MEMORANDUM

To: Crypto Task Force Meeting Log
From: Crypto Task Force Staff
Re: Meeting with Jason Gottlieb, Andrew Hinkes, and J.W. Verret

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On February 24, 2025, Crypto Task Force Staff met with Jason Gottlieb, Andrew Hinkes, and J.W. Verret.

The topic discussed was approaches to addressing issues related to regulation of crypto assets. Jason Gottlieb, Andrew Hinkes, and J.W. Verret provided the attached documents, describing the issues discussed at the meeting.

An Analysis of Pending Cryptocurrency Regulatory Issues Facing the SEC

By Jason Gottlieb et al. (Morrison Cohen LLP); Andrew Hinkes (New York University School of Law, New York University Stern School of Business, Florida State University College of Law); and J.W. Verret (Associate Professor, GMU Scalia Law School)[1]

INTRODUCTION

This document identifies 16 areas where the SEC, through positions taken in litigation, in settled enforcement actions, or in guidance, have interpreted or added glosses to the securities laws specific to crypto or digital assets which may be revisited and clarified. The Commission could make clear that the prior Commission misconstrued or misinterpreted the law in these areas. Among the tools available to the SEC to adapt the federal securities laws to the technological innovations evolving in crypto or digital assets, the most readily available include:

1) An interpretive release at the Commission level to disclaim prior controversial legal arguments made by Commission staff that the Commission determines do not represent accurate statements of law, or involve circuit splits or disagreements among district courts, or items of interest to the Supreme Court where the SEC may help to clarify the state and continuing development of the federal securities laws;

2) Amicus briefs from the Office of the General Counsel for ongoing private securities litigation;

3) A highly adapted registration path for Securities Act offerings, modeled on past adaptions to the Securities and Exchange Acts, such as Reg AB for asset-backed securities or modeled on other adapted paths for variable annuities or for master limited partnerships;

4) An exempt offering framework modeled on Commissioner Peirce's safe harbor proposal, the Reg X Exempt Offering Proposal, or the Reg X Safe Harbor Proposal. Such a path can be built using exemptive authority available pursuant to Securities Act Section 4(2) such that the crypto exemptive rule can obtain the benefit of NSMIA enabled preemption of state blue sky law;

5) A memorandum of understanding negotiated between the SEC and the CFTC;

6) Closing letters or declination letters issued to parties currently subject to investigation, to indicate to those parties that those investigations are concluded.

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[1] The authors write in their individual capacities only; institutional affiliations are for informational purposes.

This document is made available to the Commission as a starting point for consideration to develop an interpretive release from the Commission, to inform the GC's amicus program, and to catalyze efforts to use the other tools in appropriate ways (such as to begin the process of a companion SEC exemptive rule under Section 4(2)). As ancillary issues arise in the analysis below that may be addressed by the other tools, we flag them below. This memo, however, principally focuses on supportive analysis to assist the Commission in development of Tool #1, an interpretive release.

ISSUES AND ANALYSIS

1. Digital assets alone cannot be investment contracts.

- **SEC Position:** Starting with the "Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO" (Rel. No. 81207, July 25, 2017) (the "DAO Report"), the SEC has asserted that digital assets themselves are securities because they are used in the context of technology systems that may or may not allow users to engage in certain transactions that may appear similar to, or may appear to qualify as securities transactions. In the DAO Report, at page 1, the SEC concludes that "…that DAO Tokens are securities under the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act"). Likewise, the SEC asserts in the DAO Report (at page 5) that "A DAO Token granted the DAO Token holder certain voting and ownership rights." This practice of labeling the digital asset itself as a security has continued to date with minor adjustments in certain matters like *In the Matter of Galois Capital Management*, Investment Advisors Act of 1940, Re. No. 6670 (Sept. 3. 2024) ("*Galois*"), wherein the SEC asserted that implicated digital assets may be alternatively "crypto asset securities" and "crypto assets that were offered and sold as securities." Likewise, the SEC recently clarified that its prior use of the phrase "crypto asset securities" when referring to digital assets, was not intended to be understood as the SEC referring to the "crypto asset itself as the security." *SEC v Binance Holdings Limited,* 23-cv-01599-ABJ-ZMF (D.C. Cir. 2024), SEC's Memorandum of Law in Support of Motion for Leave to Amend the Complaint, ECF 273-1 n.6. Despite this claim, the practice of the SEC alleging that digital assets are themselves securities continues, leading to continued pushback from district courts, *see, e.g.*, *SEC v. Payward*, 23-cv-6003 (N.D. Cal. Jan. 24, 2025) (ECF 126 at 2 n.1) ("I will not entertain any theory of liability where the SEC asks this court to treat the crypto assets themselves as though they are securities.").

- **Alternative Proposed Approach:** The SEC should recognize that, as a matter of law, a mere technical act on a technology system, such as obtaining or controlling a digital asset, in the absence of any positive law recognizing that act as legally significant, has no legal significance and cannot create legal rights or obligations. For a digital asset itself to confer, carry or provide any legal rights or have any legal significance, there must some positive law conferring legal significance on that asset. A mere technical act on a technology system, such as obtaining or controlling a digital asset, in the absence of any positive law recognizing that act as legally significant, cannot create legal rights or obligations.

The federal securities laws, along with other positive law, require legal parties to engage in acts recognized by positive law as creating legal rights and obligations to create a security. Although there are 35 different enumerated security types found in 15 U.S.C. §77(b)(a)(1), each security is a legal right in a thing, a legal right to a thing, or a legal right against a thing. The tests used to determine if a given asset or transaction qualifies as a security or an issuance of a security rely upon a multiplicity of factors including acts and communications between parties. *See, e.g.*, *SEC v. W.J. Howey Co*., 328 U.S. 293 (1946) (requiring a court to analyze communications between buyer and seller to determine if the thing sold is a security). Securities cannot be created without legal parties performing the acts required to trigger the positive law that creates a security.

