THE SECURITIES AND EXCHANGE COMMISSION AND CRYPTOASSETS: A STUDY IN IRONY

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I. INTRODUCTION

The Securities and Exchange Commission (SEC) is an agency that prides itself on being dedicated to seeking full disclosure and transparency from those whom it regulates.[1] The SEC has an Office of Structured Disclosure,[2] which begins its explanation of the agency's focus with this statement: "Accessible and usable disclosures are central to the SEC's mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation."[3] In explaining how the SEC protects investors, the agency's website proudly proclaims that it requires "market participants to regularly disclose significant financial and other information so investors have the timely, accurate, and complete information they need . . . ."[4] This focus can perhaps be traced back to the timeless observation of Supreme Court Justice Louis Brandeis, that "sunlight is said to be the best of disinfectants."[5] But if all of these statements are accurate, should not the SEC live by the same principles that it applies to others?

At the same time that the SEC lauds the benefits of "[a]ccessible and usable" disclosures that are "timely, accurate, and complete,"[6] the SEC has embarked on an extended practice of selective and unpredictable enforcement actions seeking to impose various requirements on cryptoassets and businesses in the crypto space.[7] While repeatedly proclaiming that the "vast majority" of cryptoassets are securities,[8] and asserting confidently that the "law is clear . . . . most of these tokens are securities,"[9] the SEC's actions

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[1] *See Structured Disclosure at the SEC: History and Rulemaking,* SEC, https://www.sec.gov/page/osdhistoryandrulemaking [https://perma.cc/T3NS-TXKQ] (Aug. 11, 2023) [hereinafter SEC, *Structured Disclosure*].

[2] *See id.*

[3] *Id.*

[4] *What We Do*, SEC, https://www.sec.gov/about/what-we-do [https://perma.cc/QWX7-UH6Y] (Aug. 29, 2023) [hereinafter SEC, *What We Do*].

[5] *See* Andrew Berger, *Brandeis and the History of Transparency,* SUNLIGHT FOUND. (May 26, 2009, 10:47 AM), https://sunlightfoundation.com/2009/05/26/brandeis-and-the-history-of-transparency/ [https://perma.cc/43CQ-W9S4].

[6] SEC, *Structured Disclosure*, *supra* note 1.

[7] *See* Scott Nover, *The Head of the SEC Says Most Cryptocurrencies Are Operating Illegally*, QUARTZ (Sept. 8, 2022), https://qz.com/the-head-of-the-sec-says-most-cryptocurrencies-are-oper-1849513471 [https://perma.cc/WNR2-QRVQ].

[8] *See id.*

[9] Kevin Helms, *SEC Chair Gensler Insists Most Crypto Tokens Are Securities—Says 'the Law Is Clear'*, BITCOIN.COM (Oct. 4, 2022), https://news.bitcoin.com/sec-chair-gensler-insists-most-crypto-tokens-are-securities-says-the-law-is-clear/ [https://perma.cc/QD8T-WF9R] (quoting SEC Chair Gary Gensler as having stated, "[t]he law is clear on this. I believe based on the facts and circumstances, most of these tokens are securities.").

point very strongly to an opaque and confusing definition being applied inconsistently to an asset class that the securities laws were not designed to cover.[10]

This Article first examines, briefly, the framework of the U.S. securities laws, focusing on the long-standing definition of what constitutes a security, particularly in the context of investment contracts. The second section then considers how the SEC has said these rules should operate and be applied in the context of cryptoassets. The third section examines how the actions that have been taken by the SEC undermine and actually conflict with the public position of the agency as to the clarity of the law. This includes a consideration of the Framework for "Investment Contract" Analysis of Digital Assets[11] published by the agency in 2019 and updated in 2023, the ramifications of some of the most highly visible and recent SEC enforcement actions initiated in federal courts,[12] the lack of specificity in the Wells Notices sent to Coinbase,[13] and the persistent confusion over the appropriate classification of Ether.[14] The final substantive section of this Article suggests that while there is an important potential role for the SEC to play in the context of crypto regulation, additional clarity is essential. The conclusion advocates for legislative intervention.

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[10] *See, e.g.*, Nover, *supra* note 7.

[11] *Framework for "Investment Contract" Analysis of Digital Assets*, SEC, https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets [https://perma.cc/6T3X-8NTJ] (Mar. 8, 2023) [hereinafter SEC, *Framework*].

[12] *See infra* Part IV.B.

[13] *See infra* Part IV.C. A Wells Notice is "a notification from a regulator that it intends to recommend that enforcement proceedings be commenced against the prospective respondent. The notice references, in broad-strokes, the violation that the Staff believes has occurred." Mark Astarita, *Responding to a Wells Notice*, SECLAW.COM, https://seclaw.com/wells-notice-sec-finra-investigations/ [https://perma.cc/2NGZ-265Y].

[14] *See infra* Part IV.D. At one point, it appeared that the SEC did not believe that Ether was a security. *See* Anna Irrera, *U.S. SEC Official Says Ether Not a Security, Price Surges*, REUTERS (June 15, 2018, 2:44 PM), https://www.reuters.com/article/us-cryptocurrencies-ether/u-s-sec-official-says-ether-not-a-security-price-surges-idUSKBN1JA30Q [https://perma.cc/43G5-E93P] (quoting William Hinman, then-director of the SEC's Division of Corporation Finance, as having said that "based on [his] understanding of the present state of Ether, the Ethereum network and its decentralized structure, current offers and sales of Ether are not securities transactions."). This is no longer clear. *See* Maria Gracia Santillana Linares, *SEC Chairman Gary Gensler Implies That Ether Is a Security and Falls Under His Jurisdiction*, FORBES (June 27, 2022, 6:02 PM), https://www.forbes.com/sites/mariagraciasantillanalinares/2022/06/27/sec-chairman-gary-gensler-implies-that-ether-is-a-security-and-falls-under-his-jurisdiction/?sh=4e9878ac7775 [https://perma.cc/CYC7-3V8V]. In an April 2023 hearing before the House Financial Services Committee, SEC Chairman Gensler simply refused to clarify the status of this asset. Nikhilesh De, *SEC Chair Gensler Declines to Say if Ether Is a Security in Contentious Congressional Hearing*, YAHOO!FINANCE (Apr. 19, 2023), https://finance.yahoo.com/news/sec-chair-gensler-declines-ether-080521859.html [https://perma.cc/GK59-SHR6].

II. WHEN DO THE SECURITIES LAWS APPLY TO NOVEL ASSETS?

In considering when and how the federal securities laws apply to novel interests, like cryptoassets (which did not exist prior to 2009), it is important to keep in mind that there are actually a number of different federal statutes that constitute the "federal securities laws." For purposes of regulation of cryptoassets and transactions involving them, the two most important are the Securities Act of 1933[15] (the '33 Act) and the Securities Exchange Act of 1934[16] (the '34 Act). The '33 Act includes, among its provisions, a requirement that in order to offer or sell a security, it must first be registered with the SEC or the sale must comply with an exemption from registration.[17] The '34 Act not only imposes various on-going reporting obligations on issuers (and associated persons) that have a publicly registered class of securities,[18] but also regulates market participants such as securities exchanges[19] and broker-dealers.[20]

The requirements of both of these Acts are generally triggered only if the underlying assets are "securities," a term defined early in both statutes.[21] While the language of the two acts differs slightly, the U.S. Supreme Court has concluded that they are so alike that they should be construed in the same manner.[22] Both statutes use a definition of security which includes terms with specific, well-understood meanings, as well as words that are more elastic and possess less defined parameters.[23] For purposes of most cryptoassets,

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[15] The '33 Act is codified at 15 U.S.C. § 77a–77aa.

[16] The '34 Act is codified at 15 U.S.C. § 78a–78rr.

[17] *See* 15 U.S.C. § 77e(a), 77e(d). Section 5 of the '33 Act makes it illegal to sell or offer to sell any security unless it is registered or exempt from registration. *See id.* § 77e(a).

[18] *See id.* § 78m(a), 78p(a). For example, section 13 of the '34 Act requires periodic and other reports from issuers. *See id.* § 78m. As an example of reporting obligations of associated persons, see section 16 of the act, which imposes reporting obligations on directors, officers, and persons who own or control more than 10% of the registered shares. *See id.* § 78p(a).

[19] *See id.* § 78e. Section 5 of the '34 Act makes it unlawful for an exchange to affect any transaction in a security unless the exchange is registered or exempt. *Id.* This is codified at 15 U.S.C. § 78e.

[20] *See id.* § 78o, titled "Registration and Regulation of brokers and dealers." In addition, brokers and dealers (like exchanges) are prohibited from effecting a transaction in securities on an unregistered, non-exempt exchange. *See id.* § 78e, 78o(a).

[21] *See id.* §§ 77b(a)(1) (section 2(a)(1) of the '33 Act), 78c(a)(10) (section 3(a)(10) of the '34 Act).

[22] *See* Tcherepnin v. Knight, 389 U.S. 332, 335–36 (1967). Notwithstanding the slight differences in wording, the U.S. Supreme Court has indicated that the provisions in the two acts should be interpreted as meaning the same things, or in other words, *in pari materia*. *See id.*

[23] Consider the following definition of a security, taken from section 2(a) of the '33 Act:

> When used in this subchapter, unless the context otherwise requires—
>
> (1) The term "security" means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or

the most important category of "securities" has been anything that qualifies as an "investment contract."[24]

The phrase "investment contract" is not defined in either statute but, rather, by case law.[25] In 1946, the U.S. Supreme Court held in *SEC v. W. J. Howey* 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 . . . ."[26]

Now simply known as the *Howey* test, this approach has been clarified so it is clear that investments other than money can suffice,[27] and minor investor participation will not prevent the last part of the test from being satisfied.[28] Thus, modern courts have rephrased the *Howey* test as requiring the following elements:

> 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). In this definition, words like "stock," "bond," and "debenture" had fairly well understood meanings when they were included in the law. *See* Park McGinty, *What Is a Security?*, 1993 WIS. L. REV. 1033, 1039 (1993); *see also* 15 U.S.C. § 77b(a)(1). Other phrases, most notably, "investment contract," were less defined, and were included precisely in order to serve as a broad, catch-all category so clever fraudsters could not easily evade the securities laws. *See* McGinty, *supra*, at 1043 (noting that "[t]he securities laws were remedial in nature, and the definitional paragraph contained the phrase 'investment contract,' a category that was sufficiently broad to reach these 'devious' schemes.").

[24] *See* SEC, *Framework*, *supra* note 11, at n.4. This label is used in both the '33 and '34 Acts. *See* 15 U.S.C. §§ 77b(a)(1), 78c(a)(10). It should be noted that although early pronouncements from the SEC suggested that *the* appropriate way to determine whether cryptoassets were securities was to evaluate whether they were investment contracts, subsequent actions have suggested that another test may come into play for some kinds of interests or transactions. SEC, *Framework*, *supra* note 11, at n.4. For further analysis of the possibility that some crypto arrangements need to be evaluated as notes rather than investment contracts, see *infra* notes 299–301 and accompanying text.

[25] *See* SEC v. W. J. Howey Co., 328 U.S. 293, 298 (1946).

[26] *Id*. at 298–99.

[27] *See* Uselton v. Com. Lovelace Motor Freight, Inc., 940 F.2d 564, 574 (10th Cir. 1991). While the *Howey* test originally spoke only of "money," subsequent opinions have made it clear that "cash is not the only form of contribution or investment that will create an investment contract. Instead, the 'investment' may take the form of 'goods and services,' or 'some other exchange of value.'" *Id.* (internal citations omitted) (first quoting Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551, 560 n.12 (1979); and then quoting Hocking v. Dubois, 885 F.2d 1449, 1471 (9th Cir. 1989)).

[28] Although the Court in *Howey* said the expectation of profits needed to be based "solely" on the efforts of others, the rule has also been modified or clarified over time. *See* SEC v. Glenn W. Turner Enters., Inc., 474 F.2d 476, 481–82 (9th Cir.) (finding that the appropriate inquiry is "whether the efforts made by those other than the investor are the undeniably significant

(i) an investment of money (or something else of value);[29]
(ii) in a common enterprise;[30]
(iii) where the purchaser expects to receive profits;[31] and
(iv) the purchaser expects those profits based on the essential entrepreneurial efforts of others.[32]

Unfortunately, even outside the context of cryptoassets, application of the *Howey* test is neither simple nor straightforward.[33]

ones, those essential managerial efforts which affect the failure or success of the enterprise."), *cert. denied*, 414 U.S. 821 (1973); *see also Hocking*, 885 F.2d at 1455 (holding that the test should be whose efforts are "significant" and "essential" (quoting *Glenn W. Turner Enters., Inc.*, 474 F.2d at 482; citing *Howey*, 328 U.S. at 299)).

[29] *See supra* note 27 and accompanying text.

[30] *See Howey*, 328 U.S. at 299. The requirement of a "common enterprise" is the element of the *Howey* test that appears to have received the most comment over the years, in part because there is a divergence among the federal circuits. *See* Maura K. Monaghan, *An Uncommon State of Confusion: The Enterprise Element of Investment Contract Analysis*, 63 FORDHAM L. REV. 2135, 2137–38 (1995). Some courts appear to require "horizontal commonality," some accept "strict vertical commonality," while others accept "broad vertical commonality." *Id.* at 2152–63 (discussing the various judicial applications of the *Howey* "common enterprise" element). Horizontal commonality requires that investors' contributions be pooled together so their fortunes rise and fall together, *id.* at 2152–53; strict commonality requires the investor and promoter or investment manager to have interests that are tied together, *id.* at 2157; and broad commonality generally looks to whether the investor is depending heavily on the promoter in deciding whether to invest, *id.* at 2160. *See also* Benjamin Akins, Jennifer L. Chapman & Jason Gordon, *The Case for the Regulation of Bitcoin Mining as a Security*, 19 VA. J.L. & TECH. 669, 688–90 (2015).

On the other hand, while cases and academic commentators alike have relied on these elements for decades, officials at the SEC have taken issue with the "common enterprise" requirement, suggesting in recent documents that the SEC "does not . . . view a 'common enterprise' as a distinct element of the term 'investment contract.'" *See* SEC, *Framework*, *supra* note 11, at n.10. Ironically, the text to which note ten is appended and the note itself specifically recognize that courts do treat the *Howey* test as requiring a common enterprise as a distinct element. *See id.*

[31] *See Howey,* 328 U.S. at 299. The "expectation of profits" element has also been addressed numerous times. *See* Akins et al., *supra* note 30, at 691–93. The U.S. Supreme Court held in *United Housing Foundation, Inc. v. Forman* that in order for this element to be met, "the primary motivation for investing must be to achieve a return on the value invested." *Id.* at 691; *see* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 856–57 (1975).

[32] *See supra* note 28 and accompanying text.

[33] There has been considerable criticism of the *Howey* test over the years. *See, e.g.*, William J. Carney, *Defining a Security: The Addition of a Market-Oriented Contextual Approach to Investment Contract Analysis*, 33 EMORY L.J. 311, 313 (1984) (complaining that the Supreme Court's "application of its functional definition of an 'investment contract' has become less convincing, and apparently more detached from economic reality"); James D. Gordon III, *Common Enterprise and Multiple Investors: A Contractual Theory for Defining Investment Contracts and Notes*, 1988 COLUM. BUS. L. REV. 635, 635 (1988) (noting that after forty years, "courts have been unable to agree on" the meaning of "common enterprise," and that the cases

After adding in the complexities associated with the issuance and sale of cryptoassets, and in particular the incredible diversity of crypto and ways in which such assets are distributed,[34] it is no surprise that many observers have expressed concern about the lack of clarity and certainty as to how the *Howey* test actually works in the context of cryptoassets.[35] It is therefore important to consider how the SEC has reacted to the question of when cryptoassets should be treated as investment contracts and, therefore, are securities.

have been described "as being 'in disarray'"); McGinty, *supra* note 23, at 1084 (complaining that the *Howey* test has "created lasting problems."); Carol R. Goforth, *Cinderella's Slipper: A Better Approach to Regulating Cryptoassets as Securities*, 17 HASTINGS BUS. L.J. 271, 320 (2021) (criticizing the "uncertainty and complexity" of the *Howey* test).

[34] *See* Carla L. Reyes, *Emerging Technology's Language Wars: Cryptocurrency*, 64 WM. & MARY L. REV. 1193, 1211 n.81, 1213–14, 1216 (2023).

> Although [the first several cryptoassets, beginning with] Bitcoin . . . , shared similar characteristics, generally having been designed simply to substitute for fiat currencies, there are now a wide range of interests that [are being sold] as cryptoassets. . . . For example, a crypto[asset] might include the right to repayment of the purchase price with interest, in lieu of more conventional bonds or debentures (depending on whether the repayment obligation is secured). Alternatively, a cryptoasset might be designed to function as an equity interest, conveying a right to share in an underlying business venture's anticipated profits or appreciation, possibly even giving voting rights on certain matters. In these cases, requirements designed for conventional debt or equity securities would make sense. On the other hand, crypto can have a wide range of functions, including membership privileges, rights of access, payment rights, the ability to stake claims to underlying assets or services, or otherwise.

Goforth, *supra* note 33, at 279 n.36. It can be designed to have a stable trading price, and if so, it can be pegged to any number of other assets or currencies. *See* Reyes, *supra*, at 1218. It can be readily convertible into fiat currency or not. *See id.* at 1214. Cryptoassets can even be non-fungible. *See id.* at 1225. Treating all cryptoassets as if they all work in the same way creates a host of problems. *See id.* at 1248. For a compelling discussion of the difficulties of over- and under-inclusion as a result of collapsing different kinds of interests into single categories, see Carla L. Reyes, *Emerging Technology's Language Wars: Cryptocurrency*, 64 WM. & MARY L. REV. 1193 (2023).

[35] Even after the DAO Report and guidance from the SEC in April 2019, one commentator expressly complained that the SEC had "so far failed to provide any reliable guidance as to which criteria it uses to determine whether a token qualifies as a security." *See* Diego Zuluaga, *The SEC Can't Keep Kik-ing the Crypto Can Down the Road*, COINDESK, https://www.coindesk.com/markets/2019/06/05/the-sec-cant-keep-kik-ing-the-crypto-can-down-the-road/ [https://perma.cc/Y9JM-MHPQ] (Sept. 13, 2021, 5:16 AM). The frustration at that time was shared by others. *See, e.g.*, Laura Shin, *Crypto Companies and Investors Fed Up with the SEC*, FORBES (May 29, 2019, 7:00 AM), https://www.forbes.com/sites/laurashin/2019/05/29/crypto-companies-and-investors-fed-up-with-the-sec/ [https://perma.cc/NL2J-3LGY] (noting that crypto entrepreneurs were "impatient with the lack of clarity from the SEC for months, or earnestly developing workarounds right into their technology so as to not serve U.S. customers").

III. HOW HAS THE SEC SAID THESE RULES SHOULD APPLY TO CRYPTOASSETS?

The mission of the SEC is "to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation."[36] In furtherance of these objectives, the SEC has widely asserted its authority over transactions involving the sale of cryptoassets,[37] publicly taking the position in 2017 in the DAO Report[38] that a transaction involving the sale of cryptoassets involves securities if it falls within the definition of an investment contract under *Howey*.[39]

The 2017 DAO Report was not regarded by everyone as having widespread applicability to cryptoassets,[40] as it involved a unique business model that called for purchasers of cryptoassets, known as DAO tokens, to vote on other businesses in which the underlying

[36] *About the SEC*, SEC (Nov. 22, 2016), https://www.sec.gov/about [https://perma.cc/TY77-3ZWX].

