Linklaters

Linklaters LLP
1290 Avenue of the Americas
New York, NY 10104
Telephone (+1) 212 903 9000
Facsimile (+1) 212 903 9100

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Submitted via email to: rule-comments@sec.gov

June 13, 2023

Re: **Supplemental Information and Reopening of Comment Period for Amendments to Exchange Act Rule 3b-16 Regarding the Definition of Exchange (Release No. 34-97309; File Number S7-02-22)**

Dear Ms. Countryman:

Thank you for inviting feedback concerning the rulemaking proposal originally released on January 26, 2022 (the "**Proposing Release**") and supplemented and reopened on April 14, 2023 (the "**Reopening Release**"), including the proposed amendments to Rule 3b-16 (collectively, as supplemented, the "**Proposed Rule**"). We submit this letter (this "**Letter**") to express our deep concerns with the ability of legal counsel to meaningfully advise their clients, should the Proposed Rule be adopted in its current form, specifically – but without limitation – in connection with the Proposed Rule's use of the terms "group of persons" and "communications protocols."

We understand and appreciate the importance, for investor protection and other reasons, of periodic modifications to rules and definitions to more accurately reflect the then-current market realities and certain technological innovations. In that regard, we applaud the Securities and Exchange Commission's (the "**Commission**") efforts to provide the market with a greater understanding of what activities the Commission believes constitute functioning as a securities exchange. In addition, we greatly appreciate the thoughtful and detailed supplemental information that the Commission provided in response to comments submitted to the Commission during the comment period (ended on June 13, 2022) for the Proposing Release.[1]

We also thank the Commission for its comprehensive discussion in the Reopening Release of the term "group of persons" that is included in the Proposed Rule, including the Commission's emphasis that the determination of whether such a group exists requires a facts-and-circumstances analysis and that "one factor to consider, depending on other facts and circumstances, would be the extent to which a person acts with an agreement (formal or informal) to perform a function of a market place or facilities for bringing together buyers and sellers of securities." We also appreciate the Commission's recognition that a software developer, who – acting independently and separately from an organization – publishes or republishes code without any agreement (formal or informal) with any person for that code to be used for a function of a marketplace or facilities for bringing together buyers and sellers of

[1] Among other things, should the Commission ultimately determine to adopt the Proposed Rule, we generally are supportive of the Commission's proposal in the Reopening Release to replace the term "communications protocol," which was introduced in the Proposing Release, with the term "negotiation protocol." For purposes of this Letter, however, we will continue to use the term "communications protocol."

securities, may be less likely to be deemed to be acting *in concert* to provide a marketplace or facilities for bringing together buyers and sellers.

Nevertheless, we are deeply concerned that adoption by the Commission of the Proposed Rule in its current form will meaningfully increase the difficulty in advising clients as to whether their activities, either independently, or as part of an unspecified group of persons, fall within the definition of constituting, maintaining or providing an exchange or a mechanism of an exchange, as well as what steps any such client should take in order to ensure that its activities comply with applicable law.

Indeed, without limiting the generality of the foregoing, we have great concerns that the Commission's determination, for purposes of the Proposed Rule, of whether a "group of persons" exists will be made retroactively, with the benefit of hindsight, after the consummation of a given transaction, rather than prospectively, from the perspectives, at the outset, of the various, potentially independent actors.

As we will discuss later in this Letter, there exist well-settled principles, including in tort law, recognizing that superseding causes and independent actors may break the proximate cause chain. Similarly, in the case of individuals interacting with certain open source technologies, there exists the potential for "Choose Your Own Adventure"-style choices, affirmative actions and transactions that are driven by the individual participant him-, her- or itself, and not by technology providers.

The Proposed Rule's inclusion of an unspecified "group of persons," in some ways, appears to envision end-users as passively moving on a conveyor belt, from technology provider to technology provider, rather than as volitional actors making individual affirmative decisions.

Such affirmative decisions made by end-users may or may not result in the consummation of a transaction involving what the Commission deems to be a security for purposes of U.S. federal securities laws. While, viewed retroactively, it may appear that each "action" was the next step in an unbroken causal chain, in reality, such an end-user's intervening decisions may be among the last steps in such a securities transaction and, indeed, may be outside of the control of a given technology provider, particularly one earlier in the chain. In fact, it may be that, but-for such end-user's own volitional actions, no security would have been involved at all.

Discussion.

As proposed, the amended definition of "exchange," including the introduction of the concept of "communications protocol systems," would, in many instances, make it extremely difficult for legal counsel to advise their clients about when such clients' activities – either taken alone or viewed together with other independently operated or controlled market participants, technologies and factors[2] – would or would not constitute functioning as an exchange, or even as a communications protocol system. This is particularly true of clients that operate within the digital asset space.