Merely using a technology function to surrender technical control of one asset via a computer system and to receive control of another asset via that same computer system is only legally significant if the operation or action itself is recognized as such by positive law. In the context of digital asset issuances and transactions, the SEC has broadly conflated the digital asset itself with extrinsic acts and communications between transacting parties to assert that the asset itself is a security. The SEC should decline to continue this practice and clarify that while various factors, acts and communications between legal actors may give rise to a transaction in a security, a digital asset itself is not a security unless some positive law recognizes that the digital asset is a security or that the digital asset somehow embodies or carries with it the characteristics of a security.

2. <u>Extraterritoriality (with respect to U.S. purchasers)</u>

- ❖ **SEC Position:** The SEC has refused to issue clear guidance on when, in the agency's view, an offer or sale crosses the line into a "domestic transaction" under *Morrison* and its progeny. In late 2019, the SEC sued – and settled with – Block.one after the company launched the EOS.IO website, where issuers could offer and sell ERC-20 tokens. The SEC acknowledged that Block.one had blocked U.S.-based IP addresses from accessing the EOS.IO website, required all token purchasers to agree to an agreement that, in part, provided that U.S. purchasers were prohibited and any purchase by a U.S. person was unlawful and null and void. Nonetheless, the SEC determined that Block.one offered and sold securities in domestic transactions because Block.one did not "ascertain from purchasers whether they were in fact U.S.-based persons," "a number of U.S.-based persons purchased . . . Tokens directly through the EOS.IO Website," "participated in blockchain conferences in the U.S., including a prominent conference held in New York City ... to promote Block.one," "Block.one advertised EOSIO on a large billboard in Times Square," and because Block.one's statements and sites were "viewable by U.S. persons." *In the Matter of Block.one*, Securities Act Rel. No. 10714 (Sept. 30, 2019).

- ❖ **Alternative Proposed Approach:** Beyond reference to the specific facts outlined in the Block.one settlement, parties have no guidance on what facts and circumstances may suffice for the SEC's determination that digital assets are offered or sold in domestic transactions. The SEC should clarify that, at a minimum, where a platform discloses and implements measures to limit U.S. purchasers, those measures shall weigh against a

determination that the platform is offering or selling digital assets in domestic transactions. The SEC should also reaffirm that the availability of digital assets on generally available web pages, including discussion on social media platforms that are generally available in the United States does not change the otherwise applicable standard under *Morrison* or create jurisdiction under an "offering" theory. The SEC should support, via amicus briefs and otherwise, reasoning like that contained in the district court dismissal of the *Anderson v. Binance* class action matter (later reversed by the Second Circuit, with certiorari denied by the Supreme Court) appreciating that transactions that settle on blockchains, like the Ethereum blockchain, do not occur in the U.S. merely because validators on that blockchain may utilize Amazon services or technology assets physically located in the United States. *See, e.g.*, Brief of the Crypto Counsel for Innovation as Amicus Curiae in Support of Petition for Certiorari, *Binance v. Anderson*, No. 24-336, filed October 25, 2024 (available at https://media.cryptoforinnovation.org/2024/10/CCI-Supreme-Court-Amicus-Brief.pdf).

3. **Staking as a Service**

- **SEC Position:** In a series of settlements and enforcement actions, the SEC has prosecuted its position that software developers offering staking as a service violate the securities laws. First, in February 2023, the SEC announced that it had charged Payward Ventures and Payward Trading (d/b/a "Kraken") with the offer and sale of unregistered securities, and had settled those same charges for $30 million, on the basis that its staking services constituted the offer and sale of investment contract securities. *See Kraken to Discontinue Unregistered Offer and Sale of Crypto Asset Staking-As-A-Service Program and Pay $30 Million to Settle SEC Charges*, Press Release Announcing Action, https://www.sec.gov/news/press-release/2023-25. In June 2023, the SEC brought materially similar charges against Coinbase. One year later, the SEC sued Consensys, in part based on the theory that MetaMask's staking service constituted the offer and sale of unregistered securities and, moreover, that Consensys was acting as an unregistered broker of security transactions by providing such service. In each of these actions, the SEC has rested its position on the basis that the staking services are pooling user assets on the promise of pro rata returns based on their managerial activities. Indeed, outside of specific cases, SEC Chair Gary Gensler has publicly argued that that staking-as-a-service is directly analogous to other investment contracts subject to the securities laws, based in part on the suggestion that it is unclear whether the service providers are in fact staking users' delegated assets. *See Office Hours with Gary Gensler: Staking-as-a-Service* https://www.sec.gov/newsroom/videos/office-hours-gary-gensler-staking-service.

- **Alternative Proposed Approach:** While staking services may, on the surface, appear to offer users in-kind "profits," staking is readily distinguished from investment contracts subject to the securities laws because staking is, first and foremost, a function designed to secure Proof-of-Stake blockchain networks. This function is not akin to an investment of money in an enterprise – it is a constitutive aspect of the network itself. Its closet analogue to the ordinary person's financial life is that of a security deposit. Moreover, where the networks through which users stake their assets are sufficiently decentralized across

validator nodes, users who choose to stake their digital assets cannot be said to be expecting profits based on the efforts of others as contemplated by the *Howey* test.

The "efforts of others" element of *Howey* requires some update here. While the "common enterprise" element of the *Howey* test has enjoyed some flexibility from multiple courts, with a bifurcation of that concept into "vertical commonality" and "horizontal commonality," this sort of flexibility is not appropriate for the "efforts of others" element of *Howey*. Further, the "efforts of others" element of the Howey test began its life more strictly – as "*solely* the efforts of others" – and strong precedent describes those "others" as essentially the promoter of the investment scheme. We are a long way from that initial formula, as the SEC has alleged that remote, unaffiliated members of a crypto asset community (which may have no central promotor or corporate affiliate anyway due to its decentralized character) made statements supporting a particular investment that SEC enforcement is willing to quote as evidence to erroneously support the "efforts of others" element of the *Howey* test.

