R. Civ. P. 12(b), 23(b)(3).

[18] **Federal Civil Procedure** Time for proceeding and determination

Federal Civil Procedure Time of determination; reserving decision

As long as the named plaintiffs have standing to sue the named defendants, any concern about whether it is proper for a class to include out-of-state, nonparty class members with claims subject to different state laws is a question of predominance under the class certification rule and is to be decided after the motion-to-dismiss stage. Fed. R. Civ. P. 12(b), 23(b)(3).

***132** Appeal from the United States District Court for the Southern District of New York, No. 20-cv-2803, Andrew L. Carter, *Judge*.

Attorneys and Law Firms

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James P. Rouhandeh (Daniel J. Schwartz, Marie Killmond, on the brief), Davis Polk & Wardwell LLP, New York, NY, for Defendants-Appellees.

Before: Leval, Chin, and Nathan, Circuit Judges.

Opinion

Nathan, Circuit Judge:

Plaintiffs-Appellants, purchasers of crypto-assets on an international electronic exchange called Binance, appeal the dismissal of this putative class action against Defendants-Appellees Binance and its chief executive officer Changpeng Zhao. Plaintiffs seek damages arising from Binance's alleged violation of Section 12(a)(1) of the Securities Act of 1933 (Securities Act), 15 U.S.C. § 77*l*(a)(1), which they claim occurred when Binance unlawfully promoted, offered, and sold billions of dollars' worth of crypto-assets called "tokens," which were not registered as securities. Plaintiffs also seek recission of contracts they entered into with Binance under Section 29(b) of the Securities and Exchange Act of 1934 (Exchange Act), 15 U.S.C. § 78cc(b), on the basis that Binance allegedly contracted to sell securities without being registered as a securities exchange or broker-dealer. Lastly, Plaintiffs raise claims under "Blue Sky" laws, which are state statutes designed to protect the public from securities fraud.

***133** The district court concluded that (1) Plaintiffs' claims constitute an impermissible extraterritorial application of securities law under *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247, 130 S.Ct. 2869, 177 L.Ed.2d 535 (2010), and (2) Plaintiffs' federal claims are also untimely under the applicable statutes of limitations. On appeal, Plaintiffs argue that they have plausibly alleged that the transactions at issue are subject to domestic securities laws and that their federal claims involving purchases made during the year before filing suit are timely. [1] We agree. First, we conclude that Plaintiffs have plausibly alleged that the transactions at issue are domestic transactions subject to domestic securities laws because the parties became bound to the transactions in the United States, and therefore irrevocable liability attached in the United States. Second, we conclude that these claims accrued at the time Plaintiffs purchased or committed to purchase the tokens, and thus Plaintiffs' claims arising from transactions in tokens during the year before filing the complaint are timely. Accordingly, we **REVERSE**

and **REMAND** for further proceedings as to the claims challenged on appeal.

BACKGROUND

I. Facts

The following facts are taken from Plaintiffs' allegations in their operative complaint and documents that it incorporates. *See* *Chambers v. Time Warner, Inc.*, 282 F.3d 147, 152–53 (2d Cir. 2002). Binance is an online platform where a variety of crypto-assets can be purchased and sold. It represents itself as the largest such exchange in the world. By July 2017, Binance had been founded in China and had launched its digital asset exchange. Within less than a year, it moved its titular headquarters first to Japan and then to Malta, seeking more favorable regulatory environments. Nonetheless, Binance rejects having any physical headquarters in any geographic jurisdiction. In February 2020, in response to Maltese regulators denying that Binance was a "Malta-based cryptocurrency company," Binance founder and CEO, co-defendant Changpeng Zhao stated:

> Binance.com is not headquartered or operated in Malta ... There are misconceptions some people have on how the world must work ... you must have offices, HQ, etc. But there is a new world with blockchain now ... Binance.com has always operated in a decentralized manner as we reach out to our users across more than 180 nations worldwide.

App'x at 171–72 ¶¶ 27–28. One of those nations is the United States, where Binance now has a substantial presence, with servers, employees, and customers throughout the country. Binance never registered as a securities exchange or a broker-dealer of securities in the United States.

Plaintiffs bring claims on behalf of themselves and a class of similarly situated investors who used Binance to purchase crypto-assets known as "tokens" from seven categories: EOS, TRX, ELF, FUN, ICX, OMG, and QSP (collectively, the Tokens).[2] Each named plaintiff purchased ***134** one or more of the Tokens on Binance, placing orders on the electronic platform from their state or territory of residence: Texas, Nevada, New York, Florida, California, and Puerto Rico.

As with most crypto-assets, ownership of the Tokens is tracked on a blockchain, a decentralized ledger that records each transaction. Just as banks settle and clear transactions moving between traditional currency accounts, blockchains track transactions in crypto-assets. A critical difference is that blockchains typically operate through a decentralized process: every computer running on a given blockchain independently tracks and clears transactions to validate the crypto-asset's ownership. Blockchains therefore allow for increased security, because the decentralized nature of a blockchain means that any data recorded on the ledger cannot be altered.

Plaintiffs allege that the Tokens are a type of crypto-asset called "security tokens." Binance does not dispute—at least for the purposes of this appeal—that the tokens at issue are properly classified as "securities" as the term is used in the relevant federal and state securities laws. "Security tokens," as described by Plaintiffs in the complaint, are tokens issued to raise capital for the issuer and provide the token holder with some form of future interest in the issuer's project to create the platform and software required for its use. That future interest could increase in value if the token's creators are successful in their endeavor. But unlike traditional securities, security tokens do not give the token holder ownership or a creditor interest in any corporate entity.

Security tokens also differ from other types of crypto-assets. Unlike Bitcoin and Ethereum, security tokens are not designed to facilitate transactions or serve as a long-term store of value, but rather to raise capital for an enterprise without granting the holder ownership in any corporate entity. And unlike "utility tokens," security tokens do not grant the holder use and access to a particular service or product offered by the issuer. Security tokens are therefore distinct from other classes of crypto-assets that have some present tangible use beyond their potential to appreciate.

The Tokens at issue here are "ERC-20 tokens," meaning they were all designed on the Ethereum blockchain with a programming language called the ERC-20 protocol. Between 2017 and 2018, many ERC-20 tokens were created and sold by third party issuers in initial coin offerings (ICOs), which collectively raised nearly $20 billion. Typically,

each ICO was accompanied by a "whitepaper," which included both advertising and a technical blueprint for the proposed project associated with the token. Plaintiffs allege that these whitepapers did not include the warnings that SEC registration statements would have included, and that registration statements for the Tokens were never filed with the SEC. After their ICOs, each of the Tokens was listed on Binance for secondary-market trading. Investors could buy the tokens through the Binance platform using other crypto-assets or traditional currencies.

Plaintiffs allege that they each purchased Tokens on Binance pursuant to its Terms of Use, and that they paid Binance fees for the use of its exchange. They allege that all of their activities to transact on Binance were undertaken from each of their U.S. state or territory of residence. When users register with Binance, they are required to accept Binance's Terms of Use upon registration. Once users set up accounts, they can place buy orders to purchase tokens on the Binance platform, which are then matched with sell orders to complete a transaction. Plaintiffs allege ***135** that their trade orders were matched on, and their account data was stored on, servers hosting the Binance platform—the vast majority of which were located in the United States. The Terms of Use in effect during the class period did not require Plaintiffs to place any particular trade order. But the Terms dictated that once a trade order was placed, Binance had the right to reject a user's request to cancel it. Moreover, pursuant to the Terms, once matching occurred, the order could not be cancelled at all.