The proposed amendments to Rule 3b-16[3] would have the effect of broadening the scope of what constitutes an "exchange," with the expanded definition contemplating activities that may appear to be

[2] Such market participants, technologies and factors may include, among other things, certain open source tools and the affirmative choices and actions of such client's B2B or B2C customers and, in some cases, the interactions of such customers with decentralized apps that are in no way affiliated or in contractual privity with the original client or the customization by a B2B customer of technology hosted by a client.

[3] In particular, proposed amendments to Rule 3b-16 provide that an organization, association, or group of persons would generally be considered to constitute, maintain, or provide an exchange if it:

(i) Brings together buyers and sellers of securities using "trading interest"; and

(ii) makes available established, non-discretionary methods (whether by providing a trading facility or "communication protocols", or by setting rules) under which buyers and sellers can interact and agree to the terms of a trade.

more "passive" in nature, at least when viewed, for instance, from the perspective of a business client seeking legal advice concerning the likelihood that it inadvertently may be functioning as an exchange. For instance, as amended, the rule no longer would refer to an "order" and, instead, would include the broader concept of "trading interest"[4] and also would introduce the new concept of "communications protocols."

Unfortunately, as currently proposed, the amendments to Rule 3b-16, in many cases, would make it exceedingly difficult to advise a client that its activities amount to constituting, maintaining or providing an "exchange" or a mechanism of an exchange, as well as whether and to what extent the activities of customers or other market participants should be viewed collectively with the client's activities.

Indeed, the proposed rule's reference to "organization, association, group of persons" would make it difficult to determine when such activities of others, arguably undertaken outside of the client's direct control, are simply too attenuated to be relevant to the analyses.

In the event that a client's activities, when viewed collectively with the activities of other independent market participants and technologies, might constitute a mechanism of an exchange, it similarly would be difficult to advise such client as to how to comply under the proposed amended rule – for instance, would a client need to become an ATS or a national securities exchange, even if such client's activities, viewed alone, would not seem to fit the definition of constituting, maintaining or providing an "exchange"?

Moreover, the proposed introduction of the concept of "communications protocols" and communications protocol systems introduces additional complexity and ambiguity. For instance, does the existence of a communications protocol system and the presence of securities mean that the communications protocol system itself is functioning as an exchange or as a mechanism of an exchange? Would the host (if one exists) of a communications protocol system be required to become an ATS or national securities exchange? What if such host of the communications protocol system does not itself control the decisions as to what structured messaging fields may be selected, for example, if such hosted system is used by a variety of B2B customers, some of which B2B customers independently may decide to modify the structured messaging fields to refer to securities? In that case, would the communications protocol system be required to be registered as a national securities exchange or an ATS at all times, or only in the event that its B2B customers elect to use such system to transact in securities?

Below is one example, among many, that we believe highlights some of the difficulties that securities lawyers may encounter when attempting to advise their clients of the proposed rule change's

---

Although not defined in proposed Rule 3b-16, the proposing release notes that the following activities may be considered "communications protocols":

- setting minimum criteria for what messages must contain;
- setting time periods under which buyers and sellers must respond to messages;
- restricting the number of persons a message can be sent to;
- limiting the types of securities about which buyers and sellers can communicate;
- setting minimums on the size of the trading interest to be negotiated; or
- organizing the presentation of trading interest, whether firm or non-firm, to participants.

Rule 3b-16(b) explicitly excludes certain systems that the SEC believes are not exchanges, and accordingly, a system is not included in the SEC's interpretation of "exchange" if (i) the system fails to meet the two part test in paragraph (a) of Rule 3b-16; (ii) the system falls within one of the following exclusions in paragraph (b) of Rule 3b-16; or (iii) the SEC otherwise conditionally or unconditionally exempts the system from the definition.

[4] Trading interest means an order or any non-firm indication of a willingness to buy or sell a security that identifies at least the security and either quantity, direction (buy or sell), or price.

implications. Within the digital asset space, there exists a universe of non-custodial[5] wallets. Many such wallets have accompanying online applications, and many also provide functionality, if customers so choose, for such customers to access other websites or decentralized applications.

For instance, in some cases, customers could elect to access the wallet's online application and from there, leave such application, and visit one or more third party websites or decentralized applications. Such third party websites or decentralized applications may permit customers to buy, sell, swap, send, receive or otherwise transact in certain digital assets.