- **Commissioner Peirce Commentary:** *Kraken Down: Statement on SEC v. Payward Ventures, Inc., et al.*, https://www.sec.gov/newsroom/speeches-statements/peirce-statement-kraken-020923#_ftnref2.

4. Allegations Against Exchanges Based on Secondary Market Transactions

- **SEC Position:** Beginning with its case against Zachary Coburn (EtherDelta) and continuing to the present day with its cases against Coinbase, Kraken, and Binance, the SEC has maintained that secondary market exchanges violate Section 5 of the Exchange Act by offering and selling unregistered securities. In some of these actions, such as the action against Coburn, the SEC has not identified which digital assets are believed to be unregistered securities, let alone explain how the secondary market sale of those assets constitutes an investment contract. *See In re Matter of Zachary Coburn*, Securities Act Rel. No. 84553 at ¶ 13 (Nov. 8, 2018) ("EtherDelta") (alleging that EtherDelta made over 500 different digital assets available for trading). *See also Tokenlot* at ¶ 2 (alleging that Respondents "handled more than 200 different digital tokens in connection with both initial coin offerings … and TokenLot's secondary market activities.").

In other, more recent cases, the SEC has alleged that specific cryptocurrencies constitute securities, without having any judicial finding that the particular tokens themselves were securities, or were used in any securities transactions, and without directly bringing actions against the creators of those specific cryptocurrencies. However, not all courts have embraced the agency's view that secondary market transactions on the target exchanges constitute investment contract transactions. Indeed, when the SEC's theory was tested in its case against Ripple Labs, Judge Torres held that such transactions in fact do not constitute securities transactions because the purchasers "could not have known if their payments of money went to Ripple, or any other seller of XRP." *SEC v. Ripple Labs, Inc.*, 682 F. Supp. 3d 308, 328 (S.D.N.Y.). *But see SEC v. Coinbase, Inc.,* 726 F. Supp. 3d 260, 293 (S.D.N.Y. 2024) ("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.").

- ❖ **Alternative Proposed Approach:** Absent indicia that secondary market transactions are designed to reach otherwise prohibited counterparties to securities transactions, or that an issuer was reasonably understood to benefit directly from the sales on such platforms, secondary market digital asset exchanges should not be held liable for the sale of unregistered securities for merely facilitating blind bid/ask transactions where there is no privity between the purchaser and the issuer (and therefore no reasonable expectation that the transaction will generate profits for the project). The SEC may disagree with *Ripple*, but it is currently the sole post-Motion to Dismiss ruling on this subject, and the SEC should write an interpretive release adopting the secondary market reasoning in *Ripple*.

- ❖ **Commissioner Peirce Commentary:** *Statement Regarding Denial of Petition for Rulemaking* (Peirce & Uyeda Joint Statement), https://www.sec.gov/newsroom/speeches-statements/peirce-uyeda-petition-121523.

5. <u>Broker/Dealer Regulation</u>

- ❖ **SEC Position:** In late 2018, the SEC brought and settled charges against TokenLot, alleging that, in part, by allowing users to participate in ICO and secondary market digital asset transactions on www.tokenlot.com, TokenLot (and individual defendants) were liable for effectuating unregistered securities transactions in violation of Section 15(a) of the Exchange Act (as well as Section 5 of the Securities Act). *In the Matter of Tokenlot, LLC, Lenny Kugel, and Eli L. Lewitt*, Exchange Act Rel. No. 84075 ("TokenLot"). Almost one year after TokenLot, the SEC sued ICOBox and Nikolay Evdokimov on a similar theory – that they were acting as unregistered brokers of securities transactions by enabling participation in cryptocurrency ICOs. A judge in the United States District Court for the Central District of California entered default judgment against ICOBox and Evdokimov and ordered penalties of more than $16 million. *SEC v. ICOBox*, No. CV-19-8066 (DSF), ECF 16 (C.D. Cal. March 5, 2020). These unregistered broker allegations have continued in the exchange cases (see above).

  The SEC has likewise brought actions alleging digital asset platforms have violated the securities laws by acting as unregistered dealers. For example, in March 2024, the SEC unveiled charges against and settlement terms with ShapeShift AG. According to the SEC, Shapeshift had unlawfully purchased and sold digital asset securities with user counterparty's, thus acting as an unregistered dealer. *In the Matter of ShapeShift AG*, Securities Act Rel. No. 99676 (March 5, 2024) ("ShapeShift"). While the settlement order indicated that ShapeShift offered at least 79 distinct digital assets on its platform, the SEC failed to articulate which of those "were offered and sold as investment contract and, therefore, securities." *Id*.

- ❖ **Alternative Proposed Approach:** The key defect in the SEC's approach to charging digital platforms with brokering or dealing in unregistered securities is that those platforms

have been kept in the dark about when and why any given particular digital asset may be deemed an investment contract. If an application allows users to purchase or sell 100 different digital assets, it has no meaningful way to measure the attendant regulatory risk, or, critically, what measures it could take to mitigate the SEC's potential charges. In other words, the "fair warning" problem for individual projects is exacerbated in the context of applications that interact with dozens if not hundreds of those same projects. Making matters worse, according to the SEC's interpretation of the *Howey* test, and the "efforts of others" prong in particular, a party's efforts to analyze and/or curate the assets available for transactions may be probative of brokering activity, creating a dilemma that disincentivizes the exact kind of risk management that could protect the public. The SEC should provide clarity via interpretive release that an entity or actor that does not have custody over digital assets cannot be an exchange or broker. (And the SEC reasoning should guard against an erroneous interpretation that the mere ability to amend smart contract code constitutes custody of tokens interacting with that smart contract code.) The SEC should also adopt a new form of SPBD license that expressly allows SPBDs to deal in digital assets that are not securities along with securities.