Plaintiffs allege that Binance directly targeted the U.S. market with advertising and customer support specifically aimed at U.S. users. Although Binance ostensibly cut off access to its platform for U.S. users in September 2019, Plaintiffs allege that it simultaneously advised U.S.-based purchasers how to circumvent its own restrictions using virtual private networks (VPNs), after which several of the Plaintiffs continued trading on Binance from the United States. According to Plaintiffs, in 2019, Zhao tweeted that the use of VPNs is "a necessity, not optional" in order to trade tokens on Binance. App'x at 184 ¶ 82.

Eventually, Plaintiffs' experience trading Tokens on Binance turned sour. They allege that "the vast majority" of Tokens they purchased on Binance "turned out to be empty promises," "all of the Tokens are now trading at a tiny fraction of their 2017–2018 highs," and "investors were left holding the bag when these tokens crashed." App'x at 164 ¶ 6.

II. The Proceedings Below

Plaintiffs initiated this action on April 3, 2020, seeking recission or damages, interest, and attorney's fees in compensation for Defendants' alleged violations of federal and state securities laws. Plaintiffs filed the operative complaint on December 15, 2020. The 327-page complaint asserts 154 causes of action under the Securities Act, the Exchange Act, and the Blue Sky statutes of 49 different states, the District of Columbia, and Puerto Rico.

Defendants filed a motion to dismiss or, in the alternative, to compel arbitration. On March 31, 2022, the district court granted the motion to dismiss. *See* *Anderson v. Binance*, No. 20-cv-2803, 2022 WL 976824 (S.D.N.Y. Mar. 31, 2022). The district court held that all of Plaintiffs' claims, including those brought under state Blue Sky securities laws, were impermissibly extraterritorial. *Id.* at *4–5. The district court also concluded that Plaintiffs' federal claims under Section 12(a)(1) of the Securities Act and Section 29(b) of the Exchange Act were untimely. *Id.* at *2–4. Additionally, the district court dismissed claims brought under the Blue Sky laws of states where none of the named class members resided, concluding there was "an insufficient nexus between the allegations and those jurisdictions." *Id.* at *4. Plaintiffs timely appealed each basis for dismissal, except the district court's determination that equitable doctrines did not delay accrual of Plaintiffs' federal claims arising from transactions outside of the one-year period before the lawsuit was filed.

DISCUSSION

We hold that each of the district court's bases for dismissing Plaintiffs' claims that are before us on appeal was erroneous. First, Plaintiffs have adequately alleged that their claims involved domestic transactions because they became irrevocable within the United States and are therefore subject to our securities laws. Second, Plaintiffs' federal claims are timely insofar as they relate to transactions that occurred during the year before they filed suit because their federal claims all require a ***136** completed transaction and therefore could not have accrued before the transactions were made. Finally, we vacate as premature the district court's conclusion that there was an insufficient nexus between the named Plaintiffs' claims and the states whose laws govern the claims of putative absent class members.

I. Extraterritoriality

[1] **[2]** At the outset, the parties dispute whether the domestic securities laws apply to the claims at issue or whether applying domestic law would be impermissibly extraterritorial. "It is a longstanding principle of American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States." *Morrison v. Nat'l Australia Bank Ltd.*, 561 U.S. 247, 255, 130 S.Ct. 2869, 177 L.Ed.2d 535 (2010) (internal quotation marks omitted). Therefore, "[w]hen a statute gives no clear indication of an extraterritorial application, it has none." *Id.* In *Morrison*, the Supreme Court invoked the presumption against extraterritoriality to interpret the Exchange Act as applying only to "[1] securities listed on domestic exchanges, and [2] domestic transactions in other securities." *Id.* at 267, 130 S.Ct. 2869. The Court reached this conclusion as a matter of statutory interpretation, and by considering international comity and the need to avoid "[t]he probability of incompatibility with the applicable laws of other countries." *Id.* at 269, 130 S.Ct. 2869. Although *Morrison* involved the Exchange Act, we have applied a similar framework to Securities Act claims as well as claims under state Blue Sky laws. *See* *Univs. Superannuation Scheme Ltd. v. Petróleo Brasileiro S.A. Petrobras (In re Petrobras Sec.)*, 862 F.3d 250, 259 (2d Cir. 2017) (Securities Act); *Fed. Hous. Fin. Agency v. Nomura Holding Am., Inc.*, 873 F.3d 85, 156–58 (2d Cir. 2017) (state Blue Sky laws).

Binance contends that neither *Morrison* category applies because the securities at issue here are not listed on domestic exchanges and the transactions are not domestic. Therefore, according to Binance, Plaintiffs seek to impermissibly apply the relevant statutes extraterritorially. We disagree and conclude that Plaintiffs plausibly alleged that the transactions at issue were "domestic transactions in other securities" under *Morrison*.

[3] In light of *Morrison*, we have explained that "to sufficiently allege the existence of a 'domestic transaction in other securities,' plaintiffs must allege facts indicating that irrevocable liability was incurred or that title was transferred within the United States." *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 62 (2d Cir. 2012). Irrevocable liability attaches when parties "becom[e] bound to effectuate the transaction or enter[ ] into a binding contract to purchase or sell securities." *Miami Grp. v. Vivendi S.A. (In re Vivendi, S.A. Sec. Litig.)*, 838 F.3d 223, 265 (2d Cir. 2016) (internal quotation marks omitted). In other words, irrevocable liability attaches "when the parties to the transaction are committed to one another," or when "in the classic contractual sense, there was a meeting of the minds of the parties." *Absolute Activist*, 677 F.3d at 68 (quoting *Radiation Dynamics, Inc. v. Goldmuntz*, 464 F.2d 876, 891 (2d Cir. 1972)).

[4] To determine whether a transaction is domestic, courts must therefore consider both when and where the transaction became irrevocable. But this is not always a simple task. Indeed, this task is particularly difficult when a transaction takes place over an exchange that claims to have no physical location in any geographic jurisdiction and not be subject to ***137** the oversight of any country's regulatory authority. We have recognized, however, that irrevocable liability may attach in "more than one location," *Fed. Hous. Fin. Agency*, 873 F.3d at 156, and at more than one time, *see* *Myun-Uk Choi v. Tower Rsch. Cap. LLC*, 890 F.3d 60, 68 (2d Cir. 2018), because there is always more than one side to any given transaction.

Here, we find that Plaintiffs plausibly alleged facts showing that two transactional steps giving rise to an inference of irrevocable liability occurred in the United States. First, the transactions at issue were matched, and therefore became irrevocable, on servers located in the United States. Second, Plaintiffs transacted on Binance from the United States, and pursuant to Binance's Terms of Use, their buy orders became irrevocable when they were sent.

