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COINBASE ARGUES THAT THE SEC IS OFF-BASE WITH CRYPTO ENFORCEMENT ACTION

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On June 6, 2023, the Securities and Exchange Commission (SEC) charged Coinbase, Inc. and Coinbase Global, Inc. (Coinbase) with violations of the Securities Exchange Act of 1934 ("Exchange Act") and the Securities Act of 1933 ("Securities Act"). Coinbase is the largest cryptocurrency exchange in the United States and has a market capitalization of roughly $24 billion. The SEC's 101-page complaint, filed in the U.S. District Court for the Southern District of New York, alleges that Coinbase operates as an unregistered national securities exchange, broker, and clearing agency. The SEC further alleges that Coinbase failed to register the offer and sale of its crypto asset staking-as-a-service program under Section 5 of the Securities Act, and that the Coinbase Wallet and Coinbase Prime services offered by Coinbase constitute broker services under the federal securities laws.

The SEC's case against Coinbase is the latest front in the ongoing regulatory battle over digital assets regulation: specifically regarding centralized exchanges that allow buyers and sellers to engage in secondary market transactions in digital assets. The key issues in the Coinbase litigation revolve around whether Coinbase, in providing exchange and related services, must register as an exchange, broker, and clearing agency pursuant to the Securities Act and the Exchange Act. More generally, the Coinbase litigation raises questions about when digital assets and related services, such as staking and interest earning programs, are securities transactions subject to federal securities laws and SEC regulation.

I. BACKGROUND: DIGITAL ASSETS AND THE FEDERAL SECURITIES LAWS

To understand the issues raised by the Coinbase litigation, one must start with how the SEC and the federal courts have defined the financial instruments regulated by the federal securities laws. The definitions of "security" employed by the Securities Act and the Exchange Act are broad

and include a laundry list of examples, including stocks, bonds, options, fractional interests, investment contracts, and more.[1] Digital assets are not currently included expressly, but they potentially fall within the meaning of "investment contracts." Under the four-part test established by the U.S. Supreme Court in *SEC v. W.J. Howey Co.* (1946) (the "Howey Test"), an investment contract exists when there is: (1) an investment of money (2) in a common enterprise (3) with an expectation of profit (4) in reliance on the efforts of others.

The breadth and flexibility of the Howey Test are key features. In articulating this test, the Supreme Court held that the test fulfills "the statutory purpose of compelling full and fair disclosure relative to the issuance of 'the many types of instruments that in our commercial world fall within the ordinary concept of a security.' "[2] The adoption of a flexible definition for investment contract extends investor protections to a wide variety of commercial transactions beyond the examples listed specifically in the Securities Act and the Exchange Act, but this choice comes at a cost. The application of a flexible, fact-specific test forces courts to apply a complex, case-by-case analysis that can give rise to a regulatory landscape in which similarly-situated litigants obtain different results in different courts.[3] That outcome seems especially likely in the digital assets contexts, as courts grapple with how best to apply *Howey* to new financial products borne of new technologies that may not offer clear analogies to traditional securities.

The SEC has consistently asserted that *Howey* grants the Commission broad authority to regulate digital assets. The SEC first took this position officially when it issued a July 2017 Report of Investigation relating to German company Slock.it, the creator of a Decentralized Autonomous Organization ("DAO") used to issue and sell DAO tokens. The sale of DAO tokens generated funds that the DAO used to acquire assets and fund projects that generated returns for DAO token holders. Meanwhile, DAO token holders also could engage in secondary market trading of their tokens via several online platforms. The SEC investigated Slock.it and its cofounders following a 2016 cyberattack against the DAO. While the SEC chose not to take any enforcement action, the Commission published an investigation report asserting that the DAO tokens were regulated securities. Applying the Howey Test, the SEC stated that the tokens were securities because token purchasers had invested money (i.e., Ether) with a reasonable expectation of profits to be made from the projects that required "significant managerial efforts" by Slock.it and its cofounders.[4] The SEC also took the position in the DAO investigative report that the platforms used to trade DAO tokens were exchanges within the meaning of Rule 3b-16(a), were not subject to exemptions, and had to be registered as such pursuant to Sections 5 and 6 of the Exchange Act.[5]