- ❖ **Commissioner Peirce Commentary:** *On Today's Episode of As the Crypto World Turns: Statement on ShapeShift AG* (Peirce & Uyeda Joint Statement), https://www.sec.gov/newsroom/speeches-statements/peirce-uyeda-statement-crypto-world-turns-03-06-24.

6. Allegations Against Third Party Tokens

- ❖ **SEC Position:** In bringing its numerous enforcement actions against centralized exchanges and platforms such as Coinbase, Kraken, and Cumberland alleging that they resemble traditional securities intermediaries, the SEC has alleged that the sale of certain digital assets traded on those exchanges and platforms constitute securities transactions (*i.e.* the predicate transactions for the SEC's claims against the named defendants). The allegations against these targets are varied, but consistently include claims that the relevant platform has operated as an unregistered broker, exchange, or clearing agency. For example, beginning with *SEC v. Wahi*, as part of its complaint against Coinbase executives, the SEC separately alleged that nine specified tokens were securities. *See* Case No. 2:22-cv-01009, ECF 1 ¶¶ 89-206 (W.D. Wa. July 21, 2022). Subsequent cases followed this strategy with the SEC alleging in its *Coinbase* complaint that thirteen additional tokens are also securities. *See also SEC v. Coinbase, et al*., No. 23-cv-4738, ECF 1 ¶¶ 127-305 (S.D.N.Y. June 6, 2023). (S.D.N.Y. June 6, 2023); *SEC v. Payward Ventures* (d/b/a Kraken), No. 23-cv-588, ECF 1 (N.D. Ca. Feb. 9, 2023); *SEC v. Cumberland DRW LLC*, No. 24-cv-9842, ECF 1 (N.D. Il. Oct. 10, 2024); *SEC v. Rari Capital et al*., No. 2:24-cv-7967, ECF 12 (Final Judgment) (C.D. Ca. Sept. 18, 2024).

  Taking these cases and settlements as a whole, the SEC has alleged in federal courts that the following tokens "are" securities: ADA, ALGO, AMP, ATOM, AXS, CHZ, COTI, DASH, DDX, DFX, FIL, FLOW, FTM, ICP, KROM, LCX, LINK, MANA, MATIC,

NEAR, NEXO, OMG, POL, POWR, RGT, RLY, SAND, SOL, VGX, and XYO. None of the projects associated with these tokens were named as defendants and thus none were given an opportunity to dissuade the SEC from taking the position that their digital assets were securities before the SEC filed these complaints, and many of these projects were prejudiced by the SEC's surprise declarations of their status.

The negative effects of the above approach are multiple: token projects are not afforded fair warning or the ability to explain to the SEC why their projects should not be considered securities; those same projects incur hundreds of thousands of dollars (at least) in legal fees responding to subpoenas that, again, do not allow those projects to explain their businesses in full; and all the while, venture funds and founders alike are left wondering how courts are going to make sense of the SEC's scattershot approach, chilling innovation.

- ❖ **Alternative Proposed Approach:** The SEC should not allege the centralized exchanges or platforms are offering or selling unregistered securities without having first established that the underlying digital assets constitute securities. Under the current strategy, tokens are left to defend their regulatory status through procedurally complex interventions (as opposed to direct litigation). Likewise, the SEC should not leave centralized exchanges guessing as to which offered projects and/or services constitute, in the SEC's eyes, securities transactions and should not require centralized exchanges to defend the securities status of third party marketed and issued assets. The SEC should expressly repudiate the practice of suing third parties for securities violations on the basis that the third party violated the securities laws by allowing others to trade or sell an asset that has not been offered as a security or previously determined to be a security or to have violated Section 5 by not being registered as a security or otherwise exempted from the registration requirement. The SEC should adopt a path to compliant issuance of digital assets without those assets being deemed securities which may include adoption in whole or in part of Commissioner Peirce's proposed Token Safe Harbor, Token Safe Harbor 2.0, the LeXpunK Reg X, and or Reg X Safe Harbor proposals. Any such path should include a relaxation of the requirements of Rule 12-g of the Exchange Act to the extent that the path suggests that token issuances should be conducted as exempted private placements of securities so that any token issuance of scale would not be required to register as a public issuance and become subject to currently existing reporting and disclosure requirements.

- ❖ **Commissioner Peirce Commentary:** *Kraken Down: Statement on SEC v. Payward Ventures, Inc., et al.*, https://www.sec.gov/newsroom/speeches-statements/peirce-statement-kraken-020923#_ftnref2.

7. Non-Custodial Services

- ❖ **SEC Position:** Non-custodial services can come in many types. As an example, a non-custodial wallet is software that gives a user full control over their private keys, and thus

leaves the user with complete control over their digital assets. In its Complaint against Coinbase, the SEC alleged that Coinbase acted as an unregistered broker-dealer by offering Coinbase Wallet, which was advertised as "bring[ing] the expansive world of DEX trading to your fingertips, where you can easily swap thousands of tokens..." *See SEC v. Coinbase*, No. 23-cv-04738, ECF 1 ¶ 82 (S.D.N.Y. June 6, 2023). In its Motion for Judgment on the Pleadings, Coinbase argued that "Wallet is just passive software—in the form of a mobile application or browser extension—that allows customers to store the private keys for their own digital assets on their own computers or mobile devices." *See SEC v. Coinbase*, No. 23-cv-04738, ECF 22 at 174 (S.D.N.Y. August 4, 2023). Ultimately, the court sided with Coinbase and dismissed claims pertaining to Coinbase Wallet, finding 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." *SEC v. Coinbase*, Inc., 726 F. Supp. 3d 260, 305 (S.D.N.Y. 2024). The court emphasized that although Coinbase earned fees in connection with users' Wallet activity, "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." *Id*. Accordingly, the court dismissed the SEC's claim premised on the position that Coinbase was acting as an unregistered broker through its Wallet application.