A. Matching

[5] We begin with the matching of Plaintiffs' buy offers with sellers on servers hosting Binance's platform. In the absence of an official locus of the Binance exchange, we conclude it is appropriate to locate the matching of transactions where Binance has its servers. We therefore hold that irrevocable liability was incurred in the United States because Plaintiffs plausibly alleged facts allowing the inference that the transactions at issue were matched on U.S.-based servers.

We have previously considered the application of *Morrison* in the context of securities traded over an electronic intermediary exchange, like the securities at issue in this litigation. In *Myun-Uk Choi v. Tower Research Capital LLC*, the plaintiffs executed trades in Korea Exchange futures contracts, which were "listed and traded on CME Globex, an electronic [Chicago Mercantile Exchange (CME)] platform located in Aurora, Illinois." 890 F.3d at 63 (internal quotation marks omitted). We held that the plaintiffs plausibly alleged that those transactions were domestic because the plaintiffs incurred irrevocable liability when their trade offers were matched with offers from counterparties on the Illinois-based platform. *Id.* at 67.[2] The defendants there argued that irrevocable liability did not attach until trades were cleared and settled on the Korea Exchange in South Korea, the morning after buy and sell orders were "matched" on CME Globex. *Id.* at 67–68. But we explained that "[t]his view evinces a fundamental misunderstanding of Plaintiffs' allegations *and exchange trading generally*." *Id.* at 68 (emphasis added). We said that while "liability might ultimately attach between the buyer/seller and the [Korea Exchange] upon clearing, that does not mean liability does not *also* attach between the buyer and seller at matching prior to clearing." *Id.* We explained that

> [t]his is analogous to the traditional practice, prior to the advent of remote algorithmic high-speed trading, in which buyers and sellers of commodities futures would reach an agreement on the floor of the exchange and then subsequently submit their trade to a clearinghouse for clearing and settling. Just as the meeting of the minds previously occurred on the exchange floor, Plaintiffs plausibly allege that there is a similar meeting of the minds when the minds of the [Korea Exchange] night market parties meet on CME Globex.

Id. (cleaned up).

Here, as in *Choi*, Plaintiffs allege that they purchased and sold securities over an ***138** electronic exchange, though here these transactions were subsequently recorded on the Ethereum blockchain, which has no centralized location. Consistent with our reasoning in *Choi*, the parties here agree that at least one time at which irrevocable liability attaches is at the time when transactions are "matched." *See* Reply Br. at 5; Appellees' Br. at 4, 32; *see also* *Choi*, 890 F.3d at 67 ("[I]n the classic contractual sense, parties incur irrevocable liability on ... trades at the moment of matching." (cleaned up)).

But *where* did that matching take place? In *Choi* there was no dispute that trades were matched "on CME Globex" and that CME Globex was located in Illinois. 890 F.3d at 63. This appeal presents a more difficult case than *Choi* because the parties dispute *where* matching occurs when it takes place on Binance, an online exchange that purports to have no physical location.

We conclude that, at this early stage of the litigation, Plaintiffs have plausibly alleged that matching occurred in the United States. The complaint alleges that online crypto-asset exchanges such as Binance serve a similar function as "traditional exchanges in that they provide a convenient marketplace to match buyers and sellers of virtual currencies," such as the Tokens purchased by Plaintiffs. App'x at 175 ¶ 46. Defendants agree that "the complaint's allegations and the documents it incorporates by reference establish that matching occurred on the Binance exchange." Appellees' Br. at 33. But Defendants contend, since Plaintiffs acknowledge that Binance is decentralized, that the Binance exchange was "concededly ... not in the United States." *Id.*; *see also id.* at 35 (arguing that "matching and irrevocable liability occurred abroad on the Binance platform, ... [which] is not in the United States."). At oral argument, Binance's counsel repeated this argument but also conceded that the location of Binance's servers may be relevant to determining where matching occurs on the Binance platform. Oral Arg. at 26:00–37:40. We reject Binance's argument that Plaintiffs pled themselves out of court by noting Binance's intentional efforts to evade the jurisdiction of regulators. Binance operates by "match[ing] buyers and sellers of virtual currencies." App'x at 175 ¶ 46.

Even if the Binance exchange lacks a physical location, the answer to where that matching occurs cannot be "nowhere."

Rather, we conclude that the complaint plausibly alleges that matching occurred on "the infrastructure Binance relies on to operate its exchange." App'x at 253 ¶ 327. According to Plaintiffs' allegations, much of that infrastructure "is located in the United States." *Id.* Specifically, Plaintiffs allege that "Binance is hosted on computer servers and data centers provided by Amazon Web Services (AWS), a cloud computing company that is located in the United States"; "a significant portion, if not all, of the AWS servers and [associated data centers and support services] that host Binance are located in California"; and "[u]pon information and belief, most or all of Binance's digital data is stored on servers located in Santa Clara County, California." App'x at 170–71 ¶ 24.

Moreover, Plaintiffs allege that the fact that their purchase orders were submitted from locations in the United States renders it more plausible that the trades at issue were matched over Binance's servers located in the United States, as opposed to Binance's servers located elsewhere. At this stage, Plaintiffs need merely plead "a plausible claim for relief." *Ashcroft v. Iqbal*, 556 U.S. 662, 679, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009). Construing Plaintiffs' allegations regarding the servers in the ***139** light most favorable to them, we conclude that they have alleged facts that make it plausible that their trade orders were matched in the United States.

To be sure, our cases involving exchange-mediated securities trades, such as *Choi*, have looked to the official location of the exchange on which matching occurred to determine the situs of irrevocable liability. In cases involving traditional exchanges, there is often no dispute over where the exchange is located, and therefore where matching takes place. This is particularly so when the exchange is registered in a certain country and therefore has intentionally subjected itself to that sovereign's jurisdiction. While it may not always be appropriate to determine where matching occurred solely based on the location of the servers the exchange runs on, it is appropriate to do so here given that Binance has not registered in any country, purports to have no physical or official location whatsoever, and the authorities in Malta, where its nominal headquarters are located, disclaim responsibility for regulating Binance.

Our conclusion might be different were we faced with plaintiffs seeking to apply United States securities laws based on the happenstance that a transaction was initially processed through servers located in the United States despite all parties to the transaction understanding that they were conducting business on a foreign-registered exchange. The application of federal securities laws in that situation would squarely implicate the comity concerns that animated *Morrison*. *See* 561 U.S. at 269, 130 S.Ct. 2869. But since Binance notoriously denies the applicability of any other country's securities regulation regime, and no other sovereign appears to believe that Binance's exchange is within its jurisdiction, the application of United States securities law here does not risk "incompatibility with the applicable laws of other countries" and is consistent with the test articulated in *Morrison* and with the principles underlying *Morrison*. *Id.* We therefore hold that under these circumstances, the location of the servers on which trades are matched by Binance is deemed to be a location of the transaction. Accordingly, Plaintiffs have adequately alleged domestic transactions based on their allegations that matching occurred on Binance's servers located in the United States.

B. Plaintiffs' Submission of Trades and Payments on Binance

[6] We agree that Plaintiffs plausibly alleged that the transactions at issue are domestic for a second, interrelated reason. Because Binance disclaims having any location, Plaintiffs have plausibly alleged that irrevocable liability attached when they entered into the Terms of Use with Binance, placed their purchase orders, and sent payments from the United States.