Some two years after the DAO investigation report, the SEC presented a more detailed explanation of its *Howey* approach in its 2019 "*Framework for Investment Contract Analysis of Digital Assets*" (2019 Framework). Among other topics, the 2019 Framework focuses at length on how the SEC determines whether a purchaser has a reasonable expectation of profits derived from the efforts of others. The 2019 Framework indicates that in applying *Howey*, the SEC will seek to determine whether (a) the purchaser reasonably expects to rely on the efforts of a promoter,

sponsor, or other relevant third parties; (b) these third-party efforts are significant and managerial rather than ministerial; and (c) the purchaser reasonably expects profits, e.g., capital appreciation, resulting from the development of the initial investment or business enterprise, or a participation in earnings resulting from the use of purchasers' funds, not mere price appreciation resulting solely from the supply and demand for the underlying asset. The 2019 Framework provides that secondary sales or offers of digital assets are subject to the same analysis as an initial sale, plus additional considerations relating to the ongoing efforts of others.

While the 2019 Framework lists many non-dispositive factors the SEC may consider in determining whether a digital asset is a security, SEC Chairman Gary Gensler stated in April 2022 that he believes almost all digital assets are securities. "The fact is," he said in published remarks, "most crypto tokens involve a group of entrepreneurs raising money from the public in anticipation of profits—the hallmark of an investment contract or a security under our jurisdiction." Conversely, former SEC Director of Corporation Finance Bill Hinman stated in June 2018 that Bitcoin and Ether are not securities due to their decentralized nature and the absence of a central third party.[6]

Not all stakeholders agree that the SEC's position on digital assets is correct. Some market participants have asserted that digital assets are not securities and thus fall outside the scope of the SEC's regulatory authority absent further legislation or rulemaking. Moreover, they argue that litigation—and specifically the case- and fact-specific application of *Howey*—is not a suitable way for the SEC to give the market guidance on how it believes the federal securities laws apply to digital assets. For example, the Blockchain Association (a nonprofit blockchain trade association whose members include software developers, infrastructure providers, exchanges, custodians, investors and others) has recently argued that the SEC's claim of broad authority to regulate digital assets relies on "novel interpretations of the law" and an improper pattern of filing dozens of enforcement actions without providing additional guidance or rulemaking to clarify how U.S. securities laws apply to digital assets. In a recent letter to the Office of Inspector General (OIG) of the SEC, which asks the OIG to open an investigation into potential impropriety surrounding the approval of Prometheum Ember Capital as a first of its kind "special purpose broker dealer," the Blockchain Association characterized Chairman Gensler as seeking to "thwart congressional efforts toward legislation by continuing to spread the false narrative that the law is already clear with regard to digital asset securities."

In July 2022, Coinbase submitted a petition to the SEC requesting a clearer set of rules to govern the regulation of digital assets—claiming in part that traditional equities-focused securities regulation is not a good fit for blockchain-based technology.

Members of Congress have also been working on a legislative solution to the regulation of digital assets. More than fifty bills have been introduced thus far in Congress covering various aspects of digital assets regulation, though no bill has yet to become law. The most recent bill introduced in Congress is the Lummis-Gillibrand Responsible Financial Innovation Act. This extremely wide-ranging legislation attempts,

among many other things[7], to reallocate jurisdictional boundaries for digital assets between the SEC and the CFTC,[8] as well as other federal and state regulators, through a set of overlapping and interlocking statutory definitions and provisions.[9]

At the highest conceptual level, the bill defines a new statutory category of "crypto asset" which is a natively electronic asset, based on distributed ledger or similar technology, that conveys economic, proprietary or access rights but is not backed by and does not derive value from, or digitally represent, some other financial asset. Thus, layer-1 blockchain tokens would be "crypto assets" but neither stablecoins (generally) nor asset-backed tokens nor tokenized securities would be "crypto assets."