Undeterred by the court's rejection of its position in *Coinbase*, the SEC sued Consensys in June 2024, in part based on the position that by offering MetaMask (the self-custodial wallet Consensys developed), Consensys was acting as an unregistered broker facilitating securities transactions, including swaps. *SEC v. Consensys Software Inc.*, Case No. 1:24-cv-04578, ECF 1 (June 28, 2024) (E.D.N.Y.).

- **Alternative Proposed Approach:** Fundamentally, non-custodial services are merely technology infrastructure, and should not be regulated by the SEC. The SEC should respect the innovation non-custodial services represent, namely, the ability for users to self-custody their digital assets, and swap them for others, without the role or advice of third-party intermediaries. Accordingly, absent evidence that a third party plays some integral or necessary role in the effectuation of digital asset transactions, the SEC should presume that such software does not transform its developer into an unregistered broker (or other registered agent).

- **Commissioner Peirce Commentary:** *Statement Regarding Denial of Petition for Rulemaking*, https://www.sec.gov/newsroom/speeches-statements/peirce-uyeda-petition-121523.

8. SEC Custody Rules

- **SEC Position:** Exchange Act Rule 15c3-3 and Investment Advisers Act Rule 206(4)-2 impose restrictions concerning how investment advisors should custody client funds. Under these rules, assets must be kept with "qualified custodians" which are usually banks or broker dealers. In *Galois*, the court declared that Galois Capital Management violated Rule 206(4)-2 when it held client funds in crypto platforms such as FTX, which was deemed not to be a qualified custodian. This case represented a novel application of Rule 206(4)-2, which has ambiguous guidance, to the digital assets space.

- **Alternative Proposed Approach:** The SEC should adopt guidance with realistic standards concerning the definition of "qualified custodian" as it pertains to digital assets under the Investment Advisors Act. New digital assets-focused institutions may be more suitable custodians, and historically qualified custodians such as banks and broker dealers may not be equipped to safekeep digital assets, especially as this class of assets continues to expand into nontraditional formats such as NFTs. Further, some assets may be self-custodied, or enjoy shared custody, fitting into neither of these rules. Accordingly, further guidance is needed that identifies parameters under which certain "crypto-native" platforms that meet designated criteria may be considered qualified custodians. The SEC may wish to revisit its statement in response to the letter sent by Two Ocean (https://www.sec.gov/newsroom/speeches-statements/statement-im-finhub-wyoming-nal-custody-digital-assets) and confirm through an interpretive release the types of state and federally chartered entities that can provide qualified custody and the requirements imposed upon those entities.

9. Integration of SAFTs and Future Distributions

- **SEC Position:** A Simple Agreement for Future Tokens ("SAFT") provides an avenue for digital asset projects to raise funds while developing their products, including before the launch of the underlying token. It is likely that SAFTs, if offered to raise funds for an ongoing business enterprise, would be treated as an investment contract. However, in *SEC v. Kik Interactive*, No. 19-cv-5244, ECF 1 (S.D.N.Y. June 4, 2019), and *SEC v. Telegram Group Inc. and TON Issuer Inc*, No. 19-cv-9439, ECF 1 (S.D.N.Y. Oct. 11, 2019), the SEC took the position that not only were the SAFTs securities, but also that later token disbursements and sales pursuant to such agreements would be considered the sale of unregistered securities. In this manner, the SEC has conflated the SAFTs (the investment contract) with the actual disbursement of tokens pursuant to such SAFTs (the object of the investment contract, but not embodying the "security-ness" of the SAFT), as well as the public, secondary market transactions of such tokens on exchanges.

- **Alternative Proposed Approach:** The SEC should not collapse the distinctions between compliant private sales of token interests in the form of SAFTs, later distributions of tokens

to SAFT holders once the blockchain technology was developed and deployed, and separate, secondary market transactions of tokens. The expectations (and backgrounds) of the purchasers at each stage vary considerably, and without evidence that they are similarly situated, the SEC should decline to presume that these categories of transactions can be lumped together.

❖ **Commissioner Peirce Commentary:** *Not Braking and Breaking: Speech at Singapore Blockchain Week*, https://www.sec.gov/newsroom/speeches-statements/peirce-not-braking-breaking-2020-07-21.

10. Airdrops

❖ **SEC Position:** An "airdrop" is the process by which a digital assets project sends free tokens to a (typically large) number of recipient wallets. Airdrops are most often used as a promotional method for new projects to gain awareness and to encourage participation in the project's ecosystem. Since airdrops do not involve an investment of money and do not entail any continuing promises by the issuer (or recipient), airdrops would appear to be outside the purview of the *Howey* test. However, in *In the Matter of Tomahawk Exploration LLC, et al.,* Securities Act Rel. No. 10530 (Aug. 14, 2018) ("Tomahawk"), the SEC declared that Tomahawk's release of 80,000 TOM tokens through a "Bounty Program" (i.e., airdrop), constituted an offer and sale of securities because TOM was provided to investors in exchange for services that increased TOM's value and fostered a trading market for the token. In the aftermath of *Tomahawk*, projects based in the United States or sending tokens to U.S. persons have operated without regulatory certainty. The SEC later brought an action in September 2022, *SEC v. The Hydrogen Technology Corporation, et al*., No. 22-cv-8284 (S.D.N.Y.), alleging that alleges that Hydro tokens were distributed through an airdrop, among other means.