As discussed above, in *Choi*, we noted that irrevocable liability may attach between different parties and intermediaries in a securities transaction at more than one transactional step. *See* 890 F.3d at 67–68. Just as in *Choi*, where irrevocable liability attached first between the parties on the Illinois-based night market and then later "between the buyer/seller and the [Korea Exchange] upon clearing," here Plaintiffs' allegations allow for the inference that irrevocable liability attached at multiple points in the transaction—first when they submitted their purchase offers to Binance, and later when Binance matched their offers with seller counterparties. *Id.* at 68.

Here, because the Binance exchange disclaims having any physical location, we have particular reason to consider other factors that our cases have found relevant ***140** to the irrevocable liability analysis. In *City of Pontiac Policemen's & Firemen's Retirement Systems v. UBS AG*, we explained that "in the context of transactions not on a foreign exchange," our cases look to "facts concerning the formation of the contracts, *the placement of purchase orders*, the passing of title, or the exchange of money" to determine when and where an investor becomes irrevocably bound to complete a transaction. 752 F.3d 173, 181 n.33 (2d Cir. 2014) (quoting *Absolute Activist*, 677 F.3d at 69–70 (cleaned up)). While we have placed more emphasis on these factors when dealing with transactions that did not occur on an official exchange, we have reason here to consider where Plaintiffs' trades originated given that Binance expressly disclaims having any physical location, foreign or otherwise. In *Giunta v. Dingman*, we found that irrevocable liability occurred in New York because that was where the parties met in person, where one party received telephone calls from the other while they were negotiating a securities contract, where they sent the terms of the agreement, and where funds were transferred from. 893 F.3d 73, 76-77, 79-80 (2d Cir. 2018). Similarly, in *Federal Housing Financial Agency*, we held that evidence that employees of Fannie Mae and Freddie Mac worked in the District of Columbia and Virginia, and therefore received emailed offer materials there, supported the inference that irrevocable liability attached in those places. 873 F.3d at 156–58; *see also, e.g.*, *United States v. Vilar*, 729 F.3d 62, 76–78 (2d Cir. 2013) (looking to location where party executed documents necessary to make investment and location from where money was sent).

Applying a similar analysis to the allegations here, irrevocable liability was incurred when Plaintiffs entered into the Terms of Use with Binance, placed their trade orders, and sent payments, all of which they claim occurred from their home states within the United States. When Plaintiffs sent buy orders and payments on the Binance platform, they irrevocably "committed to the investment[s] while in" their states of residence. *Vilar*, 729 F.3d at 77. "[A]s a practical matter, [Plaintiffs were] contractually obligated" to complete the transactions after committing to them on the Binance exchange and "could not, on [their] own accord, revoke." *Giunta*, 893 F.3d at 81. The inference that Plaintiffs could not revoke once they placed a trade on Binance is also supported by allegations regarding Binance's Terms of Use, in which Binance "reserves the right to reject any cancellation reques[t] related to" a submitted trade order. App'x at 605.

True, in *City of Pontiac*, we held that the "mere placement of a buy order in the United States for the purchase of foreign securities on a foreign exchange" was not, "standing alone," sufficient to allege that a purchaser incurred irrevocable liability in the United States. 752 F.3d at 181. But here, Binance's Terms of Use, which remove the trader's ability to unilaterally revoke the trade prior to execution, plus the additional actions Plaintiffs took, including making domestic payments, provide more. Moreover, as explained above, *City of Pontiac* concerned trades executed over a foreign Swiss exchange, whereas here the relevant exchange disclaims any location, foreign or otherwise. So, as noted above, the sovereignty and comity concerns that at least partially motivate the careful policing of the line between foreign and domestic transactions in cases like *City of Pontiac* and *Morrison* are less present in a case like this. [3]

***141** Accordingly, we hold that at this stage in the litigation, Plaintiffs have plausibly alleged that they engaged in domestic transactions in unlisted securities. [4]

II. Timeliness

The parties also dispute whether the district court correctly held that Plaintiffs' federal claims under Section 12(a)(1) of the Securities Act and Section 29(b) of the Exchange Act were untimely. As a preliminary matter, Plaintiffs do not press an argument for equitable tolling on appeal, and they acknowledge that their claims relating to most of the Tokens are untimely. However, a subset of Plaintiffs argue that they have timely federal claims because they made purchases of two of the Tokens, EOS and TRX, within the year before filing their original complaint on April 3, 2020. [5] We hold that Plaintiffs' claims under each of the federal statutes did not accrue until they could have filed suit, which was only after they made their purchases. Therefore, we reverse the dismissal of Plaintiffs' claims arising from purchases made during the year before they filed this lawsuit.

A. Section 12(a) Claims

[7] A claim under Section 12(a)(1) of the Securities Act for solicitation of an unregistered security must be brought "within one year after the violation upon which it is based." 15 U.S.C. § 77m (Section 13). A half-century ago, we held that Section 13's one-year statute of limitations does not begin to run on an illegal offer until the plaintiff acquires the security. *See Diskin v. Lomasney & Co.*, 452 F.2d 871, 875–76 (2d Cir. 1971). In *Diskin*, Judge Friendly explained that "although § 13 dates" the running of the statute of limitations "from the 'violation' in cases of claims under § 12[(a)](1), it would be unreasonable to read § 13 as starting the short period for an action at a date before the action could have been brought." *Id.*; *see also* *Wigand v. Flo-Tek, Inc.*, 609 F.2d 1028, 1033 n.5 (2d Cir. 1979) (holding, based on *Diskin*, that "the limitations period ... begins to run only after the sale" of a security following an illegal solicitation in Section 12(a)(2) actions). *Diskin* is binding law. Applied here, that means Plaintiffs have timely claims against Binance under Section 12(a)(1) for its solicitation of their purchase of EOS and TRX.

Defendants fail to distinguish or discredit *Diskin*. First, they argue *Diskin* only controls in cases where a single entity both solicited and sold securities as part of a single transaction. However, Binance promoted, intermediated, and earned money from the transactions of the Tokens. The mere fact that Binance was not a direct counter-party to the transactions is an insufficient distinction, particularly given *Diskin*'s statement that "Congress quite obviously meant to allow rescission or damages in the case of illegal offers as well as of illegal sales." *Diskin*, 452 F.2d at 876. *Diskin*'s interpretation of Section 13 was driven by a concern with avoiding the "extreme case[ ]" of "a running of the statute of limitations before the claim had even arisen," which is exactly what would result from adopting Defendants' theory here. *Id.*

***142** Next, Defendants argue that *Diskin*'s interpretation of Section 13 is incorrect as a textual matter. They point out that Section 13 starts the running of the one-year limitations period from "the *violation*," not from a "purchase or sale," and that there are only two ways to violate Section 12: (1) "pass[ing] title, or other interest in the security, to the buyer for value," or (2) "successfully solicit[ing] the purchase" of the security. *Pinter v. Dahl*, 486 U.S. 622, 642, 647, 108 S.Ct. 2063, 100 L.Ed.2d 658 (1988). Based on these premises, Defendants assert that the last "violations" Plaintiffs allege relating to EOS or TRX date back to November 2018 and February 2019, respectively, when Binance republished third-party reports about each token. Since both of these dates were more than a year before April 2020, when Plaintiffs filed suit, Binance claims that under the plain text of the statute, the statute of limitations ran before Plaintiffs sued.