For purposes of the allocation of jurisdiction between the CFTC and the SEC, the bill carves out of the definition of "crypto asset" assets that have any of a short list of rights or attributes customarily associated with traditional securities issued by formal business entities: (a) debt or equity interests in a business entity; (b) liquidation rights in a business entity; (c) dividends or interest payments by an entity; and (d) any other financial interest in the entity.[10] This non-traditional-security-like crypto asset is included in the definition of "commodity" in the Commodity Exchange Act. In this way, the bill makes explicit what has not been particularly controversial: that the CFTC has jurisdiction over futures, options on futures and swaps on crypto assets. But the bill goes much further to provide the CFTC with new exclusive jurisdiction over spot transactions in these non-traditional-security-like crypto assets, as well as (a) payment stablecoins (to the extent they are traded by futures commission merchants) and (b) certain "ancillary assets" for which required disclosure has been provided.[11]

This new statutory category of "ancillary assets" reflects a reading of *Howey* that a crypto asset that (a) is not fully decentralized, (b) benefits from entrepreneurial and managerial efforts of a sponsor that determine the value of the crypto asset and (c) does not have the above-mentioned attributes customarily associated with traditional securities issued by formal business entities "is not inherently a security." Rather, it is an asset that is ancillary to the investment contract (i.e., the security) to which it relates. Under the bill, so long as the issuer of the investment contract complies with a newly-imposed disclosure regime relating to the issuer, its activities and the ancillary asset, any ancillary asset owned by the issuer or an affiliate will be presumed to be a commodity—and not a security. Thus, tokens retained by issuers in their "treasuries" or delivered to founders will not be securities.

Moreover, regardless of whether the issuer complies with these new disclosure obligations, anyone who is not the issuer, an entity controlled by the issuer (including a person that acquires an ancillary asset from the issuer for purposes of resale or distribution of the ancillary asset) or a person acting at the direction or on the behalf of the issuer will not be required to treat the ancillary asset as a security. Thus, secondary market transactions in ancillary assets would not be regulated under the securities laws. Instead, most ancillary assets will be "crypto assets" and the bill requires that any trading facility that offers a market in crypto assets (or payment stablecoins) must register with the CFTC as a "crypto asset exchange" (and with certain other regulators) and become subject to significant substantive

regulation. The trading markets in crypto assets, including ancillary assets, will therefore be regulated primarily under the commodity laws. Despite a characterization in the Section-by-Section Overview that accompanied the bill that the bill *"[c]odifies the existing* Howey *test, as interpreted by the Federal courts over the last eighty years,"* the bill proposes a new regulatory approach to digital assets that would significantly shift regulatory authority over a wide swath of digital assets from the SEC to the CFTC.

II. THE COINBASE LITIGATION

As the debate simmers over how digital assets should be regulated, the SEC has filed numerous actions charging token issuers and other industry players with violations of federal securities laws. To date, these actions have largely resulted in settlements and have not clarified the legal questions surrounding digital assets regulation. Until 2023, moreover, the SEC had not filed any charges directly against cryptocurrency exchanges.

The collapse of cryptocurrency exchange FTX in November 2022 resonated across the cryptocurrency industry and raised significant questions among media and the public as to how cryptocurrency exchanges should be regulated in the United States. In 2023 and after the fall of FTX, the SEC charged several cryptocurrency exchanges with violations of U.S. securities laws. In April 2023, the SEC charged Bittrex, Inc. and its co-founder and former CEO, William Shihara, with operating an unregistered national securities exchange, broker, and clearing agency.[12] On June 6, 2023, the SEC charged Singapore-based, global cryptocurrency exchange Binance Holdings Ltd. and a U.S. affiliate, along with Binance founder Changpeng Zhao, with operating a securities exchange while failing to comply with the registration provisions of the federal securities laws. In charging Binance, the SEC alleged strong evidence regarding state of mind—namely, a text message from Binance's Chief Compliance Officer in which he notes to a colleague that Binance was "operating as a [expletive deleted] unlicensed securities exchange in the USA bro." The SEC also charged Binance with unlawfully engaging in the unregistered offer and sale of crypto asset securities, including Binance's own "BNB" and "BUSD" crypto assets, as well as profit-generating programs and staking services. Staking programs have been a recent further focus in SEC enforcement actions—including in the SEC's February 2023 settlement with Kraken[13]—and would emerge again as focus in the SEC's complaint against Coinbase.