[37] For a list of various SEC enforcement actions involving cryptoassets, see *Crypto Assets and Cyber Enforcement Actions*, SEC (June 15, 2023), https://www.sec.gov/spotlight/cybersecurity-enforcement-actions [https://perma.cc/NK6H-GMRW]. Note that the original releases from the SEC talked about crypto as "virtual currencies." For example, in 2014 the SEC issued an investor alert about Bitcoin and "other virtual currency-related investments." *See Investor Alert: Bitcoin and Other Virtual Currency-Related Investments*, SEC (July 29, 2014), https://www.sec.gov/oiea/investor-alerts-bulletins/investoralertsia_bitcoin [https://perma.cc/3PVD-WW3S]; *see also* SEC, OFF. OF INV. EDUC. & ADVOC., PUB NO. 153, INVESTOR ALERT: PONZI SCHEMES USING VIRTUAL CURRENCIES 1 (2013), https://www.sec.gov/investor/alerts/ia_virtualcurrencies.pdf [https://perma.cc/7QXE-3ZNU]. More recently, the SEC has apparently switched to using "digital assets." *See* SEC, *Framework*, *supra* note 11. In a joint staff statement (issued with the Office of General Counsel for FINRA), the SEC referred to covered cryptoassets as "digital asset securities." *See Joint Staff Statement on Broker-Dealer Custody of Digital Asset Securities*, SEC, DIV. OF TRADING & MKTS., & FIN. INDUS. REGUL. AUTH., OFF. OF GEN. COUNS., (July 8, 2019), https://www.sec.gov/news/public-statement/joint-staff-statement-broker-dealer-custody-digital-asset-securities [https://perma.cc/8A4T-J9H5].

Instead of utilizing these phrases, this Article relies on *cryptoasset* or simply *crypto* to describe the range of cryptocoins and tokens that exist because of blockchain technology, which is more in line with how public commentators and entrepreneurs tend to speak about these interests. As one commentator noted, "crypto asset is a blanket term [which] isn't limited to cryptocurrencies." *See* Aashish Pahwa, *What Is a Cryptoasset? Types of Cryptoassets [Ultimate Guide]*, FEEDOUGH (Feb. 28, 2023), https://www.feedough.com/what-is-a-cryptoasset-types-of-cryptoassets-ultimate-guide/ [https://perma.cc/RK4S-YT8E].

[38] Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Release No. 81,207, 117 SEC Docket 745 (July 25, 2017), https://www.sec.gov/litigation/investreport/34-81207.pdf [https://perma.cc/F862-YS5V] [hereinafter DAO Report].

[39] *See id.* at 11–15. In that report, the SEC focused only on the question of whether the assets that had been sold by the DAO involved an investment contract and did not look at any of the other parts of the definition of security under the '33 or '34 Acts. *See id.*

[40] *See, e.g.*, Michael Mendelson, *From Initial Coin Offerings to Security Tokens: A U.S. Federal Securities Law Analysis*, 22 STAN. TECH. L. REV. 52, 54–55 (2019); Ethan D. Trotz, *The Times They Are a Changin': Surveying How the* Howey *Test Applies to Various Cryptocurrencies*, 11 ELON L. REV. 201, 212 (2019).

distributed autonomous organization (somewhat confusingly called The DAO) would invest.[41] Because that plan of operation involved investment in other businesses with an expected sharing of profits from those secondary investments, this closely resembled the kinds of investment vehicles that had traditionally been regulated by the SEC.[42] Most cryptoassets and crypto businesses are not set up to operate that way,[43] so this report, by itself, did not clearly articulate how other cryptoassets would be classified by the SEC.[44]

Shortly after the release of the DAO Report, however, the SEC and various high-level employees in the SEC stepped up their public condemnation of crypto sales and began asserting that cryptoasset transactions generally fall within the SEC's jurisdiction.[45] For example, in August 2017, the SEC announced that trading in three blockchain-related companies was suspended, clarifying that the SEC's concern over crypto transactions extended beyond The DAO.[46] Then, in September, Steve Peiken, the Co-Director of the SEC's Enforcement Division, publicly described persons seeking quick profits from initial crypto offerings (ICOs) as cockroaches.[47] A few months later, in December 2017, SEC Chairman Jay Clayton began repeating the mantra that most, if not all, ICOs involved the sale of securities.[48] In February 2018, in testimony before the Senate

[41] *See* DAO Report, *supra* note 38, at 4. "DAO" normally stands for any "distributed autonomous organization," but in the case the DAO in question was also named "The DAO." *See id.* at 1.

[42] *See id.* at 1. As noted in the DAO Report, the SEC did not attempt to regulate The DAO as an investment company because The DAO never commenced operations, having been shut down as a result of a hacker who exploited a bug in the underlying programming. *See id.* at 1 & n.1.

[43] For a more complete description of The DAO and the SEC's conclusions regarding its operation, see Goforth, *supra* note 33, at 280–83; *see also* Mendelson, *supra* note 40, at 74–76; Trotz, *supra* note 40, at 210–12.

[44] *See* DAO Report, *supra* note 38, at 10.

[45] *See e.g.*, Mendelson, *supra* note 40, at 69; *see also* Herbert F. Kozlov, *SEC Suspends Trading in Securities of Three Blockchain-Related Companies*, REED SMITH (Aug. 29, 2017), https://www.reedsmith.com/en/perspectives/2017/08/sec-suspends-trading-in-securities-of-three-blockchain-related-companies [https://perma.cc/M8P6-RUEZ].

[46] *See* Kozlov, *supra* note 45.

[47] Rose O'Leary, *'Roaches': SEC Chief Speaks Out Against Malicious ICOs*, COINDESK (Sept. 6, 2017, 8:00 AM), https://www.coindesk.com/markets/2017/09/06/roaches-sec-chief-speaks-out-against-malicious-icos/ [https://perma.cc/4T3L-FCW2] (reporting on Peiken's statement). ICO actually stands for "initial coin offering," but the "coin" in that phrase refers to all kinds of cryptoassets. Joseph Young, *SEC Hints at Tighter Regulation for ICOs, Smart Policies for "True Cryptocurrencies"*, COINTELEGRAPH (Feb. 9, 2018), https://cointelegraph.com/news/sec-hints-at-tighter-regulation-for-icos-smart-policies-for-true-cryptocurrencies [https://perma.cc/Z5KF-BXG9].

[48] Public Statement, Jay Clayton, Chairman, SEC, Statement on Cryptocurrencies and Initial Coin Offerings (Dec. 11, 2017), https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11 [https://perma.cc/TY9T-MKWX] ("By and large, the structures of initial coin

Committee on Banking, Housing, and Urban Affairs, he explicitly testified that every ICO he had seen was a security.[49]

While Chairman Clayton was always careful to explain both that he was giving his personal opinion and also that the SEC's approach required a consideration of the facts and circumstances of each transaction,[50] his comments were widely accepted as reflecting the SEC's belief that there was at least a rebuttable presumption that all ICOs involved the sale of securities.[51]

In the summer of 2018, the SEC's Director of the Division of Corporate Finance, William Hinman, offered a small caveat to this approach at the annual Yahoo Finance Summit.[52] At this meeting, Hinman indicated that in his opinion not all cryptoassets are securities, specifically pointing to Bitcoin and Ether as examples of tokens that should not be subject to regulation by the SEC.[53] In the case of those two assets, Hinman suggested that the underlying

offerings that I have seen promoted involve the offer and sale of securities and directly implicate the securities registration requirements and other investor protection provisions of our federal securities laws.").

[49] Stan Higgins, *SEC Chief Clayton: 'Every ICO I've Seen Is a* Security', COINDESK https://www.coindesk.com/markets/2018/02/06/sec-chief-clayton-every-ico-ive-seen-is-a-security/ [https://perma.cc/S4AC-VLQS] (Sept. 6, 2018, 3:32 AM); *see also* Young, *supra* note 47; Dylan Dedi, *SEC and CFTC Hearing: More Legitimate ICOs or "If There Was No Bitcoin, There Would Be No Blockchain"*, COINTELEGRAPH (Feb. 6, 2018), https://cointelegraph.com/news/sec-and-cftc-hearing-more-legitimate-icos-or-if-there-was-no-bitcoin-there-would-be-no-blockchain [https://perma.cc/9CLR-X2ES].

[50] For example, in an explanation to the U.S. Senate Committee on Banking, Housing, and Urban Affairs, Chairman Clayton emphasized that "determining what falls within the ambit of a securities offer and sale is a facts-and-circumstances analysis, utilizing a principles-based framework that has served American companies and American investors well through periods of innovation and change for over 80 years." *Virtual Currencies: The Oversight Role of the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission: Hearing Before the S. Comm. on Banking, Hous., and Urb. Affs.*, 115th Cong. 1 (2018) (statement of Jay Clayton, Chairman, SEC), https://www.sec.gov/news/testimony/testimony-virtual-currencies-oversight-role-us-securities-and-exchange-commission [https://perma.cc/WU7R-CK4E].

[51] *See, e.g.*, Daniel C. Zinman, James Q. Walker, Margaret Winterkorn Myers & Whitney O'Byrne, *SEC Issues Warning to Lawyers on ICOs*, BLOOMBERG L.: TECH & TELECOM L. (Feb. 22, 2018, 4:31 PM), https://news.bloomberglaw.com/tech-and-telecom-law/sec-issues-warning-to-lawyers-on-icos [https://perma.cc/9X6V-HUCR]. This source examines a number of recent pronouncements and actions taken by the SEC and concludes that "the SEC has essentially adopted a rebuttable presumption that ICO tokens are securities that must comply with the registration requirements of the securities laws." *Id.*; *accord* Evelyn Cheng, *The SEC Just Made It Clearer that Securities Laws Apply to Most Cryptocurrencies and Exchanges Trading Them,* CNBC: MKTS., https://www.cnbc.com/2018/03/07/the-sec-made-it-clearer-that-securities-laws-apply-to-cryptocurrencies.html [https://perma.cc/J7CY-CEZH] (Mar. 7, 2018, 6:48 PM); Mendelson, *supra* note at 40, at 69–70.

[52] *See* William Hinman, Dir., SEC Div. of Corp. Fin., Digital Asset Transactions: When Howey Met Gary (Plastic) (June 14, 2018), https://www.sec.gov/news/speech/speech-hinman-061418 [https://perma.cc/H3YU-DX3K].

[53] *See id.*

network was "sufficiently decentralized[,]" so that "purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts . . . ."[54] He concluded that "[a]pplying the disclosure regime of the federal securities laws to the offer and resale of Bitcoin would seem to add little value."[55]

In his April 2018 testimony before the House Appropriations Committee, Chairman Clayton appeared to acquiesce in the view that Bitcoin, at least, would not be a security.[56] He explained that "there are different types of cryptoassets. . . . A pure medium of exchange, the one that's most often cited, is Bitcoin. As a replacement for currency, that has been determined by most people to not be a security."[57] While his statements on Ether were less clear, he was also quoted as having agreed that Ether was also probably outside his agency's remit.[58]

When Chairman Clayton resigned at the end of 2020, he was replaced by Gary Gensler, who was sworn into office as Chairman of the SEC on April 17, 2021.[59] While crypto enthusiasts were briefly hopeful that Gensler would be more favorable to crypto than his predecessor,[60] these hopes were quickly shown to be unrealistic.[61] On August 3, 2021, Gensler explicitly announced his agreement with Clayton, explaining that "he believes the vast majority of crypto tokens and initial coin offerings . . . violate U.S. securities laws."[62]

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[54] *Id.*

[55] *Id.*

[56] *See* Neeraj Agrawal, *SEC Chairman Clayton: Bitcoin Is Not a Security*, COIN CENTER (Apr. 27, 2018), https://www.coincenter.org/sec-chairman-clayton-bitcoin-is-not-a-security/ [https://perma.cc/S8MF-7AKH].

[57] *Id.*

[58] *See* Nikhilesh De, *SEC Chair Clayton Affirms Agency's Stance Ether Is No Longer a Security*, COINDESK, https://www.coindesk.com/markets/2019/03/12/sec-chair-clayton-affirms-agencys-stance-ether-is-no-longer-a-security/ [https://perma.cc/MV3W-C8AQ] (Sept. 13, 2021, 8:58 AM).

[59] *See Biography: Chair Gary Gensler*, SEC, https://www.sec.gov/biography/gary-gensler [https://perma.cc/K2E6-VQ6T]; Soyoung Ho, *SEC Chairman Jay Clayton Resigns*, THOMSON REUTERS: TAX & ACCT. (Dec. 28, 2020), https://tax.thomsonreuters.com/news/sec-chairman-jay-clayton-resigns/ [https://perma.cc/LH83-YUSS].

[60] *See, e.g.*, Shanny Basar, *Crypto Industry Eyes Gary Gensler at SEC*, TRADERS MAG. (Jan. 21, 2021), https://www.tradersmagazine.com/departments/brokerage/crypto-industry-eyes-gary-gensler-at-sec/ [https://perma.cc/XD2J-NHYQ] (including a tweet from MachinaTrader commenting hopefully that the appointment of "crypto-savvy Gary Gensler" would be "[a] move that could be advantageous for the industry . . . .").

[61] *See* Nikhilesh De, *SEC Chairman Gensler Agrees with Predecessor: 'Every ICO Is a Security'*, COINDESK, https://www.coindesk.com/markets/2021/08/03/sec-chairman-gensler-agrees-with-predecessor-every-ico-is-a-security/ [https://perma.cc/D5GC-FZDL] (Sept. 14, 2021, 1:34 PM).

[62] *Id.* ("In a speech at the Aspen Security Forum on Tuesday, Gensler said he agreed with Jay Clayton, his predecessor at the SEC, who once famously said that in his view, 'every ICO I've seen is a security.'").

SEC Chair Gensler has also announced that the SEC can use a "broad" definition of what constitutes a security, giving the Commission a "great deal of authority" while simultaneously providing "a great deal of clarity."[63] In fact, Gensler has repeated on numerous occasions his belief that the scope of the federal securities laws (as they apply to crypto) is clear.[64]

Even when questioned by Congressional representatives about their constituents' concerns and confusion over how to apply the securities laws to crypto businesses, Gensler has stayed firm.[65] For example, when questioned by Congressman Sanford Bishop (D-Georgia) in March 2023 about whether "the SEC has 'any plans to issue a rule to clarify how securities laws apply to digital assets,' . . . . Gensler, in typical form, stuck to his guns that the rules for crypto could not be any clearer."[66] Gensler may be correct in pointing out that his position is clear; he personally believes most cryptoassets are securities.[67] What is not clear is whether this conclusion is justified under federal law.

IV. DO AS I SAY, NOT AS I DO—WHAT HAS THE SEC ACTUALLY DONE IN THE CONTEXT OF CRYPTO ENFORCEMENT?

A. The 2019 Framework

In 2019, the SEC released a public framework (the "Framework") with a convoluted, thirty-eight factor analysis to "help" explain when crypto will be an investment contract.[68] Most of the Framework's numerous factors focus on the question of whether purchasers have a reasonable expectation of profits derived from the efforts of others.[69] Although some of the elements are described as "especially

[63] Katelynn Bradley, Annmarie Conboy-DePasquale, & Travis Norton, *SEC Chair Gensler Signals Greater Regulation of Cryptocurrency Under Existing Authorities*, BROWNSTEIN (Sept. 22, 2021), https://www.bhfs.com/insights/alerts-articles/2021/sec-chair-gensler-signals-greater-regulation-of-cryptocurrency-under-existing-authorities [https://perma.cc/LLA6-C9GB].

[64] "The chairman of the U.S. Securities and Exchange Commission (SEC), Gary Gensler, has reiterated that most crypto tokens are securities, emphasizing that 'the law is clear on this.'" *See* Helms, *supra* note 9.

[65] *See* Mat Di Silvo, *SEC's Gensler Insists Clear Rules for Crypto Market 'Already Exist'*, DECRYPT (Mar. 29, 2023), https://decrypt.co/124872/sec-gensler-insists-clear-rules-crypto-already-exist [https://perma.cc/Y9PN-EJVF].

[66] *Id.*

[67] *See* Gary Gensler, Opinion, *Getting Crypto Firms to Do Their Work Within the Bounds of the Law,* HILL (Mar. 9, 2023, 12:45 PM), https://thehill.com/opinion/congress-blog/3891970-getting-crypto-firms-to-do-their-work-within-the-bounds-of-the-law/ [https://perma.cc/VX38-C8M6].

[68] *See* SEC, *Framework*, *supra* note 11, § I.

[69] *See id.* § II.C.

relevant,"[70] the Framework notes that no single part of the test is "necessarily determinative."[71] With regard to whether there is a reasonable expectation of profits, the Framework indicates that the more of the listed factors that are present, the more likely the asset in question is to be a security.[72] The Framework does not, however, give any indication of how many of the described characteristics are necessary or sufficient and does not explain how to weigh any of the listed items or what their absence would mean for appropriate classification of the asset in question.[73]

Not surprisingly, others have recognized that the Framework is so complicated that it is very difficult to understand or apply. Shortly after publication of the Framework, SEC Commissioner Hester Peirce gave a speech expressing doubts about the new explanation.[74] She observed that the document could "raise more questions and concerns than it answers."[75]

> While *Howey* has four factors to consider, the [F]ramework lists 38 separate considerations, many of which include several sub-points. A seasoned securities lawyer *might* be able to infer which of these considerations will likely be controlling and might therefore be able to provide the appropriate weight to each. . . . [N]on-lawyers and lawyers not steeped in securities law and its attendant lore will not know what to make of the guidance. Pages worth of factors, many of which seemingly apply to all decentralized networks, might contribute to the feeling that navigating the securities laws in this area is perilous business.[76]

Further confusing matters, the Framework suggests that a particular cryptoasset might at one time be a security and then later lose that characterization.[77] Finally, despite what seems like an

[70] *Id.*
[71] *Id.* § II.C.1.
[72] *See id.* § II.C.2.
[73] *See id.* § II.C.
[74] *See* Hester M. Peirce, Comm'r, SEC, How We Howey (May 9, 2019), https://www.sec.gov/news/speech/peirce-how-we-howey-050919 [https://perma.cc/729A-CG6C].
[75] *Id.*
[76] *Id.*
[77] *See* SEC, *Framework, supra* note 11, §§ II.C.1., II.C.2. (both noting that "[i]n evaluating whether a digital asset previously sold as a security should be reevaluated at the time of later offers or sales, there would be additional considerations . . . ."). In addition, the conclusion states that the Framework "identifies some of the factors to be considered in determining whether and when a digital asset may no longer be a security." *Id.* at § III.

extensive list of considerations, the Framework concludes with the statement that "[t]hese factors are not intended to be exhaustive in evaluating whether a digital asset is an investment contract or any other type of security . . . ."[78] This conclusion is particularly confusing given that the document already outlines more than three dozen factors,[79] while also hinting that the SEC might rely on tests in addition to *Howey* in seeking to apply the securities laws to cryptoassets.[80]

If the *Howey* test is really so clear, why is this level of complexity needed? The Framework was drafted by the Strategic Hub for Innovation and Financial Technology at the SEC,[81] and it recites that it "is intended to be instructive and is based on the Staff's experiences to date and relevant law and legal precedent."[82] While it is, thus, not a formal rule or regulation,[83] it does represent the considered opinion of staff at the Commission responsible for working with cryptoassets. Nor can it be easily dismissed as being out of date, as the document itself was updated in March 2023.[84]

The SEC has, of course, done more than just issue explanations. It has also initiated a number of enforcement actions.[85] Unfortunately, for those seeking clarity, even a superficial examination of some of the agency's recent actions demonstrates how it has confused rather than clarified how to apply the securities laws.[86]

B. Illustrative Court Cases

1. *SEC v. Ripple*[87]

The Financial Crimes Enforcement Network (FinCEN), a bureau in the U.S. Department of Treasury,[88] made headlines in May 2015,

[78] *Id.*
[79] *See id.*; Peirce, *supra* note 74.
[80] *See* SEC, *Framework*, *supra* note 11, § III.
[81] *See id.* at n.1.
[82] *Id.* at n.4.
[83] *Id.* at n.1.
[84] The very end of the document notes that it was "Modified: March 8, 2023." *Id.*
[85] *See* Yuliya Guseva, *When the Means Undermine the End: The Leviathan of Securities Law and Enforcement in Digital-Asset Markets,* 5 STAN. J. BLOCKCHAIN L. & POL'Y 1, 11 (2022) ("The SEC's enforcement efforts [have been] massive and conducted on a global scale."). For a further discussion of some of the most significant recent actions see *infra* Part IV.B.
[86] *See infra* Part IV.B.
[87] *See* Complaint at 1, SEC v. Ripple Labs, Inc., 540 F. Supp. 3d 409 (S.D.N.Y. 2021) (No. 20-CV-10832), https://storage.courtlistener.com/recap/gov.uscourts.nysd.551082/gov.uscourts.nysd.551082.1.0.pdf [https://perma.cc/77FT-JZXH] [hereinafter Ripple Complaint].
[88] *What We Do*, FIN. CRIMES ENF'T NETWORK, https://www.fincen.gov/what-we-do [https://perma.cc/X2N6-N83E].

by fining Ripple Labs, Inc. (Ripple) $700,000 for selling its XRP token and acting as a money services business without registering with the bureau.[89] In making this determination, FinCEN clearly characterized XRP as a virtual currency.[90] More than five and a half years later, on December 22, 2020, the SEC initiated legal proceedings against the same company on the grounds that the very same XRP tokens were securities.[91] While the cross-characterization of the same asset as a substitute for funds and as a security might itself be somewhat confusing, that is not the primary problem with this timeline. Rather, the FinCEN action in 2015 clearly means that Ripple's activities were on the national radar at that time and, yet, it was more than five years before the SEC weighed in to deliver its opinion on how the cryptoasset in question should be classified under the federal securities laws.[92]

The XRP ledger was completed in December of 2012, and, at that time, the computer code set a fixed supply of 100 billion tokens.[93] When launched, 80 billion XRP were transferred to Ripple, and the remaining 20 billion tokens went to a group of founders.[94] According to the SEC's complaint, what followed was a very long unregistered offering of XRP tokens.[95] As described by the Commission, Ripple eventually issued approximately 14.6 billion XRP in a combination of distributions via bounty programs, as compensation to programmers and developers, and to institutional and other market participants.[96]

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[89] Press Release, Steve Hudak, Fin. Crimes Enf't Network, FinCEN Fines Ripple Labs Inc. in First Civil Enforcement Action Against a Virtual Currency Exchanger, (May 5, 2015), https://www.fincen.gov/sites/default/files/shared/20150505.pdf [https://perma.cc/DQ3H-3LDE] [hereinafter Hudak Press Release].