This line of reasoning was equally available when *Diskin* was decided, but as described above, Judge Friendly rejected such a wooden interpretation of Section 13. Instead, he interpreted it in such a way as to effectuate Congress's purpose of protecting all investors who fall victim to illegal solicitations and bring suit within a year of doing so, not just those who happen to make their purchases within a year of the defendant's unlawful acts. We are not free to upset our respected predecessor's conclusion or ignore *Diskin*. *See* *Adams v. Zarnel* (*In re Zarnel*), 619 F.3d 156, 168 (2d Cir. 2010) ("This panel is bound by the decisions of prior panels until such time as they are overruled either by an en banc panel of our Court or by the Supreme Court." (internal quotation marks omitted)).

[8] **[9]** **[10]** Furthermore, *Diskin* makes sense of the fact that Section 13 contains both a statute of limitations and a statute of repose. The latter protects defendants and provides that no action can "be brought to enforce a liability created under section [11 or 12(a)(1)] more than three years after the security was bona fide offered to the public." 15 U.S.C § 77m. As opposed to statutes of repose, "[s]tatutes of limitations are designed to encourage plaintiffs to pursue diligent prosecution of known claims." *Cal. Pub. Emps.' Ret. Sys. v. ANZ Sec., Inc.*, 582 U.S. 497, 504, 137 S.Ct. 2042, 198 L.Ed.2d 584 (2017) (internal quotation marks omitted). Thus, "limitations periods begin to run when the cause of action accrues—that is, *when the plaintiff can file suit and obtain relief*." *Id.* at 504–05, 137 S.Ct. 2042 (internal quotation marks omitted) (emphasis added). And "a prospective buyer has no recourse against a person who touts unregistered securities to him if he does not purchase the securities." *Pinter*, 486 U.S. at 644, 108 S.Ct. 2063. It would make little sense to begin the running of Section 12's statute of limitations before a plaintiff made the purchase allowing her to sue.

[11] **[12]** On the other hand, a statute of repose "begins to run from the defendant's violation." *City of Pontiac Gen. Emps.' Ret. Sys. v. MBIA, Inc. (MBIA)*, 637 F.3d 169, 176 (2d Cir. 2011). "[S]tatutes of repose are enacted to give more explicit and certain protection to defendants," and thus run from "the date of the last culpable act or omission of

the defendant." *Cal. Pub.*, 582 U.S. at 505, 137 S.Ct. 2042. Defendants' reading of Section 13 would transform its statute of limitations into a duplicative, and shorter, statute of repose capable of running before any purchase has been made and thus before any claim has accrued. We rejected such a reading fifty years ago and do so again today. We therefore conclude, based on precedent and statutory context, that Plaintiffs' claims as to EOS and TRX purchases ***143** made after April 3, 2019 are timely. [6]

B. Section 29(b) Claims

For similar reasons, we reverse the district court's dismissal of Plaintiffs' claims for recission of the EOS and TRX purchases made after April 3, 2019 under Section 29(b) of the Exchange Act. Section 29(b) states that "[e]very contract made in violation of any provision of this chapter ... the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter ... shall be void ...." 15 U.S.C. § 78cc(b). Plaintiffs alleged that their contracts with Binance are voidable under Section 29(b) because Binance violated Section 5 of the Exchange Act by operating as an unregistered exchange, 15 U.S.C. § 78e, and Section 15(a)(1) of the Exchange Act by operating as an unregistered broker-dealer, 15 U.S.C. § 78*o*(a)(1). Unlike Section 12(a), this provision does not contain an express cause of action tied to a statute of limitations but the parties agree that claims for recission under Section 29(b) expire one year after they accrue. Their dispute is over when accrual occurs. We conclude that, as with Section 12(a), Plaintiffs' claims accrued, if at all, only after they made or committed to making their purchases.

As a threshold matter, we assume without deciding that Binance is correct that the relevant contract to be rescinded is Binance's Terms of Use and that Plaintiffs did not adequately allege that they entered into new, implied contracts every time Plaintiffs conducted a transaction on Binance's platform.

[13] With that assumption in mind, we conclude that Section 29(b)'s express limitations period governs these claims. *See* 15 U.S.C. § 78cc(b). That provision states an action must be "brought within one year after the discovery that such sale or purchase involves such violation." *Id.*

[14] **[15]** "[W]here, as here, the claim asserted is one implied under a statute that also contains an express cause of action with its own time limitation, a court should look first to the statute of origin to ascertain the proper limitations period." *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 359, 111 S.Ct. 2773, 115 L.Ed.2d 321 (1991) (superseded by statute on other grounds). Section 29(b)'s express statute of limitations for fraud-based claims is therefore the appropriate one because it "focuses on the analogous relationship, involves the same policy concerns, and provides for a similar restitutionary remedy." *Kahn v. Kohlberg, Kravis, Roberts & Co. (KKR)*, 970 F.2d 1030, 1038 (2d Cir. 1992). Under this statute of limitations, Plaintiffs' claims as to purchases of EOS and TRX made after April 3, 2019 would be timely because it is impossible to discover that a "sale or purchase involves [a] violation" of the Exchange Act before that sale or purchase has occurred. *See* 15 U.S.C. § 78cc(b).

Defendants mistakenly rely on *KKR* to argue that the limitations period for Plaintiffs' recission claims runs from the formation of the allegedly violative contract. *KKR* held that the claim at issue there—for recission of an agreement under the Investment Advisers Act—accrued at the ***144** time of contract formation and that "subsequent payments on a completed sales transaction[ ] affect the amount of damages but do not constitute separate wrongs." 970 F.2d at 1040. But that does not resolve this case because the contract at issue in *KKR* contemplated a long-term relationship in which "a certain amount of [plaintiffs'] capital" was committed from the get-go "to investments chosen by KKR." *Id.* Therefore, that contract constituted a "completed sales transaction," which in and of itself violated the Investment Advisers Act. *Id.*

That is meaningfully different from the situation we face because, by agreeing to Binance's Terms of Use, Plaintiffs did not effectuate a "completed sales transaction." Though the Terms of Use prevented Plaintiffs from unilaterally revoking a trade once it was made, they did not commit Plaintiffs to making any trades at all on Binance's platform; the Terms simply outlined the governing rules if Plaintiffs did choose to trade. Plaintiffs were not "committed to pay [an] amount under the contract," and indeed they "retained the right" to stop trading on Binance "at any time." *Id.* Therefore, *KKR* does not require that the statute of limitations run

from the time Plaintiffs agreed to the Terms of Use but before they committed to or completed any transactions. [7]

In any event, even if Defendants were correct that the statute of limitations expires a year after a "reasonably diligent plaintiff would have discovered the facts constituting the [alleged] violation," Appellees' Br. at 48 (quoting *Merck & Co. v. Reynolds*, 559 U.S. 633, 637, 130 S.Ct. 1784, 176 L.Ed.2d 582 (2010)), Plaintiffs' claims arising from purchases made during the year before filing are still timely because the "violation" at issue requires a violative transaction. Just as we concluded with respect to their Section 12(a) claims above, Plaintiffs' Section 29(b) claims could not have accrued, and therefore the statute of limitations could not have begun to run, absent a specific transaction. *See* *MBIA*, 637 F.3d at 175–76.