In March 2024, the DeFi Education Fund filed a pre-enforcement lawsuit seeking a declaratory judgment that its BEBA tokens are not investment contracts and that its airdrops of the same do not constitute an unlawful sale of securities, as well as a declaration that the SEC's regulation-by-enforcement of airdrops has violated the APA. *See Beba LLC and DeFi Education Fund v. SEC*, Case No. 6:24-cv-153, ECF 1 (W.D. Tex. March 25, 2024).

❖ **Alternative Proposed Approach:** Airdrops should not be considered an offer and sale of securities primarily because there is no "investment of money" and no ongoing promises or obligations between the parties. While the SEC has argued that many recipients of airdrops invest in other ways, such as by offering services designed to foster the token's trading community, such services do not, without more, constitute an investment of money because there is no limiting principle setting the outer bounds of this potential rule. Additionally, many airdrops are distributed at random as the result of a simple sign-up

process and do not implicate the exchange of services. Likewise, many airdrops are awarded based upon past conduct by recipients that is not directly related to a particular project, and/or that may have pre-dated the existence of the project. Accordingly, airdrops do not satisfy the "investment of money" prong under *Howey*, and do not even implicate the purpose of the Howey test (protecting investors from investing money into an enterprise, which they are not doing in an airdrop), airdrops should not be considered sales of securities. The SEC should clarify the "investment of money" prong of the Howey analysis in the context of airdrops via an interpretive release.

11. DAOs

- **SEC Position:** Beginning in 2017 with the "Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO" (Re. No. 81207, July 25, 2017) (the "DAO Report"), the SEC treated a "DAO" (a so-called "decentralized autonomous organization") as a business organization capable of being a common enterprise for the purposes of the *Howey* test. Some may be. But the DAO Report, while noting that the "DAO Token holders' pseudonymity and dispersion diluted their control over The DAO," concluded that "DAO Token holders relied on the significant managerial efforts provided by Slock.it and its co-founders" – without defining the parameters of "significant managerial control."

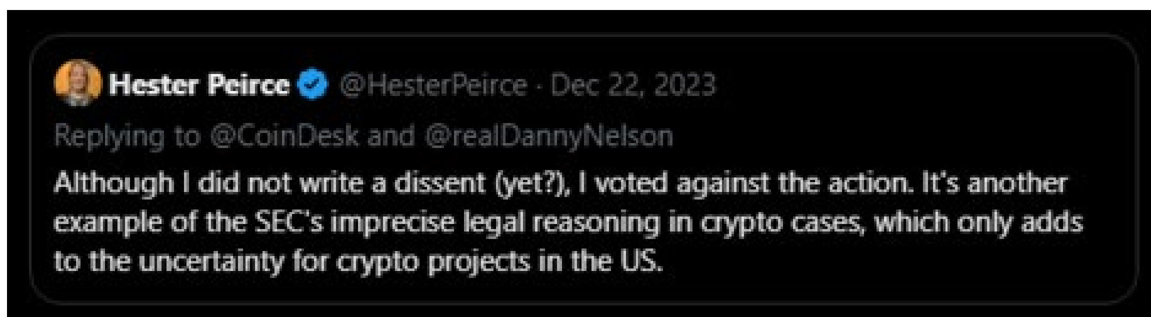
  The SEC continued this trend four years later, with *In the Matter Blockchain Credit Partners, d/b/a DeFi Money Market, Gregory Keough, and Derek Acree*, Securities Act Rel. No. 10961 (Aug. 6. 2021), where SEC stated that because a DAO constitutes a "business enterprise," its offer of digital asset tokens could be an deemed an offering of unregistered investment contracts or securities due to the "entrepreneurial or managerial efforts of others." *Id*. ¶ 45-54; *see SEC v. W.J. Howey Co*., 328 U.S. 293, 301 (1946). In *In the Matter of Barnbridge Dao*, Securities Act. Rel. No. 11262 (Dec. 22, 2023) ("Barnbridge"), the SEC declared that the Barnbridge DAO sold unregistered securities in the form of its Smart Yield bonds, and also that the Smart Yield Pools were themselves unregistered investment companies. *Id*. ¶¶ 28-35. Underpinning both declarations was the SEC's assessment that Barnbridge, led by Tyler Ward and Troy Murray, heavily advertised both the Smart Yield products and Pools as investment opportunities with high rates of return that would be developed and managed by the Barnbridge DAO, which "authorized the core team to conduct certain of its operations through BarnBridge DAO's multi-signature address." *Id*. ¶¶ 1-8.

  Most recently, as part of the SEC's ETH 2.0 investigation, the SEC served numerous subpoenas on various members of the Ethereum developer community, and even Wells Notices to some players in the space, concerning an investigation into whether ETH (after Ethereum's move to a proof-of-stake chain in 2022) was a security because of the efforts of its widely dispersed and decentralized developer community. *See generally*, *Consensys*

Software Inc., v. Gary Gensler, et al., No. 4:24-cv-00369, ECF 1 ¶¶ 72-76 (N.D. Tex. April 25, 2024). The SEC closed this investigation without action or comment, leaving the blockchain industry without any further guidance as to the SEC's views.

- **Alternative Proposed Approach:** The SEC should generally treat DAOs as nothing more than disparate groups of people. While some DAOs may have leadership or incentive structures, or may not be "fully" decentralized, many DAOs have no true central authorities, and are largely governed by self-executing smart contracts or widely dispersed communities without a clear common business purpose, any agreement to share profits or losses, any ability to admit or block new "members" or other hallmarks of corporate partnership. Such DAOs should not be considered to be undertaking efforts on which tokenholders rely for purposes of the *Howey* analysis. Before *SEC v. Glenn W. Turner Enter., Inc.,* 348 F. Supp. 766 (D. Or. 1972), the final prong of the *Howey* test required that the person expecting profits relied "solely" on the efforts of others. This requirement was relaxed in *Glen Turner*, and subsequently has been used by the SEC, for the most part, to address frauds. However, if the group of "others" are disparate or disconnected enough such that they could not coordinate a fraud together, that group should not qualify as the singular "promoter" or third party under *Howey*.