[90] *See id.*

[91] *See* Ripple Complaint, *supra* note 87, at 1–3, 71. There were some procedural deficiencies in the original filing, so the document was updated and modified on December 29, 2020, but the substance of the allegations was unchanged. *See* Text Order, Docket at no. 4, *Ripple Labs, Inc.*, 540 F. Supp. 409 (No. 20-CV-10832).

[92] *See* Ripple Complaint, *supra* note 87, at 1–3, 71; Hudak Press Release, *supra* note 89.

[93] Ripple Complaint, *supra* note 87, at 9.

[94] *Id.* There is actually some debate about the original transactions. The first 32,569 ledger entries were accidentally lost due to a bug in the program. Anton Lucian & Kyle Baird, *XRP's Genesis Block Still Has No Record*, BEINCRYPTO (Dec. 15, 2019, 5:20 PM), https://beincrypto.com/xrps-genesis-block-still-has-no-record/ [https://perma.cc/CPE9-F9WF]. While the SEC claims that the initial issuance of XRP was to the company, other versions of the genesis transactions suggest that the initial distribution was to the founders, who in turn contributed or gifted (depending on the source) 80 billion XRP to the company. *Compare* Ripple Complaint, *supra* note 91, at 9 (stating that 80 billion tokens were transferred to Ripple), *with XRPL's Origin: Provide a Better Alternative to Bitcoin*, XRPL, https://xrpl.org/history.htmlarchived [https://perma.cc/9Y9Q-856G] (stating that XRPL's founders gifted 80 billion tokens to Ripple).

[95] *See* Ripple Complaint, *supra* note 87, at 2. The amended complaint states that "Ripple engaged in this illegal securities offering from 2013 to the present . . . ." *Id.*

[96] *Id.* at 1, 11, 14, 16.

These sales raised approximately $1.38 billion to fund Ripple's operations.[97] While all of this was taking place, the SEC had no public reaction.[98]

The most common reactions to the eventual filing of the lawsuit appear to have been surprise and frustration.[99] On January 1, 2021, a group of XRP holders, led by attorney John Deaton, filed a petition for a writ of mandamus in the District of Rhode Island, asking the court to force the SEC to exclude their XRP tokens from its pending litigation against Ripple on the grounds that the plaintiffs had not purchased investment contracts.[100] Deaton's petition argues that the SEC, under the leadership of then-chairman Jay Clayton, "caused multi-billion-dollar losses to innocent investors who have purchased, exchanged, received and/or acquired the Digital Asset XRP."[101] In the memorandum submitted in support of the petition for writ of mandamus, the plaintiffs made it clear that they did not invest in XRP in order to make a profit based on the efforts of Ripple.[102]

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[97] *Id.* at 1–2, 14.

[98] *See id.* at 1, 71. According to Ripple's answer to the SEC's complaint, these actions took place up to five years after XRP was determined to be a virtual currency by FinCEN, "and after more than [two and a half years] of investigation during which the SEC [permitted Ripple] to distribute [its token and expand its network,] . . . allow[ing] millions of [purchasers] to rely on the free and efficient functioning of [the] market." Answer at 3, *Ripple Labs, Inc.*, 540 F. Supp. 3d 409 (No. 20-CV-10832), https://storage.courtlistener.com/recap/gov.uscourts.nysd.551082/gov.uscourts.nysd.551082.51.0_2.pdf [https://perma.cc/8R25-X4PR] [hereinafter Ripple Answer].

[99] *See* Jeff John Roberts, *SEC is 'Dead Wrong': Former Chair Mary Jo White Defends Ripple in Pivotal Crypto Case,* FORTUNE (Feb. 19, 2021, 11:00 AM), https://fortune.com/2021/02/19/ripple-sec-lawsuit-mary-jo-white-crypto-unlicensed-securities-xrp/ [https://perma.cc/QAB3-Y9KT] (commenting that "the broader crypto-industry reacted with surprise and alarm."). Similarly, Roslyn Layton, a senior contributor to Forbes, characterized the action as a "bombshell lawsuit" that has become a "cause célèbre in the cryptocurrency community . . . [with] sweeping implications about regulatory overreach[.]" Roslyn Layton, *SEC Assault on Ripple Provokes Wider Debate*, FORBES (Jun. 30, 2021, 4:56 PM), https://www.forbes.com/sites/roslynlayton/2021/06/30/sec-assault-on-ripple-provokes-wider-debate/ [https://perma.cc/5B6W-BWYE] [hereinafter Layton, *Debate*]. Another commentator suggested that case was a "time bomb" going off, with the case being

> emblematic of the murky regulation enveloping digital currency, reflecting the mismatch between laws largely developed during the Great Depression and today's burgeoning fintech ecosystem. While opinions differ on whether the SEC has a strong case against Ripple, almost everyone agrees that the underlying problem is a lack of clarity over how cryptocurrency can be regulated . . . .

David H. Freedman, *Why Ripple's SEC Lawsuit Could Have a Lasting Impact on Crypto*, FORTUNE (July 29, 2021, 5:20 AM), https://fortune.com/2021/07/29/ripple-xrp-sec-lawsuit-impact-on-crypto-industry/ [https://perma.cc/6TLB-5CA8].

[100] Petition for Writ of Mandamus at 24, Deaton v. Roisman (*In re* Deaton), No. 21-cv-00001 (D.R.I. Jan. 1, 2021), https://www.tbstat.com/wp/uploads/2021/01/xrp_investors_sec.pdf [https://perma.cc/9QMM-NEF4].

[101] *Id.* at 1.

[102] Memorandum in Support of Writ of Mandamus at 44, *In re Deaton*, No. 21-cv-00001, https://www.tbstat.com/wp/uploads/2021/01/xrp_investors_sec.pdf [https://perma.cc/9QMM-

While there is no statute of limitations on the SEC's ability to bring enforcement actions for conducting an unregistered offering,[103] the public backlash against this particular lawsuit has been notable.[104] Commentators first point to decisions from regulators in other jurisdictions that XRP is a currency rather than a security.[105] They then criticize the unpredictability and unfairness of the SEC waiting so long to act while continuing to assert that the rules are "clear."[106]

On July 13, 2023, Judge Analisa Torres entered a landmark order in the case, resolving most of the claims in front of her on cross-motions for summary judgment.[107] In broad brush terms, the ruling found that Ripple had sold securities when it sold its XRP tokens to institutional investors early on, but that the tokens were no longer

NEF4] ("The Petitioners and all others similarly situated are unaware of efforts or statements by Ripple leading the Petitioners to expect profits for their purchase or acquisition of XRP. To the contrary, some named Petitioners are aware that Ripple executives and former executives have publicly stated that XRP was not designed for retail investors."). It should be noted that not all XRP purchasers agree with this analysis. A class action lawsuit on behalf of purchasers alleging that Ripple violated federal (and state) securities laws in failing to register XRP as a security was initiated in the Northern District of California back on November 7, 2018, with the class being certified nearly five years later. *See* Defendants' Certificate of Interested Entities or Persons, Zakinov v. Ripple Labs, Inc., No. 18-cv-06753, 2023 WL 4303644 (N.D. Cal. June 30, 2023), https://storage.courtlistener.com/recap/gov.uscourts.cand.334410/gov.uscourts.cand.334410.1.0_2.pdf [https://perma.cc/7USG-WZH4]; Order Granting Motion for Class Certification at 1, *Zakinov*, 2023 WL 4303644 (No. 18-cv-06753), https://storage.courtlistener.com/recap/gov.uscourts.cand.334410/gov.uscourts.cand.334410.264.0_1.pdf [https://perma.cc/CHV3-LLVL].

[103] *See* Michael J. Kaufman & John M. Wunderlich, *Leave Time for Trouble: The Limitations Period Under the Federal Securities Laws* 40 IOWA J. CORP. L. 143, 171 & n.160 (2014).

[104] *See, e.g.*, "No one expected the tsunami of legal, political and social media action from retail cryptocurrency investors, outraged by the betrayal from an agency claiming to protect their interests." Roslyn Layton, *The Crypto Uprising The SEC Didn't See Coming*, FORBES (Aug. 30, 2021, 1:24 AM), https://www.forbes.com/sites/roslynlayton/2021/08/30/the-crypto-uprising-the-sec-didnt-see-coming/ [https://perma.cc/NF5L-4ZM5].

[105] Layton, *Debate*, *supra* note 99 ("Financial regulatory authorities in Japan, Singapore, the U.K., Switzerland, and the UAE have already declared that XRP is a currency, not a security.").

[106] Former SEC chair Mary Jo White, who admittedly lacks impartiality as she is serving as counsel to Ripple, reacted to the lawsuit by commenting on the fact that the Commission waited until December 2020 to bring the lawsuit. "As a former U.S. attorney and SEC chair, you know that when it takes that long to figure out a case you probably shouldn't be bringing it." Roberts, *supra* note 99.

As further evidence of the incredible complexity of the issue, Ripple's CEO has publicly stated that by the time the lawsuit is done, the company expects to have expended an astounding $200 million in legal fees litigating the question. Ryan Browne, Ripple Will Have Spent $200 Million Fighting SEC Lawsuit, CEO Says, CNBC, https://www.cnbc.com/2023/05/08/ripple-will-have-spent-200-million-fighting-sec-lawsuit-ceo-says.html [https://perma.cc/7LML-DXAJ] (May 8, 2023, 11:31 AM). This does not support the notion that the issue of whether a particular cryptoasset is a security is a simple one. See sources cited supra note 9 and accompanying text.

[107] Order on Motion for Summary Judgment, SEC v. Ripple Labs, Inc. at 34, 540 F. Supp. 3d 409 (S.D.N.Y. July 13, 2023) (No. 20-CV-10832), https://www.courtlistener.com/docket/19857399/874/securities-and-exchange-commission-v-ripple-labs-inc/ [https://perma.cc/DNC8-DF2T].

sold as securities when public investors acquired the assets in anonymous markets with secondary traders.[108] It is entirely possible, or even probable, that this decision will be appealed,[109] but, in any event, the fact that the initial ruling took so long and, in significant part, disagrees with the SEC's conclusions certainly suggests that the proper classification of cryptoassets is far from "clear."

A second, very different enforcement action also illustrates some of the problems with the SEC's assertions that the law is clear and that almost all cryptoassets are securities.

2. *SEC v. Wahi*[110]

In the summer of 2022, the Department of Justice indicted a former Coinbase employee on multiple counts of wire fraud and conspiracy.[111] The charges arose from a scheme in which the employee, Ishan Wahi, provided confidential information about cryptoassets that were to be listed on Coinbase's trading platform to his brother, Nikhil Wahi, and a friend, Sameer Ramani.[112] The criminal indictment did not allege securities violations.[113]

Apparently dissatisfied with the criminal prosecution, on July 21, 2022, the SEC initiated an insider trading case against Ishan Wahi,

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[108] Michael Birnbaum, Michael Burshteyn, Haimavathi Marlier & Silberman, *SDNY Issues Split Decision in* SEC v. Ripple Labs, *Potentially Complicating Analysis of When Crypto-Tokens Will be Treated as Securities*, MORRISON FOERSTER (July 17, 2023), https://www.mofo.com/resources/insights/230717-ripple-ruling-adds-to-digital-asset [https://perma.cc/FV6J-U68E].

[109] Some observers suggest that the SEC is particularly likely to appeal. Kevin Helms, *Former SEC Official Warns of Reversal in* SEC v. Ripple *Ruling on XRP—Says 'the Decision Resides on Shaky Ground'*, BITCOIN.COM (July 16, 2023), https://news.bitcoin.com/former-sec-official-warns-of-reversal-in-sec-v-ripple-ruling-on-xrp-says-the-decision-resides-on-shaky-ground/ [https://perma.cc/KZ3G-2VGZ]. Some have opined that both sides will appeal. Siamak Masnavi, SEC vs Ripple*: Former SEC Official Believes 'Both Sides Will Appeal'*, CRYPTOGLOBE (July 17, 2023), https://www.cryptoglobe.com/latest/2023/07/sec-vs-ripple-former-sec-official-believes-both-sides-will-appeal/ [https://perma.cc/Q7JH-6YFJ]. Other commentators doubt an appeal will follow. Alex Richardson, *Lawyer Jeremy Hogan Says SEC Unlikely to Appeal Ripple Lawsuit Ruling – Here's Why*, DAILY HODL (July 17, 2023), https://dailyhodl.com/2023/07/17/lawyer-jeremy-hogan-says-sec-unlikely-to-appeal-ripple-lawsuit-ruling-heres-why/ [https://perma.cc/22HG-5UJT].

[110] The SEC's complaint lists only nine of the twenty-five cryptoassets traded in as a result of tips from Wahi as securities, and it fails to state why these were singled out and which, if any, of the others might also be securities. Complaint at 21–22, SEC v. Wahi, No. 22-cv-01009 (W.D. Wash. July 21, 2022), https://www.sec.gov/litigation/complaints/2022/comp-pr2022-127.pdf [https://perma.cc/W68Z-H94L] [hereinafter Wahi Complaint].

[111] Indictment, United States v. Wahi, No. 22-cr-392, 2023 U.S. Dist. LEXIS 163303, (S.D.N.Y. July 21, 2022), https://www.justice.gov/usao-sdny/press-release/file/1521186/download [https://perma.cc/J95P-6UNS] [hereinafter Wahi Indictment].

[112] *Id.* at 2.

[113] *See id.*

his brother, and his friend, alleging that nine of the twenty-five cryptoassets that had been traded by the insider's brother and friend were securities.[114] The complaint did not explain why nine of the cryptoassets were singled out as securities while the other sixteen were not,[115] despite the repeated pronouncements from the agency and its chair that almost all cryptoassets are securities.[116]

As of May 2023, the nine cryptoassets identified by the SEC as securities in *SEC v. Wahi*[117] ranged in market capitalization from a high of approximately $140 million to a low of under $2 million.[118] This placed them between the 182nd and 2956th most capitalized of cryptoassets.[119] According to the criminal indictment against Wahi, the assets that were not identified by the SEC as securities included even more prominent cryptoassets,[120] including the assets ranked 103rd (with a total market capitalization of approximately $325 million)[121] and 129th (with a market capitalization of approximately

[114] *See* Wahi Complaint, *supra* note 110, at 21–22. According to Caroline D. Pham, the CFTC Commissioner, the SEC's suit is "a striking example of 'regulation by enforcement.'" Caroline D. Pham, Comm'r, Commodity Futures Trading Comm'n, Statement of Commissioner Caroline D. Pham on *SEC v. Wahi* (July 21, 2022), https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement072122 [https://perma.cc/R9WJ-T457].

[115] *See generally* Wahi Complaint, *supra* note 110.

[116] Mat Di Salvo, *Senator Toomey Challenges Gensler's View That Nearly 'All Crypto Tokens Are Securities'*, DECRYPT (Sept. 15, 2022), https://decrypt.co/109847/toomey-gary-gensler-sec-crypto-tokens-securities [https://perma.cc/ZB4A-XASN] (discussing "the chairman's view that nearly all cryptocurrencies currently trading today are likely unregistered securities."). Gensler repeated this assertion before the House Financial Services Committee in April 2023, stating that the "vast majority" of cryptoassets are securities. *SEC Chair Gensler Makes his Case before House Financial Services Committee*, FRIED FRANK: REGULATORY INTELLIGENCE (Apr. 18, 2023), https://www.findknowdo.com/news/04/18/2023/sec-chair-gensler-makes-his-case-house-financial-services-committee [https://perma.cc/5VMD-ZPV9].

[117] Wahi Complaint, *supra* note 110, at 12–20 (identifying (in order) AMP, RLY, DDX, XYO, RGT, LCX, POWR, DFX and KROM). The complaint does not identify or discuss the other sixteen cryptoassets traded in by Wahi's brother and friend.

[118] AMP, identified by the SEC in Wahi Complaint, *supra* note 110, at 12, had a market capitalization of just under $140 million on May 3, 2023. *AMP*, COINMARKETCAP, https://coinmarketcap.com/currencies/amp/ [https://perma.cc/3Y3G-U3NE]. At the other end of the spectrum, DFX, identified in Wahi Complaint, *supra* note 110, at 19–20, had a total capitalization of under $2 million. *DFX Finance*, COINMARKETCAP, https://coinmarketcap.com/currencies/dfx-finance/ [https://perma.cc/PX2E-WRK7].

[119] These rankings also come from CoinMarketCap, on the pages cited and archived *supra* note 118.

[120] The cryptoassets that were not identified by the SEC as securities included TRIBE, ALCX, GALA, and ENS. Wahi Indictment, *supra* note 111, at 8–9, 10–13; *see also infra* notes 121–22 and accompanying text.

[121] According to CoinMarketCap, as of May 3, 2023, ENS had a market cap of just under $325 million, making it the 103rd most heavily capitalized cryptoasset. *Ethereum Name Service*, COINMARKETCAP, https://coinmarketcap.com/currencies/ethereum-name-service/ [https://perma.cc/ZH6U-77GT].

$250 million).[122] Oddly, of the six examples of cryptoassets that the Department of Justice mentioned in its indictment, only two were listed by the SEC as securities.[123] The SEC has offered no explanation of why it singled out the examples that it uses in its complaint rather than any of these other assets.[124] It also did not indicate why it had not taken Coinbase to task for operating as an unregistered securities exchange if it was clear these cryptoassets were securities.[125]

This lawsuit prompted an unusual response from Commodity Futures Trading Commission (CFTC) Commissioner Caroline D. Pham, who objected to the approach taken by the SEC, saying the case was a "striking example of 'regulation by enforcement.'"[126] Pham specifically called for a more transparent approach to classifying crypto: "Major questions are best addressed through a transparent process that engages the public to develop appropriate policy with expert input—through notice-and-comment rulemaking pursuant to the Administrative Procedure Act. Regulatory clarity comes from being out in the open, not in the dark."[127]

But this case is far from the only instance in which the SEC has singled out some cryptoassets as securities while failing to explain the appropriate characterization of other, more visible, and more highly capitalized, cryptoassets.[128]

3. *SEC v. Bittrex*[129]

On April 17, 2023, the SEC initiated an enforcement action in the Western District of Washington against Bittrex, a crypto trading

[122] According to CoinMarketCap, as of May 3, 2023, GALA had a market cap of more than $250 million, making it the 129th most heavily capitalized cryptoasset. *Gala*, COINMARKETCAP, https://coinmarketcap.com/currencies/gala/ [https://perma.cc/Y7HU-RMFS].