[16] That is because a Section 29(b) claim must be predicated on an underlying violation of the Exchange Act. *See* 15 U.S.C. § 78cc(b) (providing a contract is void where "the performance of [it] involves the violation of" the Exchange Act or regulations promulgated under its authority); *see also* *Boguslavsky v. Kaplan*, 159 F.3d 715, 722 (2d Cir. 1998). And the two alleged violations of the Exchange Act underlying Plaintiffs' recission claims both require transactions. Plaintiffs allege Binance violated Section 5 of the Exchange Act by operating as an unregistered exchange and Section 15(a)(1) of the Exchange Act by operating as an unregistered broker or dealer of securities. *See* 15 U.S.C. § 78e (Section 5, titled "Transactions on unregistered exchanges"); 15 U.S.C. § 78*o*(a)(1) (Section 15(a)(1), sub-titled "Registration of all persons utilizing exchange facilities to effect transactions"). Both of these provisions clearly contemplate a transaction. Further, district courts in this circuit have long recognized that to make out a violation under Section 29(b), "plaintiffs must show that ... the contract involved a prohibited transaction." ***145** *Pompano-Windy City Partners, Ltd. v. Bear Stearns & Co.*, 794 F. Supp. 1265, 1288 (S.D.N.Y. 1992) (internal quotation marks omitted); *EMA Fin., LLC v. Vystar Corp.*, No. 19-cv-1545, 2021 WL 1177801, at *2 (S.D.N.Y. Mar. 29, 2021) (same).

As discussed above, the Terms of Use did not commit Plaintiffs to making a violative transaction. Since Plaintiffs' Section 29(b) claims require a transaction, the claims could not have accrued until a transaction occurred. [8] To conclude otherwise would be inconsistent with the caselaw discussed above, which demarcates the difference—in the securities context at least—between a statute of repose and a statute of limitations. Plaintiffs could not have known the facts "required to adequately plead ... and survive a motion to dismiss" without knowing what, if any, violative transactions constituted the alleged underlying violation of the Exchange Act. *MBIA*, 637 F.3d at 175 (citing *Merck*, 559 U.S. at 648–49, 130 S.Ct. 1784). We therefore conclude that Plaintiffs' claims under Section 29(b) as to EOS and TRX purchases made during the year before filing suit are also timely.

III. Dismissal of Absent Class Member Claims

[17] **[18]** Finally, in addition to dismissing the federal and state claims of the named Plaintiffs as untimely and impermissibly extraterritorial, the district court dismissed the claims asserted on behalf of absent class members under the Blue Sky statutes of states other than California, Florida, Nevada, Puerto Rico, and Texas, where the named Plaintiffs are from. The district court held there was "an insufficient nexus between the allegations and those [other] jurisdictions" from which no named Plaintiffs hailed. *Anderson*, 2022 WL 976824, at *4. Dismissal at this stage on this basis was improper. "[A]s long as the named plaintiffs have standing to sue the named defendants, any concern about whether it is proper for a class to include out-of-state, nonparty class members with claims subject to different state laws is a question of predominance under Rule 23(b)(3)" to be decided after the motion to dismiss stage. *Langan v. Johnson & Johnson Consumer Cos.*, 897 F.3d 88, 93 (2d Cir. 2018). We therefore vacate the dismissal of the absent class member claims.

CONCLUSION

Accordingly, we **REVERSE** and **REMAND** for proceedings consistent with this Opinion as to the claims challenged on appeal.

All Citations

96 F.4th 129, Fed. Sec. L. Rep. P 101,818

Footnotes

1 Plaintiffs do not appeal the district court's dismissal of their claims concerning tokens BNT, SNT, KNC, LEND, and CVC. Nor do they appeal the district court's decision as to the timeliness of their federal claims concerning tokens ELF, FUN, ICX, OMG, and QSP. Accordingly, such claims are not before us.

2 Plaintiffs initially brought claims regarding twelve tokens, but on appeal they challenge only the district court's dismissal of their claims regarding these seven tokens.

2 *Choi* involved claims under the Commodity Exchange Act but applied the same framework for evaluating the exterritorial reach of domestic securities laws under *Morrison* at issue here. *Choi*, 890 F.3d at 66–67; *see also* *Loginovskaya v. Batratchenko*, 764 F.3d 266, 271–74 (2d Cir. 2014).

3 We do not mean to imply that in such circumstances, irrevocability can attach in only one country. It is entirely possible that such a transaction might fall under the laws of more than one jurisdiction, especially as the result of the efforts of the exchange, or of participants, to have the transaction be subject to no country's legislative jurisdiction.

4 In light of this conclusion, we need not and do not reach Plaintiffs' alternative arguments for concluding that their claims concern domestic transactions.

5 Specifically, these plaintiffs are Hardin, Muhammad, Thiagarajan, Token Fund I LLC, and Williams.

6 We therefore do not resolve whether, by continuing to offer TRX and EOS on its website right up until the complaint was filed, Binance engaged in an ongoing violation of the Securities Act. *See* *Wilson v. Saintine Expl. & Drilling Corp.*, 872 F.2d 1124, 1126 (2d Cir. 1989) (holding that "the ministerial act of mailing" offer materials at the seller's direction did not constitute solicitation).

7 Defendants do not argue that Plaintiffs' claims accrued when the first transaction took place pursuant to the Terms of Use and that subsequent transactions affect only damages but do not restart the statute of limitations. Instead, Defendants argue that Plaintiffs' Section 29(b) claim accrued "when the allegedly illegal contract [was] signed" regardless of whether or when transactions were made pursuant to it. Appellees' Br. at 54. That is the argument we consider and reject.

8 To be clear, we express no view as to whether Plaintiffs successfully stated a claim under Section 29(b) where the contract they are seeking to rescind does not commit the parties to complete a transaction. In the district court, Defendants moved to dismiss Plaintiffs' Section 29(b) claim arguing that it failed as a matter of law because Plaintiffs did not allege that the Terms of Use committed the parties to a violative transaction. However, the district court did not reach that argument and Defendants have not raised it as an alternative basis for affirmance. Therefore, for the purpose of this opinion, we have assumed that a plaintiff can state a claim for recission of a contract based on violative transactions that are made pursuant to, but not required by, the contract.

2022 WL 2066414
Only the Westlaw citation is currently available.
United States Court of Appeals, Second Circuit.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION, Petitioner-Appellee,
v.
TERRAFORM LABS PTE LTD., Do Kwon, Respondents-Appellants.

22-368
|
June 8, 2022

Appeal from an order of the United States District Court for the Southern District of New York (Oetken, *J.*).

UPON DUE CONSIDERATION, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the February 17, 2022 order of the district court is **AFFIRMED**.

Attorneys and Law Firms

FOR PETITIONER-APPELLEE: Eric A. Reicher, Special Trial Counsel (Tracey L. Sasser, Samuel M. Forstein, on the brief), United States Securities and Exchange Commission, Washington, DC.

FOR RESPONDENTS-APPELLANTS: Douglas W. Henkin, Dentons US LLP, New York, NY.