a. THE SEC COMPLAINT

On June 6, 2023—the day after it filed charges against Binance—the SEC charged Coinbase with numerous securities laws violations. The crux of the SEC complaint against Coinbase is that as a crypto exchange listing certain digital assets and providing certain services that constitute securities, Coinbase must register—and has not—pursuant to the Securities Act and the Exchange Act. The SEC asserts that Coinbase's activities relate to digital assets that are securities under *Howey*—and that Coinbase deliberately ignored applicable securities laws to earn "billions" at the "expense of investors by depriving them of the protections to which they are entitled."[14]

The SEC separately argues in its complaint

that the "staking" services offered by Coinbase are themselves investment contracts under *Howey*. "Staking," or "proof of stake," is a mechanism used to validate certain cryptocurrency transactions on the blockchain. Blockchain transactions are not subject to centralized verification in the same way that financial institutions verify traditional currency transactions; rather, they require a decentralized mechanism for verification. A proof-of-stake protocol allows holders of certain cryptocurrencies to assign, or "stake," their digital assets, which locks up the assets for a certain period during which the holder's device can be used to validate blockchain transactions. Validators are selected randomly to confirm transactions and validate block information, and such validators earn additional cryptocurrency as a reward. The SEC claims that by pooling and staking customers' digital assets, earning rewards on customers' behalf, and returning those rewards to customers, Coinbase is offering and selling investment contracts subject to SEC regulation.

The SEC further alleges that Coinbase has operated as an unregistered broker through two services provided to investors on its platform. The first is Coinbase Prime, which the SEC alleges Coinbase refers to as a "prime broker for digital assets" and which is used to route orders for crypto assets to the Coinbase platform or to other third-party platforms. The other service mentioned in this charge is Coinbase Wallet, which routes orders through third-party digital asset trading platforms as a means to access liquidity off the Coinbase platform.

b. THE COINBASE RESPONSE

Coinbase filed its answer on June 29, 2023, and on August 4, 2023, filed a motion for judgment on the pleadings (collectively, the "Coinbase Response"). The Coinbase Response denies that any of the Coinbase services identified in the SEC complaint are or involve securities. Challenging the SEC's overall interpretation of *Howey* in the context of digital assets, Coinbase asserts that the digital assets traded on its exchange are not investment contracts under *Howey* because the buyers of digital assets do not have a "contractually-grounded expectation of delivery of future value" that is "directed in the business itself rather than a purchase of the business's products or output." Rather, the value of digital assets "inheres in the things bought and traded rather than in the businesses that generated them." If the assets' value is inherent rather than a product of managerial activity, and if buyers have no contractually-grounded expectation of profits in the seller's enterprise, *Howey* cannot be met and the assets are, as a matter of law, not securities subject to SEC regulation.

The Coinbase Response asserts that the SEC and its Commissioner, Gary Gensler, have acknowledged for years that a "regulatory gap" prevented the Commission from policing digital asset exchanges. By bringing this enforcement action against Coinbase, rather than engaging in notice-and-comment rulemaking, Coinbase claims that the SEC is abusing its discretion.