[123] The two cryptoassets that were listed in both the indictment and the complaint were XYO and POWR. *Compare* Wahi Complaint, *supra* note 110, at 14–15, 19, *with* Wahi Indictment, *supra* note 111, at 9–11.

[124] *See generally* Wahi Complaint, *supra* note 110.

[125] Subsequent to this action, the SEC did initiate such an action. *See infra* Part IV.C.3.

[126] Pham, *supra* note 114; *see also* Elise Hansen, *Coinbase Insider Trading Case Exposes Rift Over SEC's Role*, LAW360 (July 21, 2022, 12:36 PM), https://www.law360.com/articles/1513914 [https://perma.cc/5Y9Y-69AY] (discussing comments from CFTC Commissioner Caroline D. Pham).

[127] Pham, *supra* note 114.

[128] *See* discussion *infra* Part IV.B.3–4, IV.C.3.

[129] *See* Complaint, SEC v. Bittrex, Inc., No. 23-cv-00580 (W.D. Wash., April 17, 2023), https://www.sec.gov/litigation/complaints/2023/comp25694.pdf [https://perma.cc/TCM7-U86F] [hereinafter Bittrex Complaint].

platform, and a former CEO of the company.[130] The SEC explained that its action was predicated on a belief that the platform had raised at least $1.3 billion from selling cryptoassets that the SEC classifies as securities,[131] although the complaint itself only identified six of the more than 300 cryptoassets traded on the platform as securities.[132]

In addition to the six specific cryptoassets identified in the SEC's complaint, Bittrex facilitated trades in high-volume, highly capitalized cryptoassets[133] such as Ether,[134] Cardano,[135] Dogecoin,[136]

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[130] Press Release, SEC, SEC Charges Crypto Asset Trading Platform Bittrex and its Former CEO for Operating an Unregistered Exchange, Broker, and Clearing Agency (Apr. 17, 2023), https://www.sec.gov/news/press-release/2023-78 [https://perma.cc/AQ2S-877F].

[131] *Id.* ("Bittrex has held itself out as a platform that facilitated buying and selling of crypto assets that the SEC's complaint alleges were offered and sold as securities. From 2017 through 2022, Bittrex earned at least $1.3 billion in revenues from, among other things, transaction fees from investors, including U.S. investors . . . ."). Effective April 30, 2023, Bittrex voluntarily ceased U.S. operations, and its website now states: "As previously announced, as of April 30, 2023, all Bittrex operations in the United States have ceased." BITTREX, https://bittrex.com/ [https://perma.cc/HV28-8M9L]. Bittrex had announced plans to close its U.S. operations on March 30, 2023, before the SEC's complaint was filed. Mat Di Salvo, *Bittrex Shuts Down US Crypto Exchange Due to 'Regulatory Environment'*, DECRYPT (Mar. 31, 2023), https://decrypt.co/125087/crypto-exchange-bittrex-shut-down-us-operations [https://perma.cc/YEX2-9URW].

[132] The listed securities are OMG, DASH, ALGO, TKN, NGC, and IHT. *See* Bittrex Complaint, *supra* note 129, at 17, 33–51. The complaint does not say that these are the only cryptoassets that were securities, and instead makes the following claim:

> For purposes of prevailing on the Exchange Act claims set forth herein, the SEC need only establish that Bittrex transacted in a single crypto asset security. Nevertheless, set forth below are specific details regarding a non-exhaustive list of six examples of crypto asset securities available for trading on the Bittrex Platform.

Id. at 33.

[133] *See Markets*, BITTREX, https://bittrex.com/home/markets [https://perma.cc/2K5Y-6RZL] (containing a list of crypto markets in which Bittrex facilitated trades). On May 8, 2023, Bittrex filed for Chapter 11 bankruptcy protection in Delaware and, thus, no longer supports cryptoassets trading. *See* Turner Wright, *Bittrex files for Chapter 11 Bankruptcy just Weeks after SEC Charges*, COINTELEGRAPH, https://cointelegraph.com/news/crypto-platform-bittrex-files-for-chapter-11-bankruptcy-following-sec-charges [https://perma.cc/Z8XD-TT9N] (May 8, 2023 10:50 PM).

[134] *See Today's Cryptocurrency Prices by Market Cap*, COINMARKETCAP, https://coinmarketcap.com [https://perma.cc/ZFS8-QANY] [hereinafter May 2 COINMARKETCAP chart] (showing that as of May 2, 2023, Ether was the cryptoasset with the second highest market capitalization). According to CoinMarketCap, the total market capitalization of Ether was approximately $220 billion. *Id.*

[135] *See id.* (showing that Cardano (ADA) was the seventh most highly capitalized cryptoasset as of May 2, 2023, with a total market capitalization in excess of $13.42 billion). It is worth noting that the SEC did specifically name ADA as a security in two later enforcement actions. *See infra* notes 173, 254 and accompanying text.

[136] *See* May 2 COINMARKETCAP chart, *supra* note 134 (showing that as of May 2, 2023, Dogecoin was the eighth most heavily capitalized cryptoasset with a total market capitalization of nearly $11 billion). Despite having been created as a joke, Dogecoin was popularized, in part, by Elon Musk, who once described the asset as "the people's crypto." *See* Taylor Locke, *Elon Musk on his Crypto Portfolio: I Only Own Bitcoin, Ether and Dogecoin*, CNBC MAKE IT (Oct. 25, 2021, 11:34 AM), https://www.cnbc.com/2021/10/25/elon-musk-on-his-crypto-portfolio-and-why-he-supports-dogecoin.html [https://perma.cc/WZN6-85P8].

Polygon,[137] Litecoin,[138] and TRON.[139] The Bittrex exchange also facilitated transactions involving stablecoins[140] (which Gensler has also said might be securities)[141] such as Tether[142] and USDC.[143] Notwithstanding this list of cryptoassets that might be of significant interest to more people,[144] the Bittrex complaint focuses on six assets with substantially lower market capitalizations and profiles.[145]

The most heavily capitalized cryptoasset identified in the Bittrex complaint as a security is ALGO,[146] and even it is not in the top forty cryptoassets in terms of how much value is at stake.[147] In addition, it is the only cryptoasset identified by the SEC with a total market capitalization in excess of $1 billion.[148] DASH,[149] the next most heavily capitalized cryptoasset listed in the complaint, is ranked seventy-ninth in terms of overall capitalization by

[137] *See* May 2 COINMARKETCAP chart, *supra* note 134 (showing Polygon's market capitalization as of May 2, 2023, was nearly $8.9 billion, making it the ninth most heavily capitalized cryptoasset).

[138] *See id.* (showing Litecoin had a market capitalization of more than $6.42 billion as of May 2, 2023).

[139] *See id.* (showing that TRON's market capitalization was over $6 billion as of May 2, 2023).

[140] A "stablecoin" is a form of cryptoasset designed to maintain a price that is stable in relation to another asset, usually a fiat currency and most commonly the U.S. Dollar. For a description of stablecoins and how they function, see Werner Vermaak, *Stablecoins: The Complete Guide, Part I – Past & Present (2014-2019)*, COOLWALLET BLOG (Sept. 22, 2019), https://www.coolwallet.io/the-complete-guide-to-stablecoins-part-i-2014-2019/ [https://perma.cc/3XA9-8KJG].

[141] Hannah Lang, *Analysis: Stablecoin Regulatory Crackdown Sends Warning to Industry*, REUTERS (Feb. 22, 2023, 1:15 PM), https://www.reuters.com/technology/stablecoin-regulatory-crackdown-sends-warning-industry-2023-02-22/ [https://perma.cc/MYN4-9ZXA] ("SEC Chairman Gary Gensler has previously said he believes some stablecoins are in fact securities, which require registration and additional regulatory oversight.").

[142] Tether is actually the third most heavily capitalized cryptoasset, with a total market capitalization of more than $81.8 billion. *See* May 2 COINMARKETCAP chart, *supra* note 134. More significant than its market capitalization, however, is its 24-hour trading volume, which has consistently been significantly higher than the trading volume of any other cryptoasset. *See generally* Daniel Phillips, *Why Tether is the Real King of Crypto*, DECRYPT (Feb. 18, 2020), https://decrypt.co/19786/why-tether-is-the-real-king-of-crypto [https://perma.cc/8HB3-LGE4] (noting that even back in 2020, "US dollar stablecoin Tether has sucked up 50% of the entire crypto trading market.").

[143] USDC is the stablecoin managed by a consortium called Centre, which was founded by Circle in partnership with Coinbase. *USD Coin (USDC)*, CRYPTONEWS, https://cryptonews.com/coins/usd-coin/ [https://perma.cc/288J-V46N]. USDC market capitalization as of May 2, 2023, was nearly $30.4 billion, making it the fifth most heavily capitalized cryptoasset. *See* May 2 COINMARKETCAP chart, *supra* note 134.

[144] For example, there is considerable interest in the classification of Ethereum. For a discussion of concerns over this particular cryptoasset's status, see *infra* Part IV.D.

[145] *See* Bittrex Complaint, *supra* note 129, § III.B.

[146] *Id.* § III.B.iii.

[147] May 2 COINMARKETCAP chart, *supra* note 134.

[148] ALGO's total market capitalization was just over $1.27 billion, making it the forty-first most heavily capitalized cryptoasset as of May 2, 2023. *Id.*

[149] *See* Bittrex Complaint, *supra* note 129, § III.B.ii.

CoinMarketCap,[150] and its total market capitalization as of May 2, 2023, was just under $543 million.[151] OMG[152] had a market capitalization of approximately $150.3 million,[153] and total investment in TKN[154] as of May 2023 was under $2.5 million.[155] IHT[156] had a total market capitalization of less than $150 thousand.[157] CoinMarketCap ranked NGC (the fifth asset identified as securities by the SEC in its complaint)[158] at 4,055th in terms of overall market capitalization, without verification of the data provided by the issuer.[159]

Despite Bittrex clearly having listed and traded in a sizeable number of more popular and better-known cryptoassets, the SEC listed only these six "examples" of assets that qualify as securities.[160] The agency offered no reason why it failed to include any of the better known and more visible forms of crypto in its analysis. In addition, the SEC failed to clarify whether any of the assets not singled out were in fact securities, or if they would fall outside the definition of investment contract.

If the test is as clear and easy to apply as the SEC and its chair have repeatedly claimed, the delay in addressing more significant assets seems inexplicable. If almost all cryptoassets are securities, it makes no sense for the SEC to refuse to explain how its analysis applies to the assets that have attracted the highest levels of investment and that would likely impact the most people. The agency's delay in explaining how the most heavily traded assets should be characterized has also been extremely unhelpful to those in crypto businesses for whom accurate classification of cryptoassets

150 May 2 COINMARKETCAP chart, *supra* note 134.
151 *Id.*
152 *See* Bittrex Complaint, *supra* note 129, § III.B.i.
153 This gave OMG a rank of 176th in terms of overall market capitalization. *OMG Network*, COINMARKETCAP, https://coinmarketcap.com/currencies/omg/ [https://perma.cc/2MXL-MMZY]. The May 2 CoinMarketCap chart, *supra* note 134, only lists the top 100 ranked cryptoassets, so there are separate cites describing the other assets identified by the SEC in its complaint against Bittrex.
154 *See* Bittrex Complaint, *supra* note 129, § III.B.iv.
155 The TKN token's rank on May 2, 2023, was 1,184th. *Monolith*, COINMARKETCAP, https://coinmarketcap.com/currencies/monolith/ [https://perma.cc/2N3A-3YEG].
156 *See* Bittrex Complaint, *supra* note 129, § III.B.vi.
157 The IHT token was ranked 2,052nd. *IHT Real Estate Protocol*, COINMARKETCAP, https://coinmarketcap.com/currencies/iht-real-estate-protocol/ [https://perma.cc/LTU3-5ARW].
158 Bittrex Complaint, *supra* note 129, § III.B.v.
159 The unverified capitalization of this asset was just over $6 million. *NAGA*, COINMARKETCAP, https://coinmarketcap.com/currencies/naga/ [https://perma.cc/S4V8-PYNT].
160 *See* Bittrex Complaint, *supra* note 129, at 17, 33–51.

is essential.[161] Constant repetition of the conclusion that almost all cryptoassets are securities is not an adequate substitute for clear explanation of why some assets are being singled out by the SEC while others are not.

4. *SEC v. Binance*[162]

Admittedly, the SEC made progress in clarifying how it would classify some of the more significant cryptoassets less than two months later.[163] On June 5, 2023, the SEC unveiled a massive lawsuit against Binance and its founder, Changpeng Zhao.[164] Binance operates the largest cryptoasset trading platform in the world[165] and has an open presence in the U.S. through an affiliated entity, Binance.US.[166] According to the SEC's complaint, however, the parent company systematically concealed efforts so that it also retained major U.S.-based clients and also facilitated transactions with such customers.[167] The complaint alleges that Binance illegally sold its own cryptoassets (both BNB and BUSD)[168] in the U.S. without registration;[169] operated an unregistered, non-exempt securities exchange, acting as an unregistered broker/dealer and a clearing agency by trading in other cryptoassets that were securities;[170] and made numerous "materially false and misleading

[161] *See* Rohan Goswami, *Coinbase Sues SEC After Months of Silence from Federal Regulator*, CNBC (Apr. 24, 2023), https://www.cnbc.com/2023/04/24/coinbase-sues-sec-after-months-of-silence-from-federal-regulator.html [https://perma.cc/E3TY-YCZ2].

[162] Complaint, SEC v. Binance, No. 23-cv-01599 (D.D.C., June 5, 2023), https://www.sec.gov/files/litigation/complaints/2023/comp-pr2023-101.pdf [https://perma.cc/P545-AKRP] [hereinafter Binance Complaint].

[163] *See id.* § VIII.

[164] Press Release, SEC, SEC Files 13 Charges Against Binance Entities and Founder Changpeng Zhao (June 5, 2023), https://www.sec.gov/news/press-release/2023-101 [https://perma.cc/N9PV-ENJW] [hereinafter Binance Pr. Rel.]; Binance Complaint, *supra* note 162.

[165] According to CoinMarketCap, as of June 6, 2023, the 24-hour trading volume of cryptoassets on the Binance platform exceeded $12 billion, while the trading volume on Coinbase (the second largest exchange), was barely over $1.4 billion. *See Top Cryptocurrency Spot Exchanges*, COINMARKETCAP, https://coinmarketcap.com/rankings/exchanges/ [https://perma.cc/JVU6-939W].

[166] *Our US Partner, Binance.US, Opens for Registration and Deposits*, BINANCE (Sept. 17, 2019, 8:35 PM), https://www.binance.com/en/support/announcement/our-us-partner-binance-us-opens-for-registration-and-deposits-360033855351 [https://perma.cc/7XZ3-MKS7].

[167] Binance Complaint, *supra* note 162, at 2–3.

[168] As explained in the SEC's press release announcing the lawsuit, BNB is an exchange token issued by Binance, and BUSD (Binance USD) is a stablecoin pegged to the U.S. dollar. Binance Pr. Rel., *supra* note 164.

[169] Binance Complaint, *supra* note 162, at 2.

[170] *Id.* at 5–6.

statements and engaged in . . . courses of business that operated as a fraud or deceit . . . ."[171]

In addition to listing ALGO as a security (which it had previously done in the Bittrex action),[172] the SEC alleged that Binance had facilitated transactions in a number of additional cryptoassets that the Commission identified as securities for the first time.[173] In addition to Binance's own assets, BNB and BUSD, the cryptoassets identified as securities in the Binance action are SOL, ADA, MATIC, FIL, ATOM, SAND, MANA, ALGO, AXS, and COTI.[174] This list includes the seventh most heavily capitalized cryptoasset (Cardano's ADA), the ninth and tenth most heavily capitalized (SOL and MATIC, respectively), and the nineteenth most capitalized cryptoasset (ATOM).[175] Of the nine new cryptoassets identified in the complaint, only one (COTI) was not in the top sixty cryptoassets in terms of market capitalization.[176] While this is a tremendous improvement in terms of information from the SEC about the most heavily capitalized cryptoassets, the complaint still fails to explain why it took the Commission so long to identify more significant assets as securities and why these particular assets have been singled out.[177]

One of the confusing aspects of the assets that are identified in this complaint as securities is that most of them have been around for some time,[178] yet this is the first time that the SEC has called them out as being securities.[179] And while they are noticeably more heavily

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171 *Id*. at 6.

172 Bittrex Complaint, *supra* note 129, § III.B.iii.

173 Binance Complaint, *supra* note 162, at 85.

174 *Id*.

175 *Today's Cryptocurrency Prices by Market Cap*, COINMARKETCAP, https://coinmarketcap.com/ [https://perma.cc/P3DG-FET8] [hereinafter June 6 COINMARKETCAP chart].

176 As of June 6, 2023, COTI was the 304th most heavily capitalized cryptoasset according to CoinMarketCap. *COTI*, COINMARKETCAP, https://coinmarketcap.com/currencies/coti/ [https://perma.cc/4AKW-ANJZ].

177 *See* Binance Complaint, *supra* note 162.

178 As noted in the complaint, all of the assets identified as securities have been sold to the public since at least 2020, and many for years before that. *See id.* § VIII. ADA was first sold to the public in 2015. *Id.* at 92. ATOM was sold starting in 2017, *id*. at 105, as was MANA, *id*. at 111–12. MATIC was publicly sold beginning in 2018, *id.* at 95, while SAND, ALGO, and COTI were all first sold to the public in 2019, *id*. at 109, 115, 121. SOL, FIL and AXS were sold starting in 2020, *id*. at 88, 99, 119.

179 *See* Evan Jones, *What Cryptocurrencies Are Securities? A Comprehensive List*, CRYPTOVANTAGE (Sept. 8, 2023), https://www.cryptovantage.com/news/what-cryptocurrencies-are-securities-a-comprehensive-list/ [https://perma.cc/Z4VJ-CNSG]; *see also* Lyllah Ledesma, *SEC's Binance, Coinbase Suits Create Uncertain Future for Listed Tokens: Legal Experts*, COINDESK, https://www.coindesk.com/markets/2023/06/12/secs-binance-coinbase-suits-create-uncertain-future-for-listed-tokens-legal-experts/ [https://perma.cc/KX4P-YQJA] (June 13,

capitalized than assets previously identified as securities,[180] there remain inexplicable gaps. Why is Dogecoin not listed? It is the most heavily capitalized cryptoasset after ADA,[181] and it is certainly traded on Binance.[182] Other cryptoassets that are also listed on Binance.US, which is supposedly more restrictive in its listings than its parent, include a number of assets that are in the top twenty in terms of capitalization,[183] and yet LTC, DOT, SHIB, and AVAX were omitted from the SEC's list of securities with no explanation.[184]

In addition, for the assets that are singled out by the SEC in its complaint against Binance, there is a disconnect between the allegations that the Commission claims show why each asset is a security and the judicially-articulated elements of the *Howey* test.[185] The elements of *Howey* that are most difficult to apply to cryptoassets are typically a determination of whether the asset is being purchased with an expectation of profits, and whether those profits depend on the entrepreneurial efforts of another.[186] Most of the specific allegations about the cryptoassets identified in the Binance complaint seem only tangentially or inferentially related to those requirements.[187]

For example, the SEC implies that representations about the competence of the creative development team prove that purchasers would "reasonably" be anticipating profits when they buy a cryptoasset.[188] In actuality, purchasers would logically be just as

2023, 11:05 AM) (discussing the tokens that the SEC listed as securities in its lawsuits against Binance and Coinbase).

[180] *See, e.g.*, Bittrex Complaint, *supra* note 129, § III.B (listing six such assets).

[181] As of June 6, 2023, the day after the Binance suit was filed, Dogecoin was ranked as the eighth most heavily capitalized cryptoasset. June 6 COINMARKETCAP chart, *supra* note 175.

[182] *See Markets Overview*, BINANCE, https://www.binance.com/en/markets/overview [https://perma.cc/UA5M-L6K3].

[183] *Compare Markets Overview*, BINANCE.US, https://www.binance.us/price [https://perma.cc/S7WE-HLZW], *with Today's Cryptocurrency Prices by Market Cap*, COINMARKETCAP.COM, https://coinmarketcap.com/ [https://perma.cc/4CD7-JGG8] [hereinafter June 19 COINMARKETCAP chart].