PRESENT: ROSEMARY S. POOLER, RICHARD C. WESLEY, MYRNA PÉREZ, Circuit Judges.

SUMMARY ORDER

***1** Appellants Terraform Labs Pte Ltd. ("Terraform") and Do Kwon ("Kwon") (collectively "Appellants") appeal from the district court's (Oetken, *J.*) order granting the United States Securities and Exchange Commission's ("SEC") application for an order requiring compliance with investigative subpoenas for documents from Appellants and testimony from Kwon. The subpoenas were served as part of an SEC investigation into whether Appellants violated federal securities laws in their participation in the creation, promotion, and offer to sell various digital assets related to the "Mirror Protocol," a blockchain technology. On appeal, Appellants argue that the district court erred in two ways. First, the application should not have been granted because the SEC violated its Rules of Practice ("the Rules") when it served the subpoenas by handing a copy to Kwon, Terraform's chief executive officer, while he was present in New York. Second, the district court lacked personal jurisdiction because Appellants lacked sufficient contacts with the U.S. For the reasons stated below, we conclude that the district court properly granted the SEC's application. We assume the parties' familiarity with the underlying facts, procedural history, and issues on appeal, to which we refer only as necessary to explain our decision.

I. Service

The district court properly concluded that the SEC complied with the Rules. We review a district court's decision to enforce an administrative subpoena for abuse of discretion. *McLane Co. v. EEOC*, 137 S. Ct. 1159, 1169 (2017). "To win judicial enforcement of an administrative subpoena, SEC must show [1] that the investigation will be conducted pursuant to a legitimate purpose, [2] that the inquiry may be relevant to the purpose, [3] that the information sought is not already within the Commissioner's possession, and [4] that the administrative steps required have been followed." *RNR Enters. v. S.E.C.*, 122 F.3d 93, 96–97 (2d Cir. 1997) (internal quotation marks and alterations omitted). Here, only the last prong is in dispute. The Rules provide the relevant administrative steps for serving investigative subpoenas, *see generally* 17 C.F.R. Part 201, Subpart D, and require that such service comply with the provisions of Rule 150(b) through (d), *id.* § 201.232(c). Those provisions of Rule 150 in relevant part, read:

> (b) Upon a person represented by counsel. Whenever service is required to be made upon a person represented by counsel who has filed a notice of appearance pursuant to § 201.102, service shall be made pursuant to paragraph (c) of this section upon counsel, unless service upon the person represented is ordered by the Commission or the hearing officer.
>
> (c) How made. Service shall be made electronically in the form and manner to be specified by the Office of the Secretary in the materials posted on the Commission's website. Persons serving each other shall have provided the Commission and the parties with notice of an email address.
>
> [...]
>
> (d) Additional methods of service. If a person reasonably cannot serve electronically, or if service is of an

investigative subpoena pursuant to 17 C.F.R. 203.8, service may be made by delivering a copy of the filing. Delivery means:

> ***2** (1) Personal service–handing a copy to the person required to be served ...

Id. § 201.150(b)–(d).

Before the SEC served Kwon, Appellants' counsel contacted the SEC and provided some contact information. Appellants then entered a proffer agreement with the SEC. According to the SEC, despite the agreement, Appellants failed to answer questions related to their digital assets and did not commit to complying with the SEC's document requests. After attempts at voluntary compliance, the SEC prepared two investigative subpoenas—one for Kwon, one for Terraform. On September 20, 2021, a process server hand-served the subpoenas on Kwon on behalf of the SEC while he was in New York and emailed copies to Appellants' counsel. Appellants' counsel informed the SEC that he "did not believe that service of the subpoenas was proper." App'x at 70–71.

At the outset, our precedent makes clear that the SEC could serve the corporate entity Terraform through Kwon, the company's chief executive officer and authorized agent. *See* *In re Grand Jury Subpoenas Issued to Thirteen Corps.*, 775 F.2d 43, 46 (2d Cir. 1985) ("A corporation may be served through an officer or agent explicitly or implicitly authorized to accept service of process."). Here, the sole issue as to the SEC's compliance with the Rules is the method of service. Appellants contend that the SEC's service on Kwon failed to comply with Rule 150(b) because Appellants' counsel provided certain contact information to the SEC, such that Kwon and Terraform were "represented by counsel" within the meaning of that provision. 17 C.F.R. § 201.150(b). As "persons represented by counsel," Appellants assert that the SEC was obligated to comply with Rule 150(b) and effect service upon Appellants' counsel or obtain an order from the Commission or a hearing officer before serving Kwon or Terraform directly, and its failure to take either step made the service ineffective. Appellants also argue, alternatively, that the copies emailed to their counsel did not satisfy Rule 150(b) because the email "did not purport to have effected service" via their counsel and was therefore not valid service. Appellants' reading of the Rules is contrary to the text and would produce absurd results by allowing a party to insist on service through counsel, but allow the party to block said service by not authorizing their counsel to receive any filings.

Rule 150(b) only applies when a represented party's counsel "file[s] a notice of appearance pursuant to [Rule 102]." *Id.* § 201.150(b). Rule 102(d) is entitled: "[d]esignation of address *for service*; notice of appearance; power of attorney; withdrawal." *Id.* § 201.102(d) (emphasis added). Rule 102(d)(2) provides that persons "representing others" before the SEC "shall file with the Commission ... a written notice stating ... the representative's ... business address [and] email address" among other things. *Id.* § 201.102(d)(2). The "business address" and "email address" to be included in the "written notice" is obviously the "address" that is to be designated for service under Rule 102(d).[1] Accordingly, a plain reading of the text prohibits a writing from being a notice of appearance unless a party agrees to receive service at the provided address.

***3** To be clear, Appellants do not maintain that they filed a formal notice of appearance with the SEC, arguing instead there was no docket to file such notice and, their counsel's email to the SEC suffices as notice under the Rules. We need not decide whether the Rules require a formal filing on a docket because, even if counsel could "file" a notice of appearance by emailing contact information to the SEC, whatever writing Appellants' counsel provided was not a notice of appearance because it did not contain an address suitable for service. In fact, before the district court, Appellants refused to confirm whether their counsel was authorized to accept service. *See* App'x 187. At oral argument before this Court, Appellants conceded that counsel was not authorized to accept service at the time Kwon was served or at any time thereafter. Oral Arg. at 6:28–7:09. Therefore, because they never provided an address for service, Appellants cannot now claim that their counsel filed a notice of appearance that would make hand-service on Kwon improper under the Rules.

But even assuming Appellants' counsel should have been served, the subpoena copies sent via email to Appellants' counsel constituted proper service under Rule 150(c). Rule 150(b) permits the SEC to serve counsel pursuant to Rule 150(c), 17 C.F.R. § 201.150(b), and Rule 150(c) provides that "[s]ervice shall be made electronically in the form and manner to be specified by the Office of the Secretary in the materials posted on the Commission's website," *id.* § 201.150(c). According to the SEC's Office of the Secretary, "[i]nvestigative [s]ubpoenas must be served electronically" and outside of the agency's electronic filing system. OFF. OF THE SEC'Y, U.S. SEC. AND

EXCH. COMM'N, INSTRUCTIONS FOR ELECTRONIC FILING AND SERVICE OF DOCUMENTS IN SEC ADMINISTRATIVE PROCEEDINGS AND TECHNICAL SPECIFICATIONS 2, 5 (2020). Appellants argue that the SEC's email to their counsel was ineffective service because the cover email "did not purport to have effected service by being sent to [counsel]." Appellants' Br. at 11. Appellants provide no authority for the proposition that a subpoena or its cover email must convey certain specific and precise words to be effective.