Coinbase further argues that SEC tacitly approved its business model in declaring Coinbase's IPO registration statement effective in April 2021. In declaring the IPO registration statement effective, Coinbase argues, the SEC did not suggest that Coinbase was obligated to register its operations or was in violation of any securities laws. This registration statement approval fol-

lowed years of interaction between the SEC and Coinbase, including multiple meetings between the parties and comments from the SEC, and which gave the SEC a very thorough understanding of the company beyond what was included in the registration statement. Indeed, six of the twelve assets that the SEC now claims are securities were traded on Coinbase's platform when the registration statement was declared effective. According to Coinbase, given the SEC's role of protecting investors, the registration statement and offering should not have been allowed to go forward if Coinbase's operations were in violation of securities laws.

Coinbase argues that the SEC cannot approve the IPO of a business and then, two years later, determine "by decree, arbitrarily, and without congressional mandate" that fundamental aspects of the business violate federal securities law. Coinbase characterizes the SEC's view of its regulatory authority as newly expansive, without basis in federal securities laws, subject to formal rulemaking requirements unmet by the SEC, lacking in due process and, under the so-called major questions doctrine, an impermissible encroachment on Congress' ongoing consideration of how best to assign regulatory authority over cryptocurrency.[15] In changing what it considers to be an "investment contract" and otherwise pursuing aggressive action, the SEC is allegedly stepping in and trying to usurp the powers held by Congress, even as the regulators themselves are grappling over what powers in this space belong to the SEC or the CFTC.

The Coinbase Response provides that Coinbase has long publicly welcomed regulations and has exerted every effort to be compliant and to work directly with the SEC, CFTC, and other appropriate federal and state regulators. The company has even created an internal group and process to review if tokens traded on their platform could be considered a "security," into which they have provided access to the SEC. And, as discussed, on July 21, 2022, "to obtain the notice of the SEC's changed position to which it was entitled, Coinbase formally petitioned the Commission for rulemaking concerning digital asset securities."

Coinbase notes in the Coinbase Response that on the same day it submitted its petition for further guidance, the SEC brought charges in the U.S. District Court for the Western District of Washington against a former Coinbase employee and his brother.[16] These charges related to alleged securities fraud in connection with the trading of nine digital assets on the Coinbase exchange. In filing charges against these individuals, Coinbase argues, the SEC sought to take on Coinbase in a "litigation by proxy"—and to force a judicial determination that digital tokens are securities in a case involving "ill-equipped" and "unsympathetic criminals." By not directly naming Coinbase in the complaint, the SEC ensured that the company could not directly provide input into their procedures and years of efforts at compliance as presented in the action. According to Coinbase, this action was part of an ongoing SEC campaign to "impose backwards-looking liability for the crypto industry rather than forward-looking guidance."

With respect to staking, Coinbase denies that the practice constitutes an investment contract under *Howey*. The Answer states that Coinbase merely offers its customers a platform on which to stake, i.e., to participate in a particular token's protocol when that protocol allows for staking.

Coinbase argues that the staking process does not involve investment, but merely an agreement by customers to participate in a process where digital assets held in a customer account are used to stake in return for rewards. Coinbase further claims that the staking services it provides are merely IT services and not the managerial effort required for an investment contract under *Howey*. Moreover, staking on the Coinbase platform purportedly does not involve any potential risk of loss.

Coinbase also denies that its Coinbase Wallet and Coinbase Prime implicate the offering, listing, brokering, or clearing of securities transactions. According to Coinbase, "Wallet simply provides a user interface and technical connection to the third-party platforms, so that customers can use their digital assets on those platforms—just like anyone can bring their personal wallet to a store and spend money from it there." Unlike a broker, Wallet does not take or process orders, negotiate transactions for customers, make investment recommendations, provide digital asset valuations, offer other transactional advice, recommend or arrange customer financing; process trade documentation, hold customer assets or funds. Coinbase further argues that its Prime service merely allows institutional customers to execute trades of approved assets at scale.