[184] *See* Binance Complaint, *supra* note 162, at 86–87. As of June 19, 2023, LTC was the eleventh most heavily capitalized cryptoasset; DOT was thirteenth; SHIB was seventeenth; and AVAX was nineteenth. June 19 COINMARKETCAP chart, *supra* note 183. This pattern of identifying some forms of crypto as securities while skipping over others with no explanation adds to the confusion as to which assets are properly considered to be investment contracts. *See* Goforth, *supra* note 33, at 290.

[185] For a description of the *Howey* test, see *supra* notes 25–33 and accompanying text.

[186] The first two elements of *Howey* (an investment of money or something of value, and a common enterprise) are typically present in crypto sales. SEC, *Framework*, *supra* note 11; *see also* Goforth, *supra* note 33, at 286.

[187] *See* Binance Complaint, *supra* note 162, § VIII.

[188] Representations about the competence or expertise of team members are made in connection with most of the cryptoassets identified in the complaint as securities. *See* Binance Complaint, *supra* note 162, at 94 (with regard to ADA), 97 (describing MATIC as having a

interested in that information for a variety of other reasons, such as making sure that there is appropriate functionality for the cryptoasset and ensuring that reasonable precautions have been taken in the programming so that it is not susceptible to "bugs" or hacks.[189] This need not be related to any expectation of gain upon resale and, instead, could relate to the purchaser's interest in the underlying utility of the asset.[190] In fact, the complaint makes no reference to any explicit promise of profits or profitability for most of the identified assets and, instead, merely asserts, without evidence or analysis, that other statements would "lead investors" to reasonably expect profits.[191]

In apparent support of its contention that purchasers of the identified cryptoassets were expecting profits from the efforts of others, the complaint also includes a range of information that is not directly relevant to sales of the tokens themselves, or at least not to sales occurring after listing of the assets on the Binance exchange.[192] For example, SAND was listed by Binance.US since October 2022.[193] Nonetheless, the SEC discusses activity that occurred as far back as 2019,[194] as well as facts surrounding an August 13, 2020, distribution of tokens[195] and a variety of comments from 2021.[196] The SEC complaint does not elaborate on why those early actions and statements continue to be relevant, given that SAND was not yet listed on the Binance platform and that the Commission's published framework for evaluating digital assets as investment contracts[197] calls for re-evaluation of the status of such assets over time.[198]

"very, very committed" team), 102 (regarding FIL), 107 (regarding ATOM), 110–11 (regarding SAND), 118 (regarding ALGO), 120 (regarding AXS), and 122–23 (regarding COTI).

189 *See, e.g.*, Andrew Verstein, *Crypto Assets and Insider Trading Law's Domain*, 105 IOWA L. REV. 1, 33 (2019).

190 *See id.* at 10 (discussing "utility tokens"); *see also* Menesh S. Patel, *Fraud on the Crypto Market*, 36 HARV. J.L. & TECH. 171, 182–83 (2022).

191 Conclusory allegations that purchasers were led to expect profits are made throughout the complaint. *See* Binance Complaint, *supra* note 162, at 92 (SOL), 93–94 (ADA), 98 (MATIC, stating without explanation that burning of tokens means the investors were lead to expect profits), 103 (FIL, suggesting that allocating tokens to specific groups and burning of tokens, respectively, showed expectations of profit by FIL holders), 106 (ATOM), 109 (SAND), 112 (MANA), 117 (ALGO), 120 (AXS), and 121 (COTI).

192 *See id.* § VIII.

193 *Id.* at 109.

194 *Id.*

195 *Id.*

196 *Id.*

197 *See id.* at 108–11; SEC, *Framework, supra* note 11. For a description of the SEC's published framework, see *supra* Part IV.A.

198 The Framework states that "[i]n evaluating whether a digital asset previously sold as a security should be reevaluated at the time of later offers or sales, there would be additional considerations as they relate to the 'efforts of others.'" SEC, *Framework, supra* note 11.

In other cases, the SEC complaint appears to go on a tangent, discussing staking programs.[199] The complaint does not suggest that Binance created the staking protocols, so the question of whether the staking arrangements would also be investment contracts seems to be a digression from the issue of whether the staked cryptoassets themselves are securities.[200] The complaint seems to be missing a substantive analysis as to why availability of staking turns the underlying cryptoasset into a security.[201]

To illustrate some additional questions raised by the SEC's approach, consider in more detail the Commission's analysis of the AXS token, which is widely described as a crypto gaming token.[202] AXS allows players in the Axie Infinity game to interact through digital pets.[203] The token can be used for in-game purchases and can be staked.[204] Moreover, the SEC specifically suggests that the developer's efforts at improving game-play are what makes the token more like a security.[205] There are no statements or projections about profitability of the token or efforts to improve value—as opposed to growing the game—referenced in the complaint.[206] Given that the SEC's own framework on classification of such assets says that characteristics such as the ability to use the token for its intended function, and that marketing the asset "in a manner that emphasizes the functionality of the digital asset" make it less likely that the asset

Included in such considerations are the continuing efforts of the active participants and current expectations of purchasers. *Id.* Those factors are ignored in the SEC's complaint. *See generally* Binance Complaint, *supra* note 162.

[199] The list of these assets includes SOL, MATIC, SAND, ALGO, and AXS. *See id.* at 85, 95, 108, 117 (respectively).

[200] *See generally id.* (lacking any suggestion that Binance created the staking protocols).

[201] *See generally id.* (lacking a substantive analysis as to why the availability of staking turns the underlying cryptoasset into a security).

[202] *See* Omkar Godbole, *Crypto Gaming Token AXS Surges 40% Ahead of $64M Token Unlock*, YAHOO! (Jan. 23, 2023), https://www.yahoo.com/now/crypto-gaming-token-axs-surges-075102464.html [https://perma.cc/XZ2S-XHNF]. Allegations relating to AXS appear in the Binance Complaint, *supra* note 162, at 119–21. Interestingly, both SAND and MANA have similar overtones. SAND is a native token for the Sandbox platform, a virtual gaming network. *See id.* at 108. MANA is minted by Decentraland, a virtual reality platform. *See id.* at 112. All three of these assets appear to have been marketed and promoted primarily through the developer's efforts at improving the virtual experience associated with the asset. *See id.* at 109, 112, 120. Thus, the following description of how the complaint focuses on allegations about AXS also apply generally to other assets identified in the complaint as securities. *See generally id.*

[203] *Id.* at 119.

[204] *Id.*

[205] *See id.* at 120 ("Today, we're proud to share more info on the $AXS strategic sale! The participants will help open amazing new doors. The capital will help us scale the team so we can better deliver on the gameplay and feature updates you're all patiently waiting for!").

[206] *See id.* at 119–20.

will be an investment contract,[207] this analysis is both questionable and confusing.

Note that this discussion does not focus on the appropriate characterization of Binance's own coins, BNB[208] and BUSD.[209] While the SEC's complaint does allege that both of these assets are securities,[210] the specific way in which these assets were marketed (e.g., BNB allegedly being promoted as "an investment in Binance's efforts")[211] would not be in accordance with the way in which most cryptoassets are currently promoted or sold.[212] Thus, there might be less confusion about whether the securities laws should apply to sales of those assets. Overall, however, the complaint does not make a compelling case that it is easy or straightforward to predict which cryptoassets are securities, except perhaps in the unusual case where the issuer specifically markets them as an investment in the issuer itself.[213]

Binance, however, is not the most recent crypto exchange to be targeted by the SEC.[214]

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[207] *See* SEC, *Framework*, *supra* note 11. This document, specifically intended to help developers and others figure out which assets are investment contracts, states that:

> Although no one of the following characteristics of use or consumption is necessarily determinative, the stronger their presence, the less likely the *Howey* test is met:
>
> . . . .
>
> - Holders of the digital asset are immediately able to use it for its intended functionality on the network, particularly where there are built-in incentives to encourage such use.
>
> . . . .
>
> - Any economic benefit that may be derived from appreciation in the value of the digital asset is incidental to obtaining the right to use it for its intended functionality.
> - The digital asset is marketed in a manner that emphasizes the functionality of the digital asset, and not the potential for the increase in market value of the digital asset.
> - Potential purchasers have the ability to use the network and use (or have used) the digital asset for its intended functionality.

Id.

[208] According to the complaint, BNB (also known as Binance Coin) "was offered and sold as a security because Binance touted an investment in BNB as an investment in Binance's efforts to create a successful crypto asset trading platform centered around BNB." Binance Complaint, *supra* note 162, at 23.

[209] BUSD, a stablecoin issued by the Binance platform, was also alleged to be a security illegally sold without registration. *See id.* at 69.

[210] *Id.*

[211] *See id.* at 23–24.

[212] *See id.* at 20–22.

[213] *See id.* at 23–24.

[214] *See, e.g.*, Press Release, SEC, SEC Charges Coinbase for Operating as an Unregistered Securities Exchange, Broker, and Clearing Agency (June 6, 2023), https://www.sec.gov/news/press-release/2023-102, [https://perma.cc/QFH9-WA54]; Complaint at 1, SEC v. Coinbase, Inc., No. 23-Civ.-4738 (S.D.N.Y. June 6, 2023),

C. SEC and its Actions Involving Coinbase

A more recent action by the SEC against a major crypto exchange was initiated one day after its complaint against Binance was filed;[215] the target of this action is Coinbase, the largest U.S.-based crypto trading platform.[216] Coinbase itself, however, had also been the target of other SEC investigations.[217]

Between the summers of 2021 and 2023, the SEC sent Coinbase two different Wells Notices.[218] The first notice was received in the summer of 2021 in connection with the company's planned lending program.[219] The second was received in March 2023 in connection with the operation of Coinbase's crypto trading platform.[220] A consideration of both of those notices indicates considerable reason to question exactly how transparent the SEC is being, and even more importantly for this Article, whether the documents support the SEC's repeated position that the application of the securities laws to

https://www.sec.gov/litigation/complaints/2023/comp-pr2023-102.pdf [https://perma.cc/7JHL-ASYT] [hereinafter Coinbase Complaint].

[215] The Binance complaint was filed on June 5, 2023. Binance Complaint, *supra* note 162, at 136. On June 6, 2023, the SEC filed a similar action against Coinbase, Coinbase Complaint, *supra* note 216, at 101, although this complaint lacked any allegations of fraud or manipulation and instead focused on the company's failure to register as an exchange, a broker-dealer, or a clearing agency. *See id.* at 2.

In addition, while this Article was being prepared for publication, the SEC announced another lawsuit against a crypto trading platform. On November 20, 2023, the SEC announced that it had charged Payward, Inc. and Payward Ventures, Inc., collectively known as Kraken, with failing to register as a securities exchange, broker, dealer, and clearing agency. *See* Press Release, SEC, SEC Charges Kraken for Operating as an Unregistered Securities Exchange, Broker, Dealer, and Clearing Agency (Nov. 20, 2023), https://www.sec.gov/news/press-release/2023-237 [https://perma.cc/XG7Q-6Y7W]. The complaint in that case, however, does not identify additional cryptoassets as securities and instead repeats allegations in earlier complaints. *See* Complaint at 15, SEC v. Payward, Inc., No. 23-cv-06003 (N.D. Cal., Nov. 20, 2023), https://www.sec.gov/files/litigation/complaints/2023/comp-pr2023-237.pdf [https://perma.cc/5NEQ-E348].

[216] Coinbase Complaint, *supra* note 214, at 1.

[217] *See, e.g.*, David Yaffe-Bellany, *Inside a Crypto Nemesis' Campaign to Rein in the Industry*, N.Y. TIMES (Nov. 21, 2022), https://www.nytimes.com/2022/11/21/technology/gary-gensler-crypto-sec.html [https://perma.cc/GL3P-87YZ].

[218] *See* Paul Grewal, *The SEC Has Told Us It Wants to Sue Us over Lend. We Don't Know Why.*, COINBASE BLOG (Sept. 7, 2021), https://www.coinbase.com/blog/the-sec-has-told-us-it-wants-to-sue-us-over-lend-we-have-no-idea-why [https://perma.cc/PTF4-8KAN] [hereinafter Grewal, *Lend*]; Paul Grewal, *We Asked the SEC for Reasonable Crypto Rules for Americans. We Got Legal Threats Instead.*, COINBASE BLOG (Mar. 22, 2023), https://www.coinbase.com/blog/we-asked-the-sec-for-reasonable-crypto-rules-for-americans-we-got-legal [https://perma.cc/R265-7PSU] [hereinafter Grewal, *Threats*]. For a description of Wells Notices, see *supra* note 13.

[219] *See* Grewal, *Lend*, *supra* note 218.

[220] *See* Grewal, *Threats*, *supra* note 218.

cryptoassets is "clear." They also provide important insights into the most recent action by the SEC against Coinbase—the lawsuit initiated on June 6, 2023.[221]

1. The SEC Targets Coinbase Lend

In June 2021, Coinbase announced plans—that it eventually abandoned—to allow crypto owners the option of earning interest on their crypto by depositing it with the exchange.[222] The planned program, tentatively called Coinbase Lend,[223] would have allowed eligible Coinbase customers to earn interest on deposits of USD Coin (USDC)[224] at predetermined rates (originally set at 4%) that would have been significantly higher than rates available on interest-bearing deposit accounts at legacy financial institutions.[225] Coinbase would have guaranteed the USDC designated as participating in the program, but the deposits would not have been federally insured.[226]

[221] *See id.*; Grewal, *Lend*, *supra* note 218; Coinbase Complaint, *supra* note 214, at 101.

[222] The Coinbase Blog announced the planned Coinbase Lend program on June 29, 2021, suggesting that customers could pre-enroll to earn interest "with rates more than 50x the national average of a traditional savings account." *Update as of 5pm ET, Friday, September 17th: We Are Not Launching the USDC APY Program Announced Below*, COINBASE (June 29, 2021), https://www.coinbase.com/blog/sign-up-to-earn-4-apy-on-usd-coin-with-coinbase [https://archive.ph/Ef5EW] [hereinafter Coinbase Announcement]. This investment information is also available at *Earn 4% APY on USDC*, WAYBACK, https://web.archive.org/web/20210909081423/https://www.coinbase.com/lend [hereinafter Coinbase, WAYBACK].

[223] Grewal, *Lend*, *supra* note 218.

[224] Coinbase, WAYBACK, *supra* note 222. In essence, the plan was that Coinbase customers could lend assets to the platform, which would then pay those customers interest for the amounts that were on deposit, and which were pledged to the lend program. *See id.* Coinbase promised to guarantee that it would repay those amounts on demand. *Id.* For a description of stablecoins generally, see *supra* note 140.

[225] "Coinbase planned to launch the Lend product with the functionality for users to stake the stablecoin USDC and earn (*as a starting rate*) 4% APY." Lucas Matney, *Following SEC Lawsuit Threat, Coinbase Cancels Launch of 'Lend' Product*, TECHCRUNCH (Sept. 20, 2021, 1:25 PM), https://techcrunch.com/2021/09/20/following-sec-lawsuit-threat-coinbase-cancels-launch-of-lend-product/ [https://perma.cc/RW85-ZAG2]. Coinbase specifically told its customers that this was approximately "eight times the national average for high-yield savings accounts." Peter Feltman, *SEC Seen Having Clear Case Against Coinbase's Lending Program*, ROLL CALL (Sept. 28, 2021, 6:00 AM), https://rollcall.com/2021/09/28/sec-seen-having-clear-case-against-coinbases-lending-program/ [https://perma.cc/K6KK-3XBY].

[226] Coinbase, WAYBACK, *supra* note 222. Customers who participated in the program would have a contractual right to a repayment of the assets that were lent upon demand. Grewal, *Lend*, *supra* note 218. Despite explicit comparisons to conventional savings accounts, the site specifically warned that: "Lend is not a high-yield USD savings account, and Coinbase is not a bank. Your loaned crypto is not protected by FDIC or SIPC insurance." Coinbase, WAYBACK, *supra* note 222.

Despite early positive reactions from customers,[227] Coinbase publicly announced on September 7, 2021, that it had received a Wells Notice from the SEC stating the Commission's intention to initiate an enforcement action against the planned Coinbase Lend program.[228] According to the report, the drafting of which was credited to Coinbase's chief legal officer, Paul Grewal, the SEC was less than forthcoming about why it had preliminarily concluded that the planned Coinbase Lend product would be a security.[229]

While the Wells Notice itself was not made public, Coinbase reported that the SEC had referred to two different Supreme Court decisions to support its determination that the planned lending products would be securities: *SEC v. W.J. Howey Co.*[230] and *Reves v. Ernst & Young*.[231] According to Grewal, the SEC declined to provide details of how either *Howey* or *Reves* would apply to the planned Lend product, or even to explain which of the two tests was applicable.[232] As a result of the Wells Notice, Coinbase abandoned its plans to launch the Lend program, eliminating the possibility of further explanation from the SEC or the courts.[233]

Instead of adding clarity to the definition of security, the confusion over how *Howey* applies to cryptoassets was actually heightened as a result of this process.[234] If the *Howey* test and its application to cryptoassets is so clear, why was it necessary to cite to *Reves*, a Supreme Court case that considered when notes (not investment contracts) are securities?[235] It certainly could not have been that both tests apply, as the Supreme Court explicitly noted in *Reves* that the

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[227] *See* Parker Doyle, *Coinbase to Publish Regulatory Framework for U.S. Policy Makers*, VETTAFI, (Sept. 24, 2021), https://www.etftrends.com/crypto-channel/coinbase-to-publish-regulatory-framework-for-u-s-policy-makers/ [https://perma.cc/65SB-DG7H]. Coinbase had reported that "hundreds of thousands of customers across the U.S. had signed up for the Lend waitlist." *Id.*

[228] *See* Grewal, *Lend*, *supra* note 218.

[229] *See id.*

[230] SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

[231] Reves v. Ernst & Young, 494 U.S. 56 (1990).

[232] *See* Grewal, *Lend*, *supra* note 218.

[233] Following notice from the SEC that the Commission believed the plan would violate the federal securities laws, the Coinbase Lend product was abandoned without ever being brought to market. *See* Ben Bain & Bloomberg, *Coinbase Scraps Plans to Launch Crypto Lending Program After SEC Pressure*, FORTUNE (Sept. 20, 2021, 2:00 PM), https://fortune.com/2021/09/20/coinbase-crypto-lending-program-sec-trading/ [https://perma.cc/67KM-HJ7S]; Sohini Podder, *Coinbase Scraps Plans for Crypto Lending Program*, REUTERS (Sept. 20, 2021, 4:22 PM), https://www.reuters.com/business/finance/coinbase-scraps-plans-crypto-lending-program-2021-09-20/ [https://perma.cc/YB75-SV67].

[234] Grewal, *Threats*, *supra* note 218.

[235] "This case presents the question whether certain demand notes . . . are 'securities' . . . ." *Reves*, 494 U.S. at 58.

tests do not apply to the same kinds of interests.[236] Thus, this notice and this interaction between the SEC and Coinbase only served to increase the uncertainty over how and when crypto transactions are within the SEC's remit.

2. The SEC Goes After Coinbase More Broadly

The Coinbase Lend program was only the first instance of the SEC targeting Coinbase without giving much detail about the reasoning behind its conclusions. On March 22, 2023, Coinbase's Chief Legal Officer, Paul Grewal, posted a notice on the Coinbase blog that the company had received another Wells Notice from the SEC.[237] As described by Coinbase, among other things, the notice covered "an unspecified portion of our listed digital assets,"[238] without much detail about the agency's specific concerns:

> Today's Wells notice does not provide a lot of information for us to respond to. The SEC staff told us they have identified potential violations of securities law, but little more. We asked the SEC specifically to identify which assets on our platforms they believe may be securities, and they declined to do so.[239]

On April 19, 2023, Coinbase provided a written response to this notice, again making the fact of the interaction between the company and the SEC public.[240] The company's response noted that:

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[236] As the majority opinion in *Reves* explained:

> 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 instrument superfluous" . . . and would be inconsistent with Congress' intent to regulate the entire body of instruments sold as investments . . . .