- **Commissioner Peirce Commentary:**



12. NFTs

- **SEC Position:** As background, NFTs are non-fungible digital assets recorded on a blockchain that allow people to authenticate ownership in a permissionless and public way. In three separate enforcement actions, the SEC has prosecuted NFT artists with violations of the Securities Act of 1933 for offering and selling NFTs as investment contract securities without registering with the SEC. *See In the Matter of Impact Theory, LLC*, Securities Act Rel. No. 11226 (Aug. 28, 2023) ("Impact Theory"); *In the Matter of Stoner Cats 2, LLC*, Securities Act Rel. No. 11233 (Sept. 13, 2023) ("Stoner Cats"); *In the Matter of Flyfish Club, LLC*, Securities Act Re. No. 11305 (Sept. 16, 2024) ("Flyfish Club"). In Impact Theory, Stoner Cats, and Flyfish Club, the SEC declared the Defendants offered and sold NFTs as unregistered securities on the basis that each company made public statements promoting the NFTs' value and their intended use of NFT sale proceeds, encouraging

secondary market sales (for which they received royalties). In all of these cases, the purchase of NFTs entailed no obligation by the seller to do anything whatsoever to increase the NFTs' value. Similarly, the NFTs in question did not plausibly constitute equity in any company or generate any dividend for the purchasers. Nonetheless the SEC alleged in each case that the purchasers were investing in the sellers.

Taking this position one step further, according to public reporting, the SEC has also served a Wells Notice on NFT marketplace OpenSea (which does not create or issue the NFTs offered on its platform), alleging that NFTs bought and sold on its platform are unregistered securities. *OpenSea receives Wells notice from SEC, regulator says NFTs are securities*, https://www.cnbc.com/2024/08/28/sec-issues-wells-notice-to-nft-marketplace-opensea.html (Aug. 28, 2024). Reports indicate that the SEC also recently issued a Wells Notice to another NFT project (@CyberKongz on X, (Dec. 16, 2024, 11:55 AM), https://x.com/CyberKongz/status/1868746903053127941).

The SEC's position with respect to NFT creators and exchanges has a chilling effect on artistic expression and technological innovation, and does not protect Americans who merely seek to participate in new forms of culture and commerce.

- **Alternative Proposed Approach:** While the manner and communications related to the offer and sale of NFTs may, under certain circumstances, implicate the securities laws, NFTs are not presumptively securities when they are offered or sold directly by creators or on digital asset exchanges (centralized or otherwise) and where such offers or sales involve no ongoing promise or commitment by the seller to generate profits for the purchasers. Instead, when NFTs reflects the same economic dynamics – *i.e.* demand and valuation – as art, physical collectibles, club memberships, or other consumer goods, the sale of NFTs does not constitute an investment contract and should not be regulated as securities. There must be something more, specifically, evidence that purchasers are motivated by "the prospects of a return" on investment due to the sellers' ongoing commitments, rather than the purchaser's "desire to use or consume the item purchased." *United Hous. Found. Inc. v. Forman*, 421 U.S. 837, 858 (1975). The SEC may include in interpretive release clarification that, despite abusive examples to the contrary in prior enforcement matters, the SEC will no longer use representations from disparate actors in an "ecosystem," who are not part of the development team, to meet the elements of a *Howey* analysis.

- **Commissioner Peirce Commentary:** *Collecting Enforcement Actions: Statement on Stoner Cats 2, LLC* (Peirce & Uyeda Joint Statement), https://www.sec.gov/newsroom/speeches-statements/peirce-uyeda-statement-stonercats-091323.

13. <u>Treating Loans as Security Notes</u>

- **SEC Position:** This position relates to the SEC's enforcement action concerning the Gemini Earn program, and settlements with BlockFi and Celsius. To take the Gemini example, Gemini Earn gave retail crypto investors the chance to loan their cryptocurrency

to the Gemini and receive a set rate of interest in return. Gemini then sent Gemini investors' loaned crypto assets to Genesis Global Capital, who in turn made larger loans to institutional borrowers. The SEC took the position that Gemini Earn constituted an offer and sale of securities under *Reves*, notwithstanding the fact that Gemini Earn users expressly entered into a loan agreement with the parties, expected nothing more than set interest in return, and the loans were callable on demand. Remarkably, when the Second Circuit invited the SEC to explain its approach to the distinction between lending arrangements and security transactions in a case that was on appeal at the same time, the SEC explicitly declined to do so. *See Kirschner v. JP Morgan Chase Bank, N.A.*, No. 21-2726, ECF 207 (2d Cir. July 18, 2023). While Genesis has since settled with the SEC on a "no admit / no deny" basis on March 18, 2024, the case against Gemini remains ongoing.

❖ **Alternative Proposed Approach:** In the absence of a secondary market, callable, cryptocurrency-based lending products, providing interest competitive with market rates, should be treated as routine loans outside the purview of the securities laws. As the case law under *Reves* is scattershot and all over the map, the SEC should afford clarity to the financial industry as a whole and clarify the difference between "notes" (which are defined as securities in the Securities Act) and loans (which are not).

