

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street NE
Washington DC 20549-1090

June 13, 2022

Re: File No. S7-02-22

Dear Ms. Countryman:

I appreciate the opportunity to comment on the Securities and Exchange Commission’s proposal to extend Regulation ATS to certain communication protocols that bring together buyers and sellers for trading securities. I am a law professor who teaches and researches about the regulation of exchanges and broker-dealers in securities, and enforcement of broker-dealer rules. I write solely in my capacity as a scholar with an interest in promoting the development of federal securities law.¹ Given the proposal’s complexity, length, and focus, I write not to engage deeply with the details of contemplated reforms to Exchange Act Rule 3b-16. Rather, I focus on two narrow issues.

First, the Commission should take seriously the litigation risk of extending this rulemaking to crypto markets as it is currently framed. I do not mean to suggest that these challenges are likely to have “merit,” understood against longstanding doctrines that the Commission has relied upon in designing and implementing regulatory programs. Rather, as I noted in a coauthored essay earlier this year in the Yale Law Journal Forum, the technology bar is fiercely litigious—a risky adversary at a time when legacy doctrines are being unsettled.² As recent cases like *SEC v. Jareksy*³ illustrate, a radically reconstituted judiciary may mean that the Commission will no longer be justified in relying on some of those longstanding doctrines.

Second, and more important, the comment letters identify in rich detail the many forms of communications protocols in the crypto ecosystem that may be swept within the proposed revisions to Rule 3b-16. Some commenters have resisted the notion that the Exchange Act would authorize extending these proposals to crypto markets. But other commenters have acknowledged (correctly) that it plausibly does, warning that the Commission nonetheless shouldn’t extend the proposal to the crypto markets.

As a conceptual matter, the case for intervention is easy. Decentralized finance and cryptocurrency markets are unproven, speculative, risky, and wasteful. Yet there’s nothing

¹ I worked at the SEC’s Office of the General Counsel for 5 years before joining the faculty of the University of Nebraska College of Law in August 2020. I disclose these affiliations solely for identification and to signpost compliance with post-employment conflicts rules.

² See Kyle Langvardt and James Fallows Tierney, *On “Confetti Regulation”: The Wrong Way to Regulate Gamified Investing*, 131 YALE L.J. FORUM 717 (Jan. 17, 2022).

³ See *Jarkesy v. SEC*, 34 F.4th 446 (5th Cir. 2022).

inherently different about the structure of decentralized finance that means it can't fit within legacy doctrinal categories. For instance, the release proposes that certain communication protocol systems must register as an exchange or operate under the ATS exemption. A group of participants in blockchain and other DeFi applications—including developers, automated market makers, and miners—all might be understood as essential components of that market infrastructure. They might play analogous roles to in-house counsel, market makers, and back-office clearance roles in a traditional exchange setup. That these roles might be “decentralized” does not change that they would constitute a group of persons who constitute, maintain, or provide facilities for bringing together purchasers and sellers of securities.

Besides the definitional issue, the Commission should also carefully scrutinize claims about burdensome costs to comply with regulations. Given the amount of money sloshing around in these unregulated speculative markets, regulators should not be very sympathetic to the idea that compliance with securities regulation would be unduly burdensome. Such regulatory burdens and costs are inevitable; the better questions are whether they are cost-justified or in the public interest.

Understanding the Reg ATS proposal's extension to crypto in these superficial terms is as far as we can go for now. The release is not framed to discuss differences and similarities between contract design in traditional and decentralized markets. For that reason, interested commenters can't know for sure how to map potential changes to these regulatory categories to a different market structure in the real world. That includes not just those seeking to challenge the regulations, but also those commenters seeking to support them.

In short, it's time to bring crypto markets in from the cold.⁴ Some mix of legacy regulatory devices, and new regulations, may be appropriate to regulate crypto markets and participants under the Exchange Act. Whatever that equilibrium will eventually look like, what we see today—market failures like agency costs, information asymmetry, and the like—are canonical justifications for regulatory intervention.⁵ But those seeking to articulate a positive case for regulation, no less than those resisting regulation, need an opportunity to engage on regulatory design on its own terms.

To that end, I write to encourage the Commission to use the comments received in this proposed rule as a basis for evaluating how crypto market participants might fit within existing regulatory frameworks. Just as the Commission has occasionally before made bold plans for a regulatory overhaul—as with the Aircraft Carrier release⁶—here too the Commission should

⁴ See, e.g., Joshua Oliver, Scott Chipolina, & Eva Szalay, *Luna crash sends a chill through decentralised finance market*, FIN. TIMES (June 2, 2022), <https://www.ft.com/content/c10bc6f7-abbe-45dc-9367-042186c3336f>; Stephen Diehl, *The Complete Argument Against Crypto* (undated), <https://www.stephendiehl.com/blog/complete.html>.

⁵ See, e.g., Current Guidance on Economic Analysis in SEC Rulemakings (Mar. 16, 2012), http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_seculemaking.pdf (noting that possible justifications for proposed rulemaking include “market failure[s] that market participants cannot solve,” such as “market power, externalities, principal-agent problems, and asymmetric information”).

⁶ See Proposed Rules: The Regulation of Securities Offerings, Securities Act Release No. 7606A (Nov. 13, 1998), 63 Fed. Reg. 67,174 (Dec. 7, 1998).

articulate a vision of crypto regulation that takes seriously that market's structure and invites considered comments from market participants, scholars, and others. It should signpost the issues it is interested in regulating on, and invite comment on extending these regulatory categories to the analogous but not identical set of market participants and structures we see in crypto. The clock is ticking.⁷

I thank you for your consideration. Please let me know if I can be of further assistance to the Commission, the Commissioners' counsel, or the Staff as the agency considers these issues further. For questions and additional information, please contact me by mail at the address below or by email at jtierney4@unl.edu.

Sincerely,

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⁷ See Responsible Financial Innovation Act, S. 4356 (introduced 2022); *see also* Lummis, Gillibrand Introduce Landmark Legislation to Create Regulatory Framework for Digital Assets (June 7, 2022), <https://www.gillibrand.senate.gov/news/press/release/-lummis-gillibrand-introduce-landmark-legislation-to-create-regulatory-framework-for-digital-assets>.