Id. at 64 (quoting Landreth Timber Co. v. Landreth, 471 U.S. 681, 692 (1985)). The Court also cited back to *Landreth* in which the Court concluded that "the *Howey* economic reality test was designed to determine whether a particular instrument is an 'investment contract,' not whether it fits within *any* of the examples listed in the statutory definition of 'security.'" *Landreth*, 471 U.S. at 691.

[237] Grewal, *Threats*, *supra* note 218.

[238] *Id*.

[239] *Id*.

[240] *See* Wells Submission on Behalf of Coinbase Global, Inc. and Coinbase, Inc., *In re* Coinbase, Inc., File No. HO-14315) (U.S. Sec. & Exch. Comm'n Apr. 19. 2023), https://shorturl.at/cdtzL [https://perma.cc/XRE8-Y6SJ] [hereinafter Coinbase Submission].

> Because the Staff has not identified which assets it thinks are securities, Coinbase finds itself in the position of trying to respond to "some unspecified issue" with some unidentified assets, in order to "somehow . . . prove a negative"—namely that Coinbase "is not violating registration requirements." As a federal judge recently observed: "I don't know how any party could possibly be expected to address the SEC's comments with the limited guidance the SEC has provided."[241]

Coinbase did not merely argue that the SEC's guidance is limited, but also that the agency has been inconsistent in the limited guidance it has offered.[242] The company's response detailed the history of the SEC's approach, specifically pointing out that SEC Chairman Gensler had at one point argued before Congress that federal intervention was needed to give the agency authority over crypto exchanges.[243] Despite the fact that there have been no legislative developments, no new rules, and no new regulations,[244] according to Coinbase, the SEC's Wells Notice contained the apparently inconsistent assertion that its authority is now clear.[245]

According to Coinbase, the inconsistency in the SEC's approach to crypto regulation is also demonstrated by the change in position between 2021, when the agency approved the Coinbase registration statement,[246] and the pending Wells Notice which suggests the company's business model violates the federal securities laws.[247] The disparity in positions is highlighted by one of the SEC Staff's responses to the draft registration statement in 2021, in which Coinbase was asked to revise its documents

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[241] *Id*. at 37; *see id.* n.80 (citing Transcript of Hearing at 44, *In re* Voyager Digit. Holdings, No. 22-10943, 2023 WL 4305817 (Bankr. S.D.N.Y. June 30, 2023)). Coinbase also explicitly denied that it was trading in any cryptoasset that should be classified as a security. *See* Coinbase Submission, *supra* note 240, at 38–43. According to Grewal, "Coinbase has a rigorous process to analyze and review each digital asset before making it available on our exchange — a process that the SEC itself has reviewed." Ryan Browne, *Coinbase Blasts SEC Over Insider Trading Case, Says None of the Tokens It Lists are Securities*, CNBC (July 22, 2022), https://www.cnbc.com/2022/07/22/coinbase-blasts-sec-over-insider-trading-case.html [https://perma.cc/P7FH-Q7QL].

[242] *See* Coinbase Submission, *supra* note 240, at 28–29.

[243] *See id.* at 1–2; *infra* notes 321–26 and accompanying text.

[244] Coinbase Submission, *supra* note 240, at 26.

[245] *See id.*at 25–26 (noting that "now, without the passage of any legislation or rulemaking, the Commission's authority in this space has somehow appeared.").

[246] *See id.* at 1. The Coinbase response concedes that the SEC is not compelled to deny registration on the basis of potential illegality of the issuer's underlying business. *See id.* at 3. *But see id.* n.6 (describing the SEC's past practice in declining to review registration statements from marijuana cultivation companies and a sports betting company).

[247] *See id.* at 2; Grewal, *Threats*, *supra* note 218.

> to clarify that Bitcoin and Ether are the only digital assets as to which senior officials at the SEC have publicly expressed such a view, and further clarify that as to all other digital assets there is currently no certainty under the applicable legal test that such assets are not securities . . . .[248]

Consider the difference between that statement and the current position of the SEC, which appears to be based on the assumption that the vast majority of cryptoassets are clearly securities.[249]

If, as the SEC posits, the rules are clear, there should have been no hesitation in the SEC providing Coinbase a list of cryptoassets that it trades which are in fact securities. Despite the agency's claims that the rules are clear, its actions in declining to provide such a list pointed instead to a lack of clarity and transparency.

3. *SEC v. Coinbase*

On June 6, 2023, one day after filing against Binance, the SEC initiated an enforcement action against Coinbase,[250] arguing that the platform had operated improperly by failing to register as a securities exchange, a broker-dealer, and a clearing agency (as well as improperly offering an unregistered staking program of its own).[251] The complaint alleged that Coinbase had traded in a number of cryptoassets that are securities, including (without limitation) those "with trading symbols SOL, ADA, MATIC, FIL, SAND, AXS, CHZ, FLOW, ICP, NEAR, VGX, DASH, and NEXO," referred to in the complaint as the "Crypto Asset Securities."[252] SOL, ADA, MATIC, FIL, ATOM, SAND, MANA, ALGO, AXS, and COTI had already been listed in the SEC's lawsuit against Binance,[253] and DASH was listed

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[248] *See* Coinbase Submission, *supra* note 240, at 13 (quoting Letter from SEC Div. of Corp. Fin. to Brian Armstrong, Chief Exec. Officer, Coinbase Global, Inc., at 4 (Dec. 7, 2020) (emphasis omitted), https://www.sec.gov/Archives/edgar/data/1679788/000000000020011705/filename1.pdf [https://perma.cc/8WZE-46JL]).

[249] *See* Ari Levy & MacKenzie Sigalos, *SEC's Gensler Says 'The Law is Clear' for Crypto Exchanges and that They Must Comply with Regulators*, CNBC, https://www.cnbc.com/2023/04/27/sec-chairman-gary-gensler-says-the-law-is-clear-for-crypto-exchanges.html [https://perma.cc/X7FX-DZHG] (Apr. 27, 2023, 1:10 PM) ("SEC Chairman Gary Gensler has a message for Coinbase and other crypto exchanges: The rules are clear, and they must be obeyed.").

[250] *See supra* notes 215–16 and accompanying text.

[251] *See* Press Release, SEC, *supra* note 214.

[252] Coinbase Complaint, *supra* note 214, at 33.

[253] *See* Binance Complaint, *supra* note 162, at 85.

in the complaint against Bittrex,[254] meaning CHZ, FLOW, ICP, NEAR, VGX, and NEXO were the only cryptoassets identified as securities for the first time.[255]

Even following the filing of the Coinbase action, many of the questions raised by the Binance complaint remain. Why is Dogecoin still not identified as a security, unless it is not one?[256] Why are heavily traded cryptoassets such as LTC, DOT, SHIB, and AVAX again omitted from the SEC's list of securities?[257] And, of course, if the test to determine which assets are securities is so obvious, why has it taken the SEC so long to act?[258]

In another pattern reminiscent of the way the SEC approached cryptoassets in the *SEC v. Binance* complaint,[259] allegations about many of the tokens identified for the first time in *SEC v. Coinbase* also focused on the fact that various statements had been made over time about the caliber of the development team's expertise.[260] Similarly, many of the statements and actions which the SEC pointed to as evidence that the platform had listed securities occurred prior to the assets being traded on the exchange.[261] As was the case in the

[254] *See* Bittrex Complaint, *supra* note 129, at 23.

[255] *See* Coinbase Complaint, *supra* note 214, at 33; Binance Complaint, *supra* note 162, at 85; Bittrex Complaint, *supra* note 129, at 23.

[256] *See supra* notes 180–82 and accompanying text.

[257] *See supra* note 183 and accompanying text. All of these are on Coinbase's list of assets. You can verify this by going to the Coinbase website, choosing the option to "Explore" at the upper left side of the screen and then typing in the trading symbol for the asset. *Explore the Cryptoeconomy*, COINBASE, https://www.coinbase.com/explore [https://perma.cc/CJT7-MZAY]. If you scroll down, the detailed information about these assets includes their availability through Coinbase. *Id.*

[258] *See supra* notes 9, 178–79 and accompanying text (raising this issue in connection with the Binance complaint).

[259] *See generally* Binance Complaint, *supra* note 162. For a consideration of how that complaint focused attention on the expertise of development teams, see *supra* notes 188–91 and accompanying text.

[260] *See generally* Coinbase Complaint, *supra* note 214. For comments about the expertise of the CHZ development team, see *id.* at 59; for comments regarding the FLOW team, see *id.* at 64; for the ICP team's descriptions, noting that the issuer claimed to have "assembled one of the strongest science & engineering teams in tech, across several research centers worldwide," see *id.* at 67; for comments about the expertise of the Voyager founders behind the VGX token, see *id.* at 72; and for where the complaint focuses on comments about NEXO's team, see *id.* at 78. Although not quite the same as describing the expertise of the founders, the SEC complained about the issuer's mentioning the expertise of NEAR backers. *See id.* at 70 ("Near's website stated that NEAR is '[b]acked by the best,' followed by the logos of 10 venture capital firms and the following quotation from one of those firms' partners: 'NEAR is poised to be a leading smart contract blockchain platform, combining first-rate technology with a fast-growing developer ecosystem.'"). How these statements prove that purchasers would therefore have a profit motive for purchasing the cryptoassets is not explained.

[261] *See generally id.* For instance, the SEC suggests that actions relating to the original issuance of the CHZ tokens, including comments made at that time, prove an ongoing profit motive for sales after the listing on the Coinbase platform, which occurred years later. *See id.*

earlier complaint, the pleading in *SEC v. Coinbase* makes the assertion that these statements demonstrate the existence of a continuing profit motive for purchasers, without examining whether they could lead to other reasons for purchasing the assets or whether the statements are still being trusted.[262]

The SEC also seemed to continue an emphasis on gaming and similar activities,[263] singling out CHZ, the native token for the Chiliz sports and entertainment platform;[264] and FLOW, the token created by Dapper Labs as "the foundation for a new generation of games [and] applications . . . ."[265] This also follows the pattern established in the *SEC v. Binance* complaint, as there is no discussion of whether a desire to play the game or utilize the other applications might be driving the purchase decision in these cases.[266]

The *Coinbase* complaint also tends to focus on facts not directly relevant to the issue of whether the token itself is a security, but

at 58. With regard to the FLOW token, the SEC complains about the prelaunch of convertible notes, which were themselves never listed by Coinbase and which occurred long before listing of FLOW tokens by the platform. *See id.* at 62. The same kind of pre-launch fundraising was also highlighted in the case of both ICP and NEAR, without any explanation of how that conduct relates to appropriate classification of assets currently listed. *See id.* at 65–66, 68 (ICP and NEAR, respectively). The SEC also complained about NEXO's 2018 pre-sale, although Coinbase did not list those tokens until August 2021. *See id.* at 76–77.

This focus on commentary and activity substantially predating listing on the platform was also a characteristic of many of the statements focused upon in the Binance Complaint. *See supra* notes 192–98 and accompanying text.

[262] *See supra* notes 192–98. *See generally* Coinbase Complaint, *supra* note 214. For instance, the SEC states that actions and statements made both before and after CHZ was available to trade on Coinbase induced its holders to expect profits from the asset. *See id.* at 58. With regard to the FLOW token, the SEC claims that the information that was publicly disseminated led its holders to expect to profit. *See id.* at 63. The SEC made similar claims about ICP, NEAR, and NEXO, stating that the information disseminated about all three to the public led investors to expect profits. *See id.* at 66, 68–69, 77 (ICP, NEAR, and NEXO, respectively). There is no analysis explaining when the statements were made, or whether they would have continued to impact value in later decisions to trade. Certainly, statements made after investment decisions have been finalized could not have influenced the original decision to purchase.

[263] *See* Coinbase Complaint, *supra* note 214, at 57–58, 62. This was also a focus that appeared in the Binance Complaint. *See supra* notes 202–06 and accompanying text.

[264] *See* Coinbase Complaint, *supra* note 214, at 57–58 (CHZ was "advertised as the 'native digital token for the Chiliz sports & entertainment ecosystem currently powering Socios.com,' a sports fan engagement platform"). Confusingly, because the issuer touted the growth in sports and esports generally (without claiming to control the overall success of those endeavors), *see id.* at 60, this was deemed by the SEC to be evidence that token purchasers were investing for profit (rather than because of their interest in the underlying sports or esports), *see id.* at 58.

[265] *Id.* at 60 (reporting that Dapper Labs claimed that Flow (the platform) was "designed as 'the foundation for a new generation of games, applications, and the digital assets that power them'"). The complaint does not articulate a basis for concluding that purchasers would be interested in the profit potential rather than the ability to play the new games or participate in the new applications. *See id.* at 62–65.

[266] *See generally* Binance Complaint, *supra* note 162; Coinbase Complaint, *supra* note 214.

whether other contractual arrangements associated with the token could be securities.[267] Thus, issuers of three of the newly identified tokens are called out for offering staking programs.[268] While the Chairman of the SEC has been quoted as saying that staking makes it more likely that issuers are selling securities,[269] it is not certain if the SEC believes that a staking arrangement is itself an investment contract and, therefore, a security, or if its position is that the availability of staking somehow changes the nature of the underlying token.[270] The *Coinbase* complaint does not elaborate on this, but merely objects to Coinbase's decision to include tokens that operate on a proof-of-stake platform.[271]

Even more questionably, two other issuers had their crypto lending programs called into question.[272] Since it has not been clear what test the SEC uses to evaluate crypto lending under the securities laws,[273] allegations about the existence of such programs only serve to complicate the legal analysis of when particular cryptoassets are securities further.[274]

Although the SEC is gradually handing out information about how it assesses cryptoassets,[275] the application of the investment contract test to cryptoassets continues to be both murky and complex. Consider that the SEC needed approximately forty-seven pages of text in its complaint against Coinbase,[276] consisting of 191 separately

[267] *See* Coinbase Complaint, *supra* note 214, at 3–4. This was also seen in the Binance Complaint. *See supra* note 199 and accompanying text.

[268] *See* Coinbase Complaint, *supra* note 214, at 65, 66, 72–73 (FLOW, ICP, and VGX, respectively).

[269] *SEC's Gensler Says Staking May Turn Crypto into Securities*, PYMNTS (Sept. 15, 2022), https://www.pymnts.com/cryptocurrency/2022/secs-gensler-says-staking-may-turn-crypto-into-securities/ [https://perma.cc/HD53-53WG].

[270] *See generally* Coinbase Complaint, *supra* note 214; Binance Complaint, *supra* note 162.

[271] *See* Coinbase Complaint, *supra* note 214, at 81–82.

[272] *See id.* at 71, 79 (discussing the ability to earn interest by using VGX as part of Voyager Earn and focusing on NEXO, respectively).

[273] *See supra* notes 230–36 and accompanying text. As discussed earlier, there is confusion about whether the SEC believes crypto lending programs should be evaluated under the test articulated in *SEC v. W.J. Howey Co.*, 328 U.S. 293, 297–98 (1946), or the one announced in *Reves v. Ernst & Young*, 494 U.S. 56, 60 (1990).

[274] For a more detailed evaluation of the SEC's approach to crypto lending programs, see Carol R. Goforth, *Neither A Borrower Nor A Lender Be Analyzing the Sec's Reaction to Crypto Lending*, 18 U. MASS. L. REV. 2 (2022); *see also* Paul W. Richter, *Crypto Lending and SEC* Enforcement, *in* 7 J. WILLIAM HICKS, EXEMPTED TRANSACTIONS UNDER THE SECURITIES ACT OF 1933, § 16:126.10 (2d ed. 2023).

[275] *See SEC Declares Bitcoin and Ether as Non-Securities*, CASSELS (June 26, 2018), https://cassels.com/insights/sec-declares-bitcoin-and-ether-as-non-securities/ [https://perma.cc/48UR-86FM]; *see also SEC's Gensler Says Staking May Turn Crypto into Securities*, *supra* note 269.

[276] *See* Coinbase Complaint, *supra* note 214, at 33–80.

identified paragraphs,[277] to explain why it had concluded that the thirteen listed cryptoassets were securities.[278] This certainly does not make it look like the analysis is simple or obvious.

It is also worth noting that the *Coinbase* complaint criticized the platform for offering its own staking program.[279] While most of this Article focuses on cryptoassets generally rather than staking programs, many of the SEC's arguments about Coinbase's staking program raise the same questions that apply to the agency's classification of cryptoassets[280]

While the SEC is at least clear that it is applying the *Howey* test to these staking arrangements,[281] some of its conclusions are questionable. For example, the Commission maintains that the voluntary participants in Coinbase's staking programs rely on the essential efforts of Coinbase in seeking a return on their staking.[282] This analysis ignores significant aspects of the staking program.

First, each participant has to choose to invest in one of five stakeable assets (XTZ, ATOM, ETH, ADA, and SOL).[283] The participant chooses how much to place into the pool and for how long.[284] Those choices are not made by Coinbase.[285] While it is true that the participants are passive once those essential decisions are made,[286] Coinbase does not control how staking rewards are allocated; the underlying computer program relating to that particular asset sets those parameters.[287] Coinbase also does not

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[277] *See id.*

[278] *Id.* For the six assets identified for the first time as securities, the complaint required about twenty pages of text, *see id.* at 57–73, 76–80, and eighty-four paragraphs, *see id.*

[279] *See* Coinbase Complaint, *supra* note 214, at 81, 95–96.

[280] *See id.* at 81–85, 88–89, 92–95.

[281] *Id.* at 89 (claiming that "the Coinbase Staking Program, as it applied to each of the five stakeable assets, was an investment contract under *Howey*, and therefore a security . . . .").

[282] *See id.* at 93–95 (explaining why the SEC believes participants "Reasonably Expect to Profit from Coinbase's Efforts.").

[283] *See id.* at 81, 89.

[284] Lyle Daly, *What Is Staking in Crypto?*, MOTLEY FOOL, https://www.fool.com/investing/stock-market/market-sectors/financials/cryptocurrency-stocks/what-is-staking/ [https://perma.cc/3D8M-GCSC] (Apr. 21, 2023, 9:55 AM).

[285] *See* Coinbase Complaint, *supra* note 214, at 89.

[286] *See id.* at 93, 95.

[287] Consider this explanation how staking protocols may determine how to calculate and allocate staking rewards:

> Protocols calculate staking rewards in different ways, depending on a number of factors such as the number of coins staked per validator, the amount of time a validator has been staking, the total amount of tokens staked in the network, the amount of tokens in circulation compared to total supply, and various other parameters. [Proof of Stake] blockchains take different approaches to the rate of rewards issued over time, but generally target issuance and yield rates based on total stake deposited in the network.

What Is Staking? Blockchains, Oracles, and DeFi, CHAINLINK, https://chain.link/education-hub/what-is-staking-crypto [https://perma.cc/V67R-UBWG] (May 24, 2023). Note that

determine the value of the staking reward, which is a combination of the programming and market value of any cryptoassets paid out as a reward.[288]

Coinbase may make participation in the staking arrangements simpler for inexperienced crypto-holders[289] by holding the keys and maintaining the pools,[290] but the eventual profits are not derived primarily from those efforts.[291] Instead, the profits are derived from the staking program itself, which is not created, overseen, or controlled by Coinbase, and by the market for cryptoassets, which is similarly outside Coinbase's control.[292]

This kind of complexity further demonstrates the difficulty of applying the *Howey* investment contract test to crypto transactions, and certainly does nothing to clarify the issue of when cryptoassets are securities.

D. And What About Ether?

Finally, it is worth considering how the SEC has approached the question of how to classify Ether[293] under the securities laws. As mentioned earlier in this Article, at one point, it seemed the SEC had concluded that Ether was so decentralized that it was no longer a security (although it might have been initially).[294] In 2018, the Director of the Division of Corporation Finance, William Hinman, articulated that point of view,[295] and then-Chairman Jay Clayton

Coinbase has no control over this for any of the stakeable assets that its customers could allocate to staking. *See* Coinbase Complaint, *supra* note 214, at 86.

[288] "Every time a block is added to the blockchain, new cryptocurrency coins are minted and distributed as staking rewards to that block's validator. In most cases, the rewards are the same type of cryptocurrency that participants are staking. However, some blockchains use a different type of cryptocurrency for rewards." *See* Daly, *supra* note 284.

[289] Coinbase Complaint, *supra* note 214, at 93–94.

[290] *Id*. at 94.