14. Clarify that *Barnbridge* did not assert that ether, stablecoins or LP tokens are securities

❖ **SEC Position:** In *Barnbridge*, the SEC formally addressed decentralized finance (DeFi) protocols and DAOs, expressly holding that the pools that issued securities were unregistered investment companies, and treating all assets held in those pools – without differentiation – as securities. In concluding that the Pools operated by Barnbridge were unregistered investment companies, the SEC asserted that "[T]he *only* assets held in the SMART Yield Pools were investment securities, held for the purpose of generating the returns to pay SMART Yield Pool investors, and constituted more than [40%] of the value of each Pool's total assets" (emphasis added). This language suggests that, in the view of the SEC, every asset held in the Pool was an investment contract. Although the settlement order does not specifically list each asset held in the Pools, the order indicates that DAI was held in the Pools, and materials published on the Barnbridge website suggest that ether and certain liquidity provider tokens (LP Tokens) received from the Pools' deployment of assets in other DeFi protocols were also held in the Pools. Thus, the SEC seemed to be taking a broad view that certain stablecoins, ether, and LP Tokens are securities, without explaining its analysis in the Order.

❖ **Alternative Proposed Approach:** The lack of clarity on whether the SEC believes that stablecoins, ether and LP tokens are securities will continue to create uncertainty and thus elevated risk to users of those assets and users who wish to transact those assets. This uncertainty effectively tracks the uncertainty around the SEC's categorization of digital assets as the subject of securities transactions more generally, with implications for users

of DeFi protocols. The SEC should therefore clarify that in its settlement with Barnbridge it was not asserting that stablecoins, ether or LP tokens are securities.

- **Commissioner Peirce Commentary:** Although Commissioner Peirce did not dissent to enforcement against Barnbridge, she did post on Twitter the statement referenced above: "Although I did not write a dissent (yet?), I voted against the action. It's another example of the SEC's imprecise legal reasoning in crypto cases, which only adds to the uncertainty for crypto projects in the US." (https://x.com/HesterPeirce/status/1738381410908377150).

15. Security-Based Swaps

- **SEC Position:** Following passage of the Dodd-Frank Act in 2010, the SEC has promulgated a number of rules related to security-based swaps (https://www.sec.gov/newsroom/press-releases/2023-104) and security-based swap execution facilities (https://www.sec.gov/newsroom/press-releases/2023-230). Even before promulgating such rules, the SEC began targeting parties in the crypto space who, according to the SEC, offered or sale security-based swaps to U.S. persons who were not eligible, most notably the SEC's 2018 action against 1Pool and its CEO, Patrick Brunner. https://www.sec.gov/files/litigation/complaints/2018/comp24330.pdf. Without going to trial to test the SEC's theory, which did not necessarily turn on alleging that digital assets constituted securities underlying the alleged security-based swaps, 1Pool and Brunner settled with the SEC (and CFTC). All the while, because the SEC has taken an inconsistent approach to determining when and why digital asset projects may be offering or selling securities, those same projects cannot be sure that they will not be subject to a SEC enforcement action for offering or selling swaps based on those same digital assets.

- **Alternative Proposed Approach:** Absent clarity on when the offer or sale of digital assets (including swaps and derivatives based on cryptocurrencies or tokens) constitute securities transactions, there will continue to be a chilling effect on projects who fear that in lieu of clear rules, the crypto industry will continue to be subject to regulation by enforcement. This uncertainty effectively tracks the uncertainty around the SEC's categorization of digital assets as the subject of securities transactions more generally, with implications for developers of projects including DeFi front ends. The SEC should therefore clarify that in the digital assets context, security-based swap rules only apply in cases where the underlying asset is in fact a security – or yield to the CFTC scope of authority under the shared authority rubric of the Dodd-Frank Act. And the SEC should clarify how SEC swaps that pertain to offerings that relate to assets that obtain new crypto related exemptions apply to this jurisdictional overlap.

- **Commissioner Peirce Commentary:** Flexibility at the Expense of Clarity: Statement on Adoption of Exchange Act Rules 9j-1 and 15fh-4(c), https://www.sec.gov/newsroom/speeches-statements/peirce-statement-security-based-swaps-060723; Dissenting Statement on proposed Security-Based Swap Rules (Dec. 15, 2021), https://www.sec.gov/newsroom/speeches-statements/peirce-statement-proposed-security-based-swap-rules-121521

16. Digital Assets Clearing

- **SEC position**. The SEC has brought actions against Beaxy, Coinbase, Kraken, and Binance alleging that they acted as clearing agencies as defined in Section 3(a)(23)(A) of the Exchange Act without registration as a clearing agent in violation of the requirements of Section 17A(b) of the Exchange Act. In each of those actions, the SEC has alleged that the exchange defendant was engaged in clearing by, among other things, settling third party trades on their own set of records.

- **Alternative Proposed Approach**: More recently, in *Williams v. Binance*, the Second Circuit provided some insight on clearing and settlement in the context of cryptocurrencies, recognizing in other contexts not involving an intermediary maintaining its own set of records of user activity, that the blockchains themselves clear and settle transactions. The Court explained: "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." *Williams v. Binance*, 96 F.4th 129, 134 (2d Cir. 2024), *cert. denied sub nom*. *Binance v. Anderson*, No. 24-336, 2025 WL 76442 (U.S. Jan. 13, 2025).

  With blockchain settlement, the transaction information (including the transfer of ownership and payment) must be recorded on a blockchain and the trade is "settled" when a new block with transaction data is added to the blockchain, subject to blockchain -specific settlement practices. While centralized service providers may commingle User assets, treat User assets as fungible, or settle User transactions on their own platform or system, DeFi protocols generally are non-custodial and thus cannot and do not operate this way. The SEC should clarify that non-custodial systems or products that rely upon blockchain networks as opposed to internal recordkeeping to clear and settle third party transactions (*i.e.* most DeFi protocols and applications) are not engaged in clearing activities as defined in the Exchange Act and are not required to register as a clearing agency. The SEC must further ensure that any accommodation it develops to permit NMS registered exchanges to list crypto also addresses settlement and clearing rules such that withdrawal to user self-custody, in non-KYC'd wallets, is seamless and frictionless. Such an approach must respect the nature of crypto as a fundamentally self-custody centric, user-empowering asset.