Great care may be taken by the wallet company to ensure that the wallet and its accompanying online application provides buy, sell and similar support only for digital assets it deems unlikely to be characterized as securities (for example, Bitcoin and Ether); nevertheless, wallet holders may be permitted to hold and view in their wallets, but not transact in, other digital assets owned by such customers that may constitute securities. In such ways, many wallet companies currently are taking significant steps to avoid constituting, maintaining or providing "exchanges," as that definition currently exists. At present, many wallet companies also are designed to enable the use of certain open source technology, if a wallet holder independently takes affirmative steps to access such technology. Through the use of such open source technology, a wallet holder may be able to access, through a portal of sorts,[6] a broad range of decentralized applications, covering a wide array of digital assets and functions, including, among others, decentralized finance ("**DeFi**"), non-fungible tokens and other assets and activities. Some of such assets and activities may be deemed to constitute securities or transactions in securities under U.S. federal securities laws.

Importantly, however, such decentralized applications and activities generally are operated independently from the open source technology that largely passively permits wallet holders to seek out such decentralized applications and activities – and all such applications and activities are even further attenuated from the control or activities of the wallet provider or its accompanying online application.

The proposed new definition of exchange, and the introduction of the definition of communications protocol, would increase the difficulty in advising clients as to whether their activities, either independently, or as part of an unspecified group of persons, fall within the definition of constituting, maintaining or providing an "exchange" or a mechanism of an exchange, as well as what steps such client should take in order to ensure that its activities comply with applicable law.

If a wallet holder wishes to access a given decentralized application, independently elects to enable and install open source functionality through its wallet, accesses such open source technology and, through it, accesses a decentralized application that may permit transactions in digital assets, some of which digital assets may constitute securities under U.S. federal securities laws, could the open source technology itself be deemed to constitute a communications protocol system or an exchange, or a mechanism of an exchange? And, if so, could the wallet company itself be deemed to be functioning as an exchange or a mechanism of an exchange, even though, in this example, the wallet company's activities (if any) would appear to be passive in nature, with the wallet holder itself taking steps to access decentralized applications and digital assets that could not be accessed directly via the wallet's accompanying online application? Or would such activities be deemed to be too attenuated from those of the wallet company and/or an application-agnostic open source technology? Would the result be the same if the wallet company does not itself support buy, sell or other similar functionality for certain digital assets purchased by wallet holders using such decentralized applications? In addition, what registration requirements might apply? Could the wallet company be required to become an ATS or a

[5] Non-custodial wallets are wallets in which the users are in full control of their private keys and their assets, whereas in a custodial wallet the private key is held by a third party.

[6] Wallet holders and other persons may access the decentralized applications via such a "portal," or through any separate web browser, with similar ease.

national securities exchange, as a result of the affirmative activities of certain of its wallet holders and the existence of open source tools?

We believe that it would be inappropriate to regulate such wallet providers or open source technologies as an exchange, because whether or not such wallet company or open source technology passively brings together buyers and sellers of securities using "trading interest" and makes available established, non-discretionary methods under which buyers and sellers can interact and agree to the terms of a trade, hinges on the intervening affirmative actions independently taken by each particular wallet holder – including, among other things, the choice of which decentralized application to access, which transactions in which to engage and which digital asset to access – instead of the wallet company's or open source technology's activities, which generally would appear passive in nature.

Without limiting the generality of the foregoing, we are deeply concerned that the Proposed Rule, while expanding the definition of "exchange" to include much more passive activities, fails to acknowledge the reality that there are other actors – affirmative actors – in the space, such as end-users or wallet holders, that access and interact with open source technology with the intention to achieve their own goals. Such an individual end-user's or wallet holder's aims may differ materially not just from the objectives of other end-users or wallet holders, but also from those of the individual technology or service providers with which such end-users or wallet holders interact.

The existence of open source technology and sophisticated end-users creates the possibility of a "Choose Your Own Adventure"-style interaction that is end-user driven. Indeed, in that respect, an end-user may choose to treat various technologies and technology providers as tools to achieve his, her or its individual objectives, rather than being ushered along in a planned, coordinated manner, by a technology or other service provider. Importantly, even if a technology or service company takes steps to mitigate the risk that the Commission may view it as constituting an exchange or a mechanism of an exchange, we are concerned that the Commission may not view the affirmative actions of certain end-users for what they, in fact, may be – superseding causes.

We acknowledge that tort law differs in many ways from U.S. federal securities laws and that, as such, analogies drawn between the two almost certainly will be incomplete. Nonetheless, we believe that it may be helpful to the Commission to consider tort law's long-established doctrine of superseding cause, including in the case of the above-mentioned example, a wallet company that enables the use of certain open source technology to wallet holders.

Under such doctrine, a superseding cause is an intervening cause that breaks the proximate-cause relationship. The doctrine generally is invoked when, after a defendant has undertaken some negligent conduct, "something else" occurs that gives the court or jury the sense that the something else is "the" cause of the plaintiff's injury. A superseding intervening act occurs when a third party intervenes and such intervention is so extraordinary that it is unforeseeable, thus breaking the causal nexus between the other two parties.