[291] *See What Is Staking? Blockchains, Oracles, and DeFi*, *supra* note 289; Daly, *supra* note 286; *see also supra* text accompanying notes 287–87.

[292] *See* Daly, *supra* note 284 ("Staking rewards are an incentive that blockchains provide to participants."); *see also supra* notes 287–88 and accompanying text.

[293] Although usage in the popular press is not always consistent, Ether, abbreviated as ETH on trading platforms, is the underlying cryptoasset, while Ethereum is actually the blockchain network underlying all Ethereum-backed tokens, including Ether. Toshendra K. Sharma, *Is Ether The Same As Ethereum?*, BLOCKCHAIN COUNCIL (Oct. 4, 2019), https://www.blockchain-council.org/blockchain/is-ether-the-same-as-ethereum/ [https://perma.cc/7UUN-VSHD]; *see also What is Ether (ETH)?*, ETHEREUM (Sept. 28, 2023), https://ethereum.org/en/eth/ [https://perma.cc/ZKN9-R4TQ].

[294] *See supra* notes 54, 58 and accompanying text; *see also SEC Declares Bitcoin and Ether as Non-Securities*, *supra* note 275.

[295] "In an announcement at Yahoo Finance's All Market Summit: Crypto in San Francisco on Thursday [June 14, 2018], the U.S. Securities and Exchange Commission Director of Corporate Finance [sic] William Hinman said that the commission would not be classifying ether or bitcoin

appeared to agree with that conclusion.[296] Even current SEC Chair Gensler was believed to have acquiesced in that position at one time.[297] Any certainty as to this conclusion, however, has since evaporated.

In 2022, Ethereum shifted from its historical proof-of-work (POW) consensus protocol[298] to proof-of-stake (POS),[299] in a process generally referred to as "the Merge."[300] This conversion resulted in a small group of businesses controlling about "two-thirds of [all] staked Ether" (which is necessary for performing validation functions under the new protocol).[301] This degree of concentration has been compared

as securities." Ethan Wolff-Mann, *SEC Announces Cryptocurrency Ether is not a Security*, YAHOO!FINANCE (June 14, 2018), https://www.yahoo.com/entertainment/sec-announces-ether-not-security-162658147.html [https://perma.cc/SVD8-46KW].

[296] Without mentioning Ether by name, Jay Clayton was quoted as agreeing with the approach articled by William Hinton.

> I agree with Director Hinman's explanation of how a digital asset transaction may no longer represent an investment contract if, for example, purchasers would no longer reasonably expect a person or group to carry out the essential managerial or entrepreneurial efforts. Under those circumstances, the digital asset may not represent an investment contract under the *Howey* framework.

Nikhilesh De, *supra* note 58.

[297] "Gensler has previously suggested Ether was a security after its initial coin offering but had become more decentralized and turned into a commodity since then." Luke Huigsloot, *CFTC Declares Ether as a Commodity Again in Court Filing,* COINTELEGRAPH (Dec. 14, 2022), https://cointelegraph.com/news/cftc-declares-ether-as-a-commodity-again-in-court-filing [https://perma.cc/WT79-RW58] (also noting that Gensler's view has apparently shifted). For another recent statement from the SEC during Gensler's tenure, see the original position of the SEC staff to Coinbase's 2021 registration statement, opining that the agency had only identified Bitcoin and Ether as being something other than securities. *See supra* note 248 and accompanying text.

[298] Although far beyond the scope of this Article, a proof-of-work protocol involves "miners" who devote computational resources to solving a difficult algorithmic problem in order to validate transactions before they are added to the ledger that constitutes a blockchain. For a more detailed explanation of proof of work, see E. Napoletano, *Proof of Work Explained*, FORBES, https://www.forbes.com/advisor/investing/cryptocurrency/proof-of-work/ [https://perma.cc/UJ6X-E5DS] (Aug. 25, 2023, 1:26 PM); *see also What is "Proof of Work" or "Proof of Stake"?*, COINBASE, https://www.coinbase.com/learn/crypto-basics/what-is-proof-of-work-or-proof-of-stake [https://perma.cc/2CPN-RTDJ] (also explaining proof-of-stake).

[299] Proof-of-stake requires validators to "lock-up" or stake a portion of their cryptoassets to ensure good-faith validation of transactions; because they stand to lose their staked assets in the event of bad faith actions, their validation is trustworthy. *Proof-of-Stake (POS),* ETHEREUM, https://ethereum.org/en/developers/docs/consensus-mechanisms/pos/ [https://perma.cc/NVF7-SYD6] (Sept. 25, 2023).

[300] The process of converting from a POW to POS system took years to achieve and is far too complex to be fully described in an article of this length. For a brief explanation of the process, see Brooke Becher & Tamara El-Waylly, *What is the Ethereum Merge*, BUILT IN, https://builtin.com/blockchain/ethereum-merge [https://perma.cc/7JU7-62CJ] (Mar. 7, 2023).

[301] Sean Stein Smith, *Is Ether A Security? How The Merge Reignited Questions Around Crypto Regulation*, FORBES (Sept. 21, 2022, 11:33 PM), https://www.forbes.com/sites/seansteinsmith/2022/09/21/is-ether-a-security-how-the-merge-reignited-questions-around-crypto-regulation/ [https://perma.cc/L8NF-Z335] (reporting that following the switch "almost two-thirds of staked ether . . . are held by Lido, Coinbase, Binance and Kraken").

to the very large group of persons who were reported to have been mining Ether before the switch in protocols.[302] On the other hand, although a small number of validators controlled a significant amount of staked assets following the Merge,[303] data suggests that there were nearly 92,500 unique staking depositors at the start of 2023,[304] with the total number of validators standing at about 500,000.[305] In addition, while there may have been a million machines mining Ether prior to the merge,[306] sources suggest that as transactions had become more difficult to validate, mining power had also "be[come] increasingly concentrated in a few Ethereum miners."[307] This analysis suggests that the difference in concentration in validation power before and after the Merge may have been more apparent than real.

Regardless of whether there was, in fact, a significant change in how concentrated the validation process became, the day after the Merge took place, SEC Chairman Gensler publicly announced that "under the *Howey* test—which determines whether an asset qualifies as an 'investment contract' and is therefore subject to federal securities law—PoS cryptocurrencies could qualify as securities."[308] He has repeated that claim multiple times, albeit without specifically identifying Ether.[309]

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[302] "As many as one million people were mining Ether with over $10 billion dollars' worth of mining equipment before the Merge, which was completed early on Thursday [September 15, 2022] morning, New York Time." David Pan, *Ether Miners Are Piling Up Losses As 'Merge' Shifts Them to Altcoins*, BLOOMBERG: TECH. (Sept. 15, 2022, 2:19PM), https://www.bloomberg.com/news/articles/2022-09-15/ether-miners-are-piling-up-losses-after-shifting-to-altcoins#xj4y7vzkg [https://perma.cc/ML63-5GC8].

[303] *See* Smith, *supra* note 301.

[304] Sage D. Young, *Staked ETH Passes 16M*, COINDESK: TECH., https://www.coindesk.com/tech/2023/01/12/number-of-staked-eth-passes-16m/ [https://perma.cc/C2T7-C6KX] (Jan. 12, 2023, 10:51 AM).

[305] Bessie Liu, *Ethereum Hits 500,000 Validator Milestone*, BLOCKWORKS (Jan. 12, 2023, 6:16 PM), https://blockworks.co/news/ethereum-to-reach-500000-validators [https://perma.cc/D6JC-QQ3G].

[306] *See* Pan, *supra* note 302.

[307] Randy Fares, *Ethereum Miners Future: What will Happen after the Merge?*, CRYPTOTICKER (Aug. 28, 2022, 12:37 PM), https://cryptoticker.io/en/ethereum-miners-future-what-will-happen-after-the-merge/ [https://perma.cc/E6Z8-EBTN].

[308] Smith, *supra* note 301.

[309] "According to a Thursday [September 15, 2022] WSJ report, SEC Chairman Gary Gensler said proof-of-stake cryptocurrencies could qualify as securities under the *Howey* Test." Mat Di Salvo, *Gensler Says Proof-of-Stake Assets Could Be Securities: Report*, DECRYPT (Sept. 15, 2022), https://decrypt.co/109881/gensler-proof-of-stake-ethereum-securities, [https://perma.cc/2P6U-SBXB]. "US Securities and Exchange Commission Chair Gary Gensler suggested once again that so-called proof-of-stake tokens, which represent many major cryptocurrencies, should be regulated as securities." David Pan, *SEC's Gensler Reiterates 'Proof-of-Stake' Crypto Tokens May Be Securities*, FIN. POST (Mar. 15, 2023),

In many ways, this conclusion is somewhat odd.[310] First, there is no explanation of why the change in consensus mechanisms matters.[311] Nowhere in the *Howey* investment contract test is "concentration" of control after an asset's distribution listed as a relevant factor in classifying the asset as an investment contract.[312] Second, if Gensler means to claim that Ether is a security, why won't he just say that? Instead, he prevaricates.

In April 2023, Chairman Gensler was directly asked by The Block, an online news source devoted to cryptoassets and infrastructure,[313] "whether more direct guidance on ether might make sense given conflicting views from policymakers on the cryptocurrency, including from a former SEC divisional head."[314] Instead, as that source notes, "Gensler responded that 'this is a field that has clarity and mistakenly attempts to ignore it.'"[315] That refusal to explain Ether's status is not limited to interviews with the press.

A hearing before the House Financial Services Committee on April 18, 2023, opened with Committee Chair Patrick McHenry asking the SEC Chairman specifically whether Ether was a security, but "Gensler repeatedly declined to say whether Ether, the world's

https://financialpost.com/pmn/business-pmn/secs-gensler-reiterates-proof-of-stake-crypto-tokens-may-be-securities, [https://perma.cc/D2XY-LBGG].

[310] Commentators have observed the inconsistency between the repeated claims of clarity and the continued refusal to explain Ether's status under the law. *See* Smith, *supra* note 301.

> Prior comments by both the SEC and the Commodity Futures Trading Commission (CFTC) agreeing that [E]ther acted more like a commodity, and the fact that the SEC—under prior leadership and chair Gensler—have not issued a definitive checklist or guide as to what criteria crypto would need to possess for securities classification, continues to create an environment of regulatory ambiguity and uncertainty.

Id.

[311] Note that Gensler's statements merely say that proof-of-stake tokens could be securities, not that a change in status would trigger application of the securities laws. *See* Cheyenne Ligon, *SEC Chairman Gensler Suggests Again That Proof-of-Stake Tokens Are Securities: Report*, COINDESK: POLICY, https://www.coindesk.com/policy/2023/03/15/sec-chairman-gensler-suggests-again-that-proof-of-stake-tokens-are-securities-report/ [https://perma.cc/R3X2-8LA9] (Mar. 16, 2023, 10:46 AM) (reporting that "(SEC) Chairman Gary Gensler is doubling down on his opinion that proof-of-stake tokens could meet the definition of securities under the *Howey* Test, thus bringing them under his agency's regulatory authority.").

[312] The *Howey* test is described previously in this Article. *See supra* notes 27–33 and accompanying text.

[313] "Through The Block's website, newsletters, research portal, our podcast 'The Scoop', data, and bespoke research engagements, we interact daily with tens of thousands of technologists, financial market participants, Fortune 500 professionals, global service providers, policymakers and more." *About*, THE BLOCK, https://www.theblock.co/about [https://perma.cc/5UD5-CAUR].

[314] Colin Wilhem, *Gensler Says Securities Law is Time-Tested, Crypto Just Deeds to Fall in Line,* THE BLOCK (Apr. 18, 2023, 7:24 PM), https://www.theblock.co/post/226974/gary-gensler-ether-security-crypto-clarity-congress-sec, [https://perma.cc/Q3CU-3GAQ].

[315] *Id.*

second-largest cryptocurrency, is a security."[316] Instead, Gensler opined that the appropriate characterization of cryptoassets "depends on the facts and the law."[317]

Gensler's refusal to answer the question directly casts substantial doubt on the agency's position that its authority over cryptoassets is "clear." If the SEC's Chairman cannot determine the proper classification of the second most highly capitalized cryptoasset in existence, saying only that its appropriate characterization "depends," that would seem to be the very definition of uncertainty.[318]

V. CLARITY IS NEEDED

On May 6, 2021, SEC Chairman Gensler testified before Congress:

> I do think that working with Congress, and I think it is only Congress that could really address it, ... because right now the exchanges trading in these crypto assets do not have a regulatory framework either at the SEC, or our sister agency, the [CFTC] . . . . Right now, there is not a market regulator around these crypto exchanges.[319]

Less than three weeks later, in another hearing, he not only asked for additional resources for the SEC to enable it to extend its efforts, but also specifically called out regulatory gaps applicable to crypto exchanges, commenting that was "just one of many regulatory gaps

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[316] Aleksander Gilbert, *Gensler Refuses to Call Ether a Security at Congressional Hearing*, DEFIANT (Apr. 18, 2023), https://thedefiant.io/gensler-testifies-congress, [https://perma.cc/N85W-C8QR].

[317] *Id*. The head of the DeFi Education Fund crypto advocacy group, Miller Whitehouse-Levine was later quoted as having said that "Gensler's refusal to answer McHenry 'points to the disingenuousness of the SEC's supposition that [the law] is perfectly clear.'" *Id*.

[318] Gensler's refusal "to provide a non-ambiguous response to the question of whether Ethereum is a security" highlights the lack of predictability in classifying cryptoassets. Simon Chandler, *Is Ethereum a Security? SEC Gensler Won't Say and It's a Problem for Crypto*, CRYPTOVANTAGE (Apr. 19, 2023), https://www.cryptovantage.com/news/is-ethereum-a-security-sec-gensler-wont-say-and-its-a-problem-for-crypto/, [https://perma.cc/KR5B-GJV4].

[319] *Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide, Part III: Before the H. Comm. on Fin. Servs.*, 117th Cong. 12 (2021), (statement of Gary Gensler, Chairman, SEC); *see also* Bradley et al., *supra* note 63. Testimony of Gary Gensler from May 6, 2021, in a hearing before the House Committee on Financial Services, included the fact that he had already affirmatively asked his staff "to consider whether expanded enforcement mechanisms are necessary" to deal with rapid changed in financial markets. Testimony, Gary Gensler, SEC, Testimony Before the House Committee on Financial Services (May 6, 2021), https://www.sec.gov/news/testimony/gensler-testimony-20210505 [https://perma.cc/XQT4-6TYR].

in these crypto asset markets."[320] During a meeting with CNBC's Squawk Box on May 7, 2021, he proclaimed that "[t]here is no federal authority to actually bring a regime to the crypto exchanges . . . . [The SEC] will be working with Congress, if they see fit to try to bring some protection."[321]

On August 3, 2021, he again reiterated this point of view, telling the audience at a global conference on crypto that Congress needed to "give the agency more authority to better police cryptocurrency trading, lending and platforms," which he analogized to a "Wild West" that "is riddled with fraud and investor risk."[322] Speaking at the 2021 Aspen Security Forum, SEC Chair Gensler publicly claimed that his agency needed additional statutory authority to regulate businesses operating crypto exchanges.[323] And on September 14, 2021, when he testified before the Senate Banking Committee, he reported that "clarity is needed from Congress on how the federal regulatory agencies can work together on crypto issues."[324]

Somewhere along the way, however, Gensler's point of view, and the position of the SEC, changed. Contrary to his opinion that the SEC lacked clear authority in 2021, by 2023, despite the lack of any change in the underlying legislation and a total dearth of new rules or regulations, Gensler had begun describing the SEC's mandate and authority over crypto as being clear.[325] As commentators have noted,

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[320] On May 26, 2021, in his opening statement before a House subcommittee, Chairman Gensler not only made the case for expanded resources for the SEC but specifically called our regulatory gaps applicable to crypto exchanges, commenting that was "just one of many regulatory gaps in these crypto asset markets." *Securities and Exchange Commission Oversight Hearing Before the Subcomm. On Fin. Servs. & Gen. Gov't U.S. House Appropriations Comm.*, 117th Cong. 8 (2021) (testimony of Gary Gensler, Chairman, SEC). With regard to crypto regulation in particular, he also noted that he looked forward to working "with Congress to fill in the gaps of investor protection in these crypto markets." *Id.* at 9.

[321] *SEC Chairman Gary Gensler: There Needs to Be 'Greater Investor Protection' of Crypto Markets*, CNBC at 02:27–03:00 (May 7, 2021, 8:46 AM), https://www.cnbc.com/video/2021/05/07/sec-chairman-gary-gensler-there-needs-to-be-greater-investor-protection-of-crypto-markets.html.

[322] Katanga Johnson, *U.S. SEC Chair Gensler Calls on Congress to Help Rein in Crypto 'Wild West'*, REUTERS: TECH., https://www.reuters.com/technology/us-sec-chair-gensler-calls-congress-help-rein-crypto-wild-west-2021-08-03/ [https://perma.cc/Q4V5-3BRQ] (Aug. 3, 2021, 6:43 PM).

[323] *See* Thomas Franck, *The SEC Needs More Power from Congress to Fully Regulate Crypto, Chair Gensler says*, CNBC: POLITICS, https://www.cnbc.com/2021/08/03/the-sec-needs-more-power-from-congress-to-fully-regulate-crypto-chair-gensler-says.html [https://perma.cc/GN3F-YKYL] (Aug. 4, 2021, 5:35 PM).

[324] Ted Knutson, *SEC Chair Gensler: Crypto Assets Are Catalyst For Change But Need Greater Oversight*, FORBES (Sept. 14, 2021, 1:36 PM), https://www.forbes.com/sites/tedknutson/2021/09/14/sec-chair-gensler-crypto-assets-are-catalyst-for-change-but-need-greater-oversight/?sh=1e2485172f74 [https://perma.cc/H8DQ-95FF].

[325] *See generally* Sam Lyman, *From Ally to Adversary: The 3 Stages of Gary Gensler's Crypto Evolution*, FORBES: DIGITAL ASSETS (July 2, 2023, 6:00 AM), https://www.forbes.com/sites/digi

"Gensler has made his point clear: he sees all tokens aside from bitcoin as securities."[326]

While this may or may not be an accurate depiction of Gensler's position, it is certain that he is no longer waiting for legislative action to expand the SEC's jurisdiction over cryptoassets.[327] Instead, he has sought to step up enforcement, seeking significant increases in budget and staffing to combat problems that he sees in the increasingly complex crypto industry.[328] This increasing complexity has not prevented the SEC from publicly proclaiming that the law is clear, while instituting multiple enforcement actions that actually lack clarity or transparency.[329]

tal-assets/2023/07/02/from-ally-to-adversary-the-3-stages-of-gary-genslers-crypto-evolution/ [https://perma.cc/9TJ5-WTZB] (discussing Gensler's changing views on the SEC's authority over crypto from 2018 to 2023).

[326] Casey Wagner, *No Laws, No Policy, No Clarity: The Parlous State of Crypto Regulation*, BLOCKWORKS (Mar. 17, 2023, 2:35 PM), https://blockworks.co/news/crypto-regulation-policy-law [https://perma.cc/X3VC-F9D4]; *see also* Anndy Lian, *SEC Chair Gensler Confirms "everything other than Bitcoin" is a Security: Implications and Analysis*, CRYPTOSLATE, https://cryptoslate.com/sec-chair-gensler-confirms-everything-other-than-bitcoin-is-a-security-implications-and-analysis/ [https://perma.cc/CF6P-5ENB] (July 25, 2023, 12:14 PM) (quoting Gensler as having said that "everything else other than bitcoin is a security," although the opinion piece later notes that Gensler actually declined to label assets other than bitcoin).

[327] *See* Lyman, *supra* note 325.