III. REFLECTIONS

The Coinbase litigation is one of several ongoing cases in which the SEC and market participants contest the proper scope of SEC regulatory authority over digital assets. As highlighted by the parties' positions, a significant gap exists between recent SEC enforcement actions and market participants' position that a more clearly defined regulatory structure is necessary, including with respect to secondary markets and exchange trading. Such participants—including Coinbase[17]—have publicly petitioned for more formal SEC rulemaking or for Congress to pass legislation that clarifies when U.S. securities laws apply to digital assets. The SEC has instead brought litigation pursuant to rules they claim are well-established and clear. "Crypto markets suffer from a lack of regulatory compliance," SEC Commissioner Gary Gensler stated during an April 2023 hearing before Congress, "not a lack of regulatory clarity."[18]

In contrast to the SEC's enforcement approach, the regulatory model anticipated by the draft Lummis-Gillebrand legislation promises to provide market clarity through a reallocation of regulatory authority between the SEC, the CFTC and other regulators, as well as by imposing new rules applicable to the space.

No matter one's position on how crypto is or ought to be regulated, the SEC seems unlikely to abandon its current aggressive enforcement stance. Market participants might prefer formal SEC guidance or new legislation, but recent SEC actions against Coinbase, Binance, Kraken, Genesis, Gemini, and others suggest that the Commission is seeking to assert its jurisdiction over digital assets as aggressively as courts will allow. Former SEC Chairman Jay Clayton characterized this position critically in June 2023 as: "If we're not losing cases, if we're not getting pushed back on by the courts, we're not doing enough."[19]

An SEC win in the Coinbase litigation would affirm the SEC's jurisdiction over the services provided by cryptocurrency exchanges. Moreover, the impact of this litigation is likely to

reverberate far beyond just crypto exchanges. A finding that Coinbase's staking services are "investment contracts," for example, and therefore securities, would likely lead to similar claims against cryptocurrency issuers that offer unregistered staking programs. Conversely, a win by Coinbase on the basis of its interpretation of *Howey* and the application of the major questions doctrine would be a major setback for the SEC, potentially depriving it of its most effective tool in regulating digital assets. In such a case, and without new legislation by Congress or further regulatory action by the CFTC, much of the spot digital assets industry would be largely unregulated.

While the SEC aggressively pursues litigation against market participants that it believes put investors at risk, Coinbase is pushing back on the notion that digital assets exchanges and related services are or should be subject to SEC regulation. The Coinbase litigation raises a variety of difficult factual, legal, and policy questions not often addressed so explicitly in the early stages of litigation, e.g., whether and which digital assets are securities, whether secondary markets and exchange trading of digital assets are regulated transactions, whether staking programs involve sufficient managerial effort to constitute securities transactions, whether the SEC has a due process obligation to provide more rulemaking guidance to crytpo market participants before commencing further litigation, and whether the SEC's view of its regulatory authority over digital assets is sufficiently unmoored from the federal securities laws as to require further guidance from Congress. In the near term, it seems unlikely that the Coinbase litigation will answer such questions once and for all. More SEC litigation seems likely. Market participants, legislators, and the general public will all be watching closely.

ENDNOTES:

[1]*See* 15 U.S.C.A. § 77b(a)(1) (defining "security" for purposes of the Securities Act) ("The term 'security' means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a 'security,' or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing." *See also* 15 U.S. Code § 78c(a)(10) (defining "security" for purposes of the Exchange Act).

[2]*S.E.C. v. W.J. Howey Co.*, 328 U.S. 293, 299, 66 S. Ct. 1100, 90 L. Ed. 1244, 163 A.L.R. 1043 (1946) (citing H.Rep.No.85, 73rd Cong., 1st Sess., p. 11) (further providing that the Howey Test "embodies a flexible rather than a static principle" that is "capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits").

[3]*See* Miriam R. Albert, *The Howey Test Turns 64: Are the Courts Grading this Test on a Curve?*, 2 Wm. & Mary Bus. L. Rev. 1, 8 (2011) (available at https://scholarship.law.wm.edu/wmblr/vol2/iss1/2) ("Indeed, the specter of inconsistent interpretation and/or application by the lower courts arguably threatens to undermine the utility of the Howey test itself as a trigger for investor

protection.")