For instance, a wallet company may make available a wallet for digital assets and may implement certain restrictions and other risk mitigation strategies, designed to avoid facilitating transactions in digital assets that are securities. Nevertheless, wallet holders themselves may elect to access certain open source technologies (unaffiliated with the wallet company) that provide to such wallet holders "portals" to various decentralized applications. Certain of such decentralized applications may permit transactions of a type that the wallet company itself does not support, for example, purchases and sales of digital assets that the Commission is likely to view as securities.

While the assessment necessarily is facts-and-circumstances-dependent, we would argue that a wallet holder's use of an open source technology "portal" to access decentralized applications and engage in securities transactions on those decentralized applications would be an intervening cause that would break the proximate-cause connection between the wallet company, on the one hand, and the "bringing

together of buyers and sellers of securities using 'trading interest' and making available established, non-discretionary methods under which buyers and sellers can interact and agree to the terms of a trade," on the other hand.

Indeed, the affirmative actions independently taken by each particular wallet holder – including the choice of which decentralized application to access, which transactions in which to engage and which digital asset to access – instead of the wallet company's or open source technology's activities, would be "the" cause of the bringing together of buyers and sellers of securities using "trading interest."

While we acknowledge that it may be foreseeable that some wallet holders may want to access decentralized applications to engage in DeFi, other wallet holders may want to access NFTs, among various other possibilities.

As such, what is *unforeseeable* – from the perspective of the wallet company (among others) – is which decentralized application, which transaction and which digital asset a given wallet holder will elect to access. We believe that the unforeseeability of a given wallet holder's affirmative actions at any one time may be analogized to a superseding cause that breaks proximate causation – meaning that the wallet company's passive actions would be separate from any arguable mechanism of exchange between a "group of persons."

Yet, even if the wallet company's platform or the open source technology were to be regulated as a national securities exchange or an ATS, questions remain about how either such party would satisfy the requirements of being either a national securities exchange or an ATS, including, for example, diligence requirements. Moreover, with the amended definition's inclusion of generally passive activity by "groups of persons," with no requirement of contractual privity, otherwise concerted activity or even necessarily direct knowledge of the activities of others, it would seem very challenging to determine at which point inclusion of a party in such "group of persons" goes too far.

Beyond the legal questions and uncertainty potentially raised by the Commission's adoption, in its current form, of the proposed expanded definition of "exchange," we believe that the amended definition would cause within the market significant commercial uncertainty.

For example, market participants may be unsure whether their entrance into certain business relationships with other market participants, or even steps taken to enable technological upgrades or access to open-source technology, could expose them or their investors to undue and previously unenvisioned risks.

Similarly, the ability to satisfy due diligence requirements concerning potential business partners or transactions, or the ability to provide accurate and complete representations, disclosures or opinions may be unduly hampered by the broadened definition and its inclusion of more passive activities and unspecified groups of people. Business plans and technological innovations may need to be rethought and potentially abandoned.

While we understand that the securities law analyses necessarily are facts-and circumstances-specific and principles-based, we believe that the broadly expanded definition creates additional ambiguity, and may result in potentially unduly burdensome compliance obligations, concerning when a securities law violation may exist, as well as what steps may be taken to avoid any such violation.

We fully appreciate the gravity and importance of protecting investors, and the rapid advancements in technology and the proliferation of many new types of digital assets and activities that, in the Commission's view, are likely to constitute securities or transactions in securities. Nevertheless, we believe that the proposed amendments, in the current, broad form, are likely to lead to significant market and legal uncertainty.

While we understand the potential challenges in doing so, we would greatly appreciate any efforts by the Commission to develop a more clearly articulated standard addressing whether and, if so, when technologies of the types described in this Letter are intended by the Commission to be deemed to be exchanges or mechanisms of exchanges, in order to enable securities lawyers to provide clear guidance to their clients.[7]

Thank you for this opportunity to provide our response concerning the proposed amendments. If the Commission would find it helpful and appropriate, we would welcome the ability to share additional thoughts and feedback.

Very truly yours,

/s/ Doug Davison /s/ Joshua Ashley Klayman /s/ Erika Cabo

[7] We acknowledge that, given the broad application to many business types, industries and activities of the proposed expanded definition of exchange, it may be difficult to provide precise replacement language suggestions that would be appropriate across-the-board. Nevertheless, set forth below, for the Commission's consideration and for discussion, are a few potential ideas with respect to the proposed amendments to Rule 3b-16:

(i) the Commission could refer to "directly" making available established non-discretionary methods (whether by providing a trading facility or "communication protocols", or by setting rules) under which buyers and sellers can interact and agree to the terms of a trade; or

(ii) indicate that the groups of people contemplated are in contractual privity with one another; or

(iii) provide a carve-out for intervening activities of a user or other third party.