[328] "United States Securities and Exchange Commission Chair Gary Gensler says the regulator is spread thin and needs additional funding to keep up with the 'increased complexity in the capital markets.'" Luke Huigsloot, *SEC's Gensler Seeks $2.4B in Funding to Chase Down Cypto 'Misconduct'*, COINTELEGRAPH (Mar. 20, 2023), https://cointelegraph.com/news/sec-s-gensler-seeks-2-4b-in-funding-to-chase-down-crypto-misconduct [https://perma.cc/LZ8D-BQ2K]. According to Gensler, additional funding would enable the agency to hire 170 additional staff, most of whom would work in enforcement and examinations. *See id.*

[329] *See SEC Crypto Enforcement Actions on Track to Outpace 2022*, PYMNTS (May 5, 2023), https://www.pymnts.com/cryptocurrency/2023/sec-crypto-enforcement-actions-could-outpace-2022/ [https://perma.cc/4P6F-N334]. The SEC's increasing activism in the area is evident in the aggressive enforcement agenda that the SEC has embarked upon:

> While the crypto industry has criticized the SEC for failing to engage in formal rulemaking or waiting for Congress to pass a clear legal framework around U.S. securities laws and their applicability to digital assets, the agency under its present chair, Gary Gensler, has continued to bring singular enforcement actions as a way to set regulatory policy.
>
> In 2022, the Gensler-led agency brought a total of 30 cryptocurrency-related enforcement actions, up 50% from 2021.
>
> In the first months of 2023, the SEC has handed out 13 enforcement actions, which is on pace for an increase of more than 25% over last year's numbers.

Id.

Others, however, are not convinced that the SEC is correct,[330] and they continue to call for the clarity that they believe is still missing.[331] Timothy Massad, former chairman of the CFTC and former Assistant Secretary for Financial Stability at the Treasury, explained in 2019 that "[t]here is a gap in the regulation of crypto-assets that Congress needs to fix."[332] His report concluded that "[c]rypto-assets cut across current jurisdictional boundaries" of the SEC and CFTC, and that "neither [agency] has sufficient jurisdiction" to address the risks that they could present.[333] Massad's conclusions remain the same in 2023.[334]

Testifying before the House Committee on Agriculture, Subcommittee on Commodity Markets, Digital Assets and Rural Development April 27, 2023, Massad explained his belief that "[t]he SEC's current regulation-by-enforcement strategy is time consuming and inadequate; court case precedent is not enough clarity."[335] While Massad suggested that currently pending litigation initiated by the SEC might bring some additional clarity to the question of which cryptoassets are securities, he also concluded that this approach is likely to be unsatisfactory:

> The SEC has some pending enforcement actions that may bring greater clarity to the question. But that is uncertain

[330] *See* Ashrith Rao, *US SEC's Gary Gensler Shrugs Off Republicans' Reprimand*, BLOCKHEAD (Apr. 20, 2023, 9:58 AM), https://www.blockhead.co/2023/04/20/us-secs-gary-gensler-shrugs-off-republicans-reprimand/ [https://perma.cc/6272-2CG4]. Shortly after Gensler's April 18, 2023, testimony before the House Financial Services Committee, *supra* notes 318–19, Ripple CEO Brad Garlinghouse publicly called for a political solution to the lack of clarity in determining what is a security: "For the Chair of the SEC to assert that he dictates what is a security—and not the legislation from which his agency derives its power—is beyond comprehension. It's time for elected officials in the US to take notice." Brad Garlinghouse (@bgarlinghouse), TWITTER (Mar. 30, 2023, 3:15 PM), https://twitter.com/bgarlinghouse/status/1641519600721330177 [https://perma.cc/MQZ9-HXJY].

[331] *See* Tomio Geron, *Washington is Rushing to Regulate Crypto. It's a Mess.*, PROTOCOL (May 20, 2021), https://www.protocol.com/fintech/bitcoin-cryptocurrency-regulations [https://perma.cc/6NK5-7934] (noting that "a substantial number of players in the crypto industry have been seeking more regulatory clarity.").

[332] TIMOTHY G. MASSAD, IT'S TIME TO STRENGTHEN THE REGULATION OF CRYPTO-ASSETS 2 (2019), https://www.brookings.edu/wp-content/uploads/2019/03/Economis-Studies-Timothy-Massad-Cryptocurrency-Paper.pdf [https://perma.cc/HD2C-YS5N].

[333] *Id*.

[334] *See generally The Future of Digital Assets: Identifying Gaps in Spot Market Regulation: Hearing Before the Subcomm. on Commodity Mkts., Digit. Assets and Rural Dev. of the H. Comm. on Agric.*, 118th Cong. (2023) (Statement of Timothy Massad, Former Chairman of CFTC), https://docs.house.gov/meetings/AG/AG22/20230427/115803/HHRG-118-AG22-Wstate-MassadT-20230427.pdf [https://perma.cc/6DVN-32K6] [hereinafter Massad Statement].

[335] Casey Wagner, *Former CFTC Chair Massad Also Can't Say if ETH is a Security*, BLOCKWORKS (Apr. 27, 2023 6:02 PM), https://blockworks.co/news/former-cftc-chair-ether-security [https://perma.cc/6HDD-Q6E5]; *see also* Massad Statement, *supra* note 334, at 3.

> and could take time, during which investors will continue to be at risk. Moreover, even if the SEC prevails in particular cases, it may face a game of whack-a-mole, where proponents of other tokens and the trading and lending platforms themselves argue that other tokens are different from the particular facts of an SEC victory, triggering further litigation.[336]

Other observers have also bemoaned the lack of Congressional action to explain how these new assets should be regulated.[337] "Over the last decade, digital assets and blockchain technology have developed from a fringe interest to a top concern of central banks and other financial institutions. But cryptocurrency remains underutilized and poorly understood. In the United States, this failure is symptomatic of congressional neglect."[338] The public certainly seems confused, as evidenced by the fact that "[a]s of the afternoon of Aug[ust] 22, 2022, almost 1,700 individuals or organizations signed a form letter specifically asking SEC Chair Gary Gensler for clear rules of the crypto road."[339]

Even an SEC Commissioner seems to recognize the need for additional transparency. Commissioner Hester Peirce has repeatedly called for additional clarity with regard to the appropriate classification of cryptoassets.[340] She readily admits that applying the *Howey* test[341] to crypto is not easy or straightforward,[342] which

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[336] Massad Statement, *supra* note 334, at 3.

[337] *See* Craig Stevens, *Congress Should Deliver Crypto Clarity and Reassert its Authority*, ROLL CALL (Aug. 18, 2021, 6:00 AM), https://rollcall.com/2021/08/18/congress-should-deliver-crypto-clarity-and-reassert-its-authority/ [https://perma.cc/6X8D-2RXX].

[338] *Id*. One comment on the process to decentralization likened it to the "yellow brick road," the tricky path detailed in the Wizard of Oz that did not really lead to the objective that travelers might have anticipated. *See* David L. Concannon, Yvette D. Valdez & Stephen P. Wink, *The Yellow Brick Road for Consumer Tokens: The Path to SEC and CFTC Compliance: An Update*, *in* BLOCKCHAIN & CRYPTOCURRENCY REGULATION 64 (2d ed. 2020) (noting that the framework for compliance "remains unclear.").

[339] Soyoung Ho, *Industry Ratchets Up Pressure on SEC Asking for Crypto Regulation, but Gensler Says Clear Rules Already Exist*, THOMSON REUTERS: TAX & ACCT. (Aug. 26, 2022), https://tax.thomsonreuters.com/news/industry-ratchets-up-pressure-on-sec-asking-for-crypto-regulation-but-gensler-says-clear-rules-already-exist/ [https://perma.cc/CA54-NT7G].

[340] As she explained in early 2022, in her opinion "the SEC needs to offer the digital asset industry a clear framework on how they will regulate crypto." Jennifer Schoneberger, *Crypto Regulation is Coming, Just Not this Year: SEC's Peirce*, YAHOO!NEWS (Feb. 3, 2022), https://news.yahoo.com/crypto-regulation-coming-just-not-this-year-se-cs-pierce-172824069.html [https://perma.cc/6H63-V6SP].

[341] For a discussion of this test, see *supra* notes 26-33 and accompanying text.

[342] Rahul Nambiampurath & Kyle Baird, *SEC Commissioner Hester Peirce: Don't 'Swipe Left' on Crypto*, BE (IN) CRYPTO, https://beincrypto.com/sec-commissioner-hester-peirce-dont-swipe-left-crypto/ [https://perma.cc/SPQ6-GP2E] (Jan. 24, 2023, 6:53 AM).

explains some of the existing confusion in the space. Unfortunately, she also believes the SEC "would have to admit that we likely need more, or at least more clearly delineated, statutory authority to regulate certain crypto tokens" in order to proceed with additional clarifying rule-making.[343] And even more unfortunately for those seeking additional clarity, "Peirce has been unsuccessful in convincing her colleagues in the SEC to abandon the pattern of fractured regulation by enforcement action and to instead consider creating comprehensive, clear regulations for cryptocurrencies that benefit consumers and investors."[344]

VI. CONCLUSION

This information brings us full circle. The SEC worries about the extreme volatility in cryptoasset markets,[345] and yet one of the most significant contributors to sudden price drops for cryptoassets is the announcement of an SEC enforcement action.[346] The SEC objects to promoters who improperly tout the profit-making potential of crypto-

[343] Courtney Degen, *Commissioner Peirce Calls for SEC Rule on Cryptocurrency*, PENSIONS & INVS. (Jan. 23, 2023, 12:46 PM), https://www.pionline.com/regulation/commissioner-hester-peirce-calls-sec-rule-cryptocurrency [https://perma.cc/3EX4-MSJ7] (referring to remarks made by Commission Peirce at the January 20, 2023 Digital Assets at Duke conference, hosted by Duke University).

[344] Sarah Milby, *Hester Peirce, "Crypto Mom"*, UNIV. OF CHI.: WOMAN IS A RATIONAL ANIMAL (Feb. 12, 2021), https://womanisrational.uchicago.edu/2021/02/12/hester-peirce-crypto-mom-on-responsible-regulation-and-innovation/ [https://perma.cc/2PGQ-UVYB]; *see also* Brian Croce, *SEC Commissioner Calls on Congress to Pass Crypto Regulatory Bill*, PENSIONS & INVS. (Oct. 12, 2022, 4:01 PM), https://www.pionline.com/regulation/sec-commissioner-calls-congress-pass-crypto-regulatory-bill [https://perma.cc/4TTS-Y39V].

[345] For example, a March 2023, Investor Alert from the agency's Office of Investor Education and Advocacy explicitly warned that "[i]nvestments in crypto asset securities can be exceptionally volatile and speculative, and the platforms where investors buy, sell, borrow, or lend these securities may lack important protections for investors. The risk of loss for individual investors who participate in transactions involving crypto assets, including crypto asset securities, remains significant." Investor Alerts and Bulletins, SEC, Exercise Caution with Crypto Asset Securities: Investor Alert (Mar. 23, 2023), https://www.sec.gov/oiea/investor-alerts-and-bulletins/exercise-caution-crypto-asset-securities-investor-alert [https://perma.cc/GK59-ZZGX].

[346] "First, the market responds most strongly to news events regarding the legal status of cryptocurrencies. Besides general bans on their use for financial transactions, news events related to their possible treatment under securities market law have strongly adverse impacts . . . ." Raphael Auer & Stijn Claessens, *Regulating cryptocurrencies: assessing market reactions*, 2018 BIS Q. REV. 51, 52 (Sept.), https://www.bis.org/publ/qtrpdf/r_qt1809f.htm [https://perma.cc/Q685-RCGA]; s*ee also* Yuliya Guseva, *When the Means Undermine the End: The Leviathan of Securities Law and Enforcement in Digital-Asset Markets*, 5 STAN. J. BLOCKCHAIN L. & POL'Y 1, 13 n.71 (2022) (citing Yuliya Guseva, Irena Hutton & Hang Miao, *National Crypto-Enforcement and International Consequences* (2021) (unpublished manuscript) as empirical support for the conclusion that SEC enforcement actions focused on failure to register "had a negative effect on cryptocurrency prices.").

investments,[347] but also attacks companies that encourage others to avoid such statements.[348] Most critically, the SEC lauds the benefits of full and transparent disclosure[349] as it embarks on a path of enforcement against crypto companies and executives while refusing to clarify in advance (or sometimes even at the time that an enforcement action is embarked upon) how the law applies to them.[350]

This Article does not claim that the SEC or its staff is acting in bad faith. In all probability, they perceive a genuine need for additional and consistent enforcement in the crypto space. While one can take issue with Chair Gensler's statement that crypto is an unregulated "Wild West,"[351] it is abundantly clear that there are bad actors in the space.[352] Thus, there is a need for appropriate regulation, and the SEC could be a logical source of oversight.

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[347] The SEC found in 2018 that two ICO issuers who had led purchasers to expect profits by promising to build out an "ecosystem" and adding functionality had sold securities without registration or an exemption. Press Release, SEC, Two ICO Issuers Settle SEC Registration Charges, Agree to Register Tokens as Securities, Rel. No. 2018-264 (Nov. 16, 2018), https://www.sec.gov/news/press-release/2018-264 [https://perma.cc/TU7K-GFWS] (providing additional information about the cases against CarrierEQ Inc. (Airfox) and Paragon Coin Inc.). By 2019, the SEC was emphasizing the question of whether the issuer or a promoter has created "a reasonable expectation of profits" in the minds of crypto purchasers in order to ascertain whether a particular cryptoasset is a security. *See* SEC, *Framework, supra* note 11, § II.C.

[348] For example, in the complaint in *SEC v. Bittrex*, the agency complained about Bittrex having asked companies seeking to list their cryptoassets to stop promoting their assets with "price prediction[s]" or "statements related to 'expectation of profit.'" Bittrex Complaint, *supra* note 129, at 25–26. The SEC characterized this behavior as scrubbing of the issuer's marketing materials without materially altering the reality of the offering, although the question of how an asset is marketed and whether that marketing creates a reasonable expectation of profits is explicitly identified as a critical component of the *Howe*y test. *See supra* note 31 and accompanying text.

[349] *See supra* notes 3–4 and accompanying text.

[350] *See supra* Part IV.

[351] *See supra* note 321 and accompanying text.

[352] One of the analytics firms that evaluates the crypto ecosystem for illegal activities is Chainalysis, which describes itself as enabling "[b]usinesses, banks, and governments . . . to make critical decisions, encourage innovation, and protect consumers." *See The Blockchain Data Platform – Chainalysis*, CHAINALYSIS (May 11, 2023), https://www.chainalysis.com/ [https://perma.cc/Y93G-BJ9W]. As explained by the company at the start of its 2023 Crypto Crime Report, "[e]very year, we publish our estimates of illicit cryptocurrency activity to demonstrate the power of blockchains' transparency . . . ." CHAINALYSIS, THE 2023 CRYPTO CRIME REPORT, 4 (Feb. 2023) [https://perma.cc/5VR5-55XH]. The 2023 report, which collects and reports on data from 2022, concluded that "illicit transaction volume rose for the second consecutive year, hitting an all-time high of $20.6 billion." *Id.* at 4–5. Although this number is large, and certainly made the headlines, much of this related to transactions with entities sanctioned by the Office of Foreign Assets Control, including a number of Russian-based businesses. *See id.* In addition, the report also emphasizes that as a percent of all cryptocurrency transfers, illicit activity accounted for only 0.24% of all transactions. *Id.* at 6. Even so, these numbers clearly illustrate that criminal activity does occur in the crypto ecosystem. *See, e.g.*, *id.* at 5 (illustrating total cryptocurrency value received by illicit addresses from 2017 to 2022).

Regrettably, it also seems that the law, as it currently exists, is not sufficiently clear to enable observers, whether entrepreneurial, academic, or investment-minded, to predict or understand when the securities laws apply to cryptoassets.[353] Although the words that SEC representatives use proclaim that clarity exists, the actions taken to date by the agency demonstrate the questionable veracity of that position.[354] In fact, the insistence from the SEC that its authority is clear,[355] despite evidence to the contrary, might be the most significant justification for placing primary enforcement authority elsewhere.[356]

This Article attempts to set out a compelling case for legislative intervention. While it might seem that this is obvious, elected representatives do not all agree with this conclusion.

On May 10, 2023, a joint hearing between the two house subcommittees most involved with crypto regulation focused on gaps in the crypto market oversight.[357] In opening remarks, House Financial Services Committee Chair Patrick McHenry (R-North

[353] *See supra* Part V. The reality is that "[w]hether some cryptocurrencies should be considered securities is a contentious matter that has flustered both regulators and crypto firms alike." Browne, *supra* note 243.

[354] *See supra* Part IV.

[355] As has been noted elsewhere, Gensler "has repeatedly said the SEC has the authority to reign in crypto firms and that the challenge they face is a lack of compliance, rather than a lack of clarity." Aislinn Keely, *'Historic' Hearing Spotlights Deep Split on Crypto Regulation*, LAW360 (May 10, 2023, 10:33 PM), https://www.law360.com/articles/1605889 [https://perma.cc/W3E5-KV63].

[356] The question of who the best regulator for cryptoassets would be is beyond the scope of this Article but is a topic that has been addressed at length elsewhere. *See, e.g.*, Joel Seligman, *The Rise and Fall of Cryptocurrency: The Three Paths Forward*, 19 N.Y.U. J.L. & BUS. 93 (2022); Lindsay Sain Jones, *Beyond the Hype: A Practical Approach to CryptoReg*, 25 VA. J.L. & TECH. 175 (2022); Carol R. Goforth, *Regulation by Enforcement: Problems with the SEC's Approach to Cryptoasset Regulation*, 82 MD. L. REV. 107 (2022); Frank Emmert, *Cryptocurrencies: The Impossible Domestic Law Regime?*, 70 AM. J. COMPAR. L. (SUPPLEMENT) i (2022). A particularly intriguing possibility for a path forward was recently outlined by former CFTC Chairman Timothy Massad in his written statement to the House Subcommittee on Digital Assets, Financial Technology and Inclusion. *See generally* Massad Statement, *supra* note 334. In this statement Massad suggests that baseline standards should be imposed for cryptoassets no matter whether they are trading as commodities or securities, thus the argument over the appropriate classification of the assets would become largely irrelevant while the purchasing public would receive the protections of those standards. *See id.* at 3, 5.

[357] The hearing was held before the crypto-focused subcommittees of the Financial Services and Agriculture committees. Notice of the hearing was published May 5, 2023. *See* Memorandum from Comm. on Fin. Servs. & Comm. on Agric. Majority Staff to Members (May 5, 2023), https://democrats-financialservices.house.gov/uploadedfiles/hhrg-118-ba21-20230510-sd002.pdf [https://perma.cc/Q6GY-8FAN]. A video recording of the joint hearing is also available. *The Future of Digital Assets: Measuring the Regulatory Gaps in the Digital Asset Markets*, U.S. HOUSE COMM. ON FIN. SERVS.: DEMOCRATS (May 10, 2023, 9:30 AM), https://democrats-financialservices.house.gov/events/eventsingle.aspx?EventID=410399 [https://perma.cc/85PG-JB4Q].

Carolina) and his counterpart from across the aisle, Representative Maxine Waters (D-California), agreed that the best direction would indeed require legislative intervention.[358] However, Representative Stephen Lynch (D-Massachusetts), a senior member of the digital assets subcommittee, instead chose to repeat the mantra of SEC Chair Gensler that current rules should suffice.[359] Lynch's stated position was that "[t]he problem is not regulatory ambiguity . . . . It is mass non-compliance."[360]

This Article suggests that buying into Gensler's rhetoric, no matter how often it is repeated, is in fact not the best way forward. It is easy to take the word of SEC officials that the rules are clear, but the actions of the agency do not support that contention. The end result is that if one believes in transparency and full disclosure, some additional direction is needed, and, at this point, that is only likely to come from Congressional intervention.[361]

[358] Jesse Hamilton, *Joint U.S. House Hearing on Crypto's Future Opens with Discord*, COINDESK (May 10, 2023, 4:16 PM), https://www.coindesk.com/policy/2023/05/10/joint-us-house-hearing-on-cryptos-future-opens-with-discord/ [https://perma.cc/VLX2-5K7L].

[359] *Id.*

[360] *Id.*

[361] One might argue that the courts could step in to clarify the situation, but this is an incredibly expensive and time-consuming (as well as uncertain) proposition. Consider this analysis by former CFTC Chairman Timothy Massad:

> The SEC has some pending enforcement actions that may bring greater clarity to this question. But that is uncertain and could take time, during which investors will continue to be at risk. Moreover, even if the SEC prevails in particular cases, it may face a game of whack-a-mole, where proponents of other tokens and the trading and lending platforms themselves argue that other tokens are different from the particular facts of an SEC victory, triggering further litigation.

Massad Statement, *supra* note 334.