[4]Securities & Exchange Commission, Release No. 81207 (Jul. 25, 2017) (https://www.sec.gov/litigation/investreport/34-81207.pdf), at 12.

[5]*Id.* The Exchange Act prohibits brokers, dealers, and exchanges from effecting or reporting securities transactions on a national securities exchange unless the security and the exchange are registered or are exempted from registration requirements. *See* 15 U.S.C.A. § 78e. Under Section 3(a)(1) of the Exchange Act, an "exchange" is "any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a marketplace or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood. . . ." Exchange Act Rule 3b-16(a) further provides that an organization, association, or group of persons shall be considered to constitute, maintain, or provide "a marketplace or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange," if such organization, association, or group of persons: (1) brings together the orders for securities of multiple buyers and sellers; and (2) uses established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of the trade. 15 U.S.C.A. § 78c(a)(1).

[6]*See* William Hinman, Director, Division of Corporate Finance, *Digital Asset Transactions: When Howey Met Gary (Plastic)* (June 14, 2018) (https://www.sec.gov/news/speech/speech-hinman-061418). In *S.E.C. v. Ripple Labs, Inc.*, 540 F. Supp. 3d 409 (S.D. N.Y. 2021), the court issued a summary judgement order ruling that at least certain kinds of digital assets transactions are not securities transactions. In the order, the court applied the Howey Test and held that institutional buyers which "knowingly purchased XRP directly from Ripple pursuant to a contract" had engaged in securities transactions; "programmatic buyers" who purchased XRP via a blind sale mechanism did not engage in securities transaction because, unlike the institutional investors, they did not purchase XRP with a reasonable expectation of profit in reliance on the managerial efforts of Ripple. The court further held that Ripple's issuance of XRP to employees and other third parties did not involve the investment of money, and were not securities under the Howey Test for that reason. The Ripple order does not address whether secondary sales of cryptocurrencies or tokens, including sales on exchanges, would be considered sales of securities, though it does suggest, through its holding on ''programmatic buyers'', that secondary transactions on exchanges via a blind sale mechanism would not be securities transactions. Prior to *Ripple,* courts addressing whether the offer and sale of digital assets are securities transactions have generally found that they are. Given the nature of the Howey Test, these findings are generally fact-specific and have not given rise to a general rule for the evaluation of digital assets. *See, e.g.*, *SEC v. Kik Interactive, Inc.*, Case No. 19-cv-5244 (AKH) (Oct. 21, 2020) (final judgment resolving SEC charges that Kik's unregistered "Kin" token offering violated the federal securities laws); *S.E.C. v. Telegram Group Inc.*, 2020 WL 1547383, at *1 (S.D. N.Y. 2020) (holding that while "Gram" token purchase agreements were not securities by themselves, Telegram's pre-sale scheme, including the Gram purchase agreements and related understandings and undertakings, were securities).

[7]The Lummis-Gillibrand bill reworks various prior bills, including a previous Lummis-Gillibrand bill. In addition to re-allocating regulatory jurisdiction for digital assets between the SEC and the U.S. Commodity Futures Trading Commission (CFTC), as discussed above, the bill (among other things): creates new crypto asset consumer protection requirements and allocates enforcement authority among the CFTC, the SEC, banking agencies and a new Customer Protection and Market Integrity Authority; requires all crypto asset intermediaries to maintain proof of reserves and undergo an annual verifica-

tion process enforced by the PCAOB; specifies that customer agreements for crypto assets must be written in plain language, and that these agreements, and subsequent changes, must be filed in a public database; creates advertising standards for crypto assets and tasks the SEC and the CFTC with developing cybersecurity standards; addresses illicit finance by heightening criminal penalties for crypto-related violations of the Bank Secrecy Act and requires regulators to develop related standards, guidance and recommendations; authorizes the SEC and the CFTC to charter customer protection and market integrity authorities to supervise crypto asset intermediaries and provides related registration and rulemaking authority; requires all payment stablecoin issuers to become state- or federally-chartered depository institutions with mandatory federal supervision for state issuers; addresses taxation of crypto asset transactions; and provides for interagency coordination and funding.