Accordingly, the district court correctly concluded that the SEC's service of the subpoenas complied with the Rules.

II. **Personal Jurisdiction**

The district court properly concluded that it had personal jurisdiction over Terraform and Kwon. We review the factual findings in a district court's decision on personal jurisdiction for clear error and its legal conclusions de novo. *Frontera Res. Azer. Corp. v. State Oil Co. of Azer. Republic*, 582 F.3d 393, 395 (2d Cir. 2009). Appellants are a foreign person and entity—Terraform is a Singapore-incorporated company and Kwon is a resident of the Republic of Korea. For a court to exercise specific jurisdiction over these non-residents, three conditions must be satisfied. "First, the [non-resident] must have purposefully availed itself of the privilege of conducting activities within the forum State or have purposefully directed its conduct into the forum State. Second, the plaintiff's claim must arise out of or relate to the [non-resident's] forum conduct. Finally, the exercise of jurisdiction must be reasonable under the circumstances." *U.S. Bank Nat'l Ass'n v. Bank of Am. N.A.*, 916 F.3d 143, 150 (2d Cir. 2019) (internal quotation marks and citations omitted).

The district court's specific personal jurisdiction determination rested on seven contacts with the U.S.[2] We agree. Appellants purposefully availed themselves of the U.S. by promoting the digital assets at issue in the SEC's investigation to U.S.-based consumers and investors. *See, e.g.*, *Securities & Exch. Commn. v. PlexCorps*, 2018 WL 4299983, at *10 (E.D.N.Y. Aug. 9, 2018) ("Defendants created contacts with the United States by ... doing business while traveling in the United States, ... and marketing their products to United States consumers via the Internet."). Appellants retained U.S.-based employees, including a Director of Special Projects that has promoted these digital assets in the U.S. *See, e.g.*, *Goldfarb v. Channel One Russia*, 442 F. Supp. 3d 649, 664 (S.D.N.Y. 2020) (exercising personal jurisdiction where corporation's in-forum employee served subscribers in the forum). Appellants entered into agreements with U.S.-based entities to facilitate the trade of these same digital assets, including a $200,000 deal with one U.S.-based trading platform. *See, e.g.*, *U.S. Titan, Inc. v. Guangzhou Zhen Hua Ship. Co.*, 241 F.3d 135, 152 (2d Cir. 2001) (concluding corporation purposely availed itself of the U.S. forum by "negotiating and forming a contract" with U.S.-based corporation). While seeking to enter into an agreement with a U.S.-based company, Appellants indicated that 15% of users of its Mirror Protocol are within the U.S. *See, e.g.*, *EMI Christian Music Grp., Inc.*, 844 F.3d at 98 (exercising specific personal jurisdiction because non-resident was aware that his company provided services to users in the forum). Moreover, the district court's exercise of jurisdiction was reasonable and would not "offend traditional notions of fair play or substantial justice" because the conduct was "purposefully directed toward residents of [the U.S.], and the suit arose from and related directly to those [forum] contacts." *U.S. Bank Nat'l Ass'n*, 916 F.3d at 152.

***4** Appellants' arguments to the contrary are unpersuasive. First, they argue that the SEC's previous efforts to obtain voluntary cooperation suggests that the SEC knew Appellants' contacts with the U.S. were not sufficient to support personal jurisdiction. This argument is not relevant because personal jurisdiction is a question of federal law to be decided by federal courts—not the SEC. *See, e.g.*, *Chew v. Dietrich*, 143 F.3d 24, 30 (2d Cir. 1998). Second, Appellants argue that the district court's exercise of personal jurisdiction was so expansive that it could subject any corporation listed on a U.S. securities exchange as well as any "digital asset" company to the court's jurisdiction. However, this argument misinterprets the district court's justification for its exercise of *specific* personal jurisdiction which relied on Appellants' purposeful and extensive U.S. contacts, including marketing and promotion to U.S. consumers, retention of U.S.-based employees, contracts with U.S.-based entities, and business trips to the U.S., all of which related to the Mirror Protocol and digital assets at issue in the SEC's investigation. *See, e.g.*, *Balestra v. ATBCOIN LLC*, 380 F. Supp. 3d 340, 350–51 (S.D.N.Y. 2019) (exercising specific personal jurisdiction over founders of a "blockchain" company based on conduct "target[ing] the U.S. market in an effort to promote the

sale of ... the very unregistered security at issue in [the] litigation"). [3]

We have considered all of Appellants' remaining arguments and conclude they are without merit. [4] For the foregoing reasons, we conclude that the district court properly granted the SEC's application for an order requiring compliance with the investigative subpoenas and we **AFFIRM** the order of the district court.

All Citations

Not Reported in Fed. Rptr., 2022 WL 2066414

Footnotes

1 Although we need not resort to the regulation's history, we note that it, too, confirms our interpretation of Rule 102. In 1995, the SEC adopted comprehensive revisions to the Rules, including a revision to Rule 102 to require "persons filing a notice of appearance [to] keep the information contained in the notice, such as address and telephone number, up-to-date." *Rules of Practice*, 60 Fed. Reg. 32738, 32747 (June 23, 1995). The SEC clarified that "[c]urrent information is necessary to permit the expeditious *service* of orders as well as other efforts to contact a party." *Id.* (emphasis added). In 2020, the SEC amended the Rules "to require persons involved in Commission administrative proceedings to file and *serve* documents electronically." *Amendments to the Commission's Rules of Practice*, 85 Fed. Reg. 86464, 86464 (Dec. 30, 2020) (emphasis added). Rule 102(d) was amended to require "both a mailing address and an email address" in the "notice" for the purposes "of electronic filing and *service*." *Id.* at 86473 (emphasis added).

2 In evaluating Kwon and Terraform's contacts with the U.S., we have, consistent with our precedent, imputed Terraform's contacts onto Kwon. *See, e.g.*, *EMI Christian Music Grp., Inc. v. MP3tunes, LLC*, 844 F.3d 79, 98 (2d Cir. 2016) (holding that it is "appropriate" to consider company's contacts in forum in evaluating whether court could exercise personal jurisdiction over CEO who "exercised extensive control" over said company).

3 Appellants also argue that the district court's personal jurisdiction analysis took improper judicial notice of a sponsorship agreement between the Washington Nationals baseball team and an entity known as "Terra Community Trust." We need not resolve, however, whether the judicial notice was an abuse of discretion as the district court found more than enough contacts in the U.S. to support specific personal jurisdiction despite the sponsorship agreement.

4 Appellants contend that the SEC would likely have difficulty establishing that the digital assets at issue could be subject to federal securities laws, arguing they are not listed or traded on any U.S. exchange. We need not address the question of whether Terraform's digital assets are securities to conclude the district court properly exercised personal jurisdiction.