[8]The CFTC regulates leveraged retail commodity transactions, derivatives and futures contracts, among other products, and it has taken the position that Bitcoin and Ether are commodities subject to CFTC jurisdiction. The CFTC further asserts that fund managers investing in digital asset futures contracts, or that use leverage or margin to invest in digital assets, must register with the CFTC. *See, e.g.*, *In re BFXNA INC. d/b/a BITFINEX*, CFTC Docket No. 16-19 (June 2, 2016).

[9]On August 11, 2023, Senator Lummis filed an amicus curiae brief in the Coinbase litigation. Senator Lummis argues that the court should reject the SEC's claims against Coinbase because digital assets are not ''investment contracts'' under *Howey* unless they give the buyer an enforceable legal interest in a business entity. Senator Lummis further argues that Congress has not ''conferred on the SEC wholesale regulatory power'' over digital assets, the ''SEC is not suited to the task of crafting a holistic regulatory framework for crypto assets'', and its assertion of jurisdiction over Coinbase ''encroaches on Congress's legislative role''.

[10]It is noteworthy that the definition of "business entity" does not appear to include sole proprietorships, general partnerships or most DAOs, leaving open interesting possibilities for "crypto assets" that may carry a wide variety of payment rights or attributes in informal business arrangements.

[11]This new spot authority is in addition to the CFTC's existing authority over leveraged retail commodity transactions, which itself would be augmented by a new grant of rulemaking authority over such transactions.

[12]*See S.E.C. v. Bittrex Inc.*, 2023 WL 4866373 (W.D. Wash. 2023). The SEC also charged Bittrex, Inc.'s foreign affiliate, Bittrex Global GmbH, for failing to register as a national securities exchange in connection with its operation of a single shared order book along with Bittrex.

[13]*See* https://www.sec.gov/news/press-release/2023-25 ("To settle the SEC's charges, the two Kraken entities agreed to immediately cease offering or selling securities through crypto asset staking services or staking programs and pay $30 million in disgorgement, prejudgment interest, and civil penalties.").

[14]*See* https://www.sec.gov/news/press-release/2023-102 (June 6, 2023).

[15]As discussed, Senators Cynthia Lummis (R-Wyoming) and Kirsten Gillibrand (D-New York) are crafting bipartisan legislation that would create a broad regulatory framework for digital assets and give the CFTC the bulk of the responsibility for oversight. Senator Debbie Stabenow (D-Michigan) has also introduced another bill that would grant the CFTC broad jurisdiction over digital assets and trading platforms. In the U.S. House of Representatives, a bipartisan group has introduced legislation that would allow for the regulation of digital commodity exchanges by the CFTC and establishes conditions for the sale of digital commodities and the registration of exchanges, among other requirements. These bills overlap but do not fully align. Moreover, they are just a few of over 50 bills and resolutions introduced so far in Congress that relate to the regulation of digital assets.

[16]*S.E.C. v. Wahi*, 2023 WL 3582398 (W.D. Wash. 2023).

[17]See *Coinbase, Petition for Rulemaking—*

Digital Asset Securities Regulation (July 21, 2022) (requesting that the SEC "propose and adopt rules to govern the regulation of securities that are offered and traded via digitally native methods, including potential rules to identify which digital assets are securities").

[18]Securities and Exchange Commission, *SEC Charges Crypto Asset Trading Platform Bittrex and its Former CEO for Operating an Unregistered Exchange, Broker, and Clearing Agency*, https://www.sec.gov/news/press-release/2023-78 (Apr. 17, 2023).

[19]CNBC, *Former SEC Chair Jay Clayton: 'Remarkable' markets are stable after Wagner's rebellion in Russia*, available at https://www.cnbc.com/video/2023/06/26/former-sec-chair-jay-clayton-remarkable-markets-are-stable-after-wagners-rebellion-in-russia.html/ (June 26, 2023, 9:09 AM).