Navigating the Regulatory Labyrinth :

A Legal Analysis on an ETH ETF Approval

The Cryptophobic Cryptophile

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Content

Foreword

About me

I have always taken the road less travelled. Albeit having embarked on the traditional legal path, I have developed a fascination for areas where law and technology intersect. Fuelled by this passion, I founded a LegalTech AI start-up in my undergraduate. Looking forward, I strive to leverage my tech-savviness and legal acumen to transform academic theories into realistic analysis and applications. In these unprecedented times where emerging technologies proliferate, the words of Darwin still hold true:

> *"It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is able best to **adapt and adjust** to the changing environment in which it finds itself."*

Embracing this spirit, I have immersed myself in the realms of technology law, crypto regulations, and DeFi applications. In this paper, I dissect the pivotal legal issues that may impact the SEC's highly anticipated decisions regarding the ETH spot ETPs. My analysis delves into the registration of ETPs, the classification of ETH, the implications of the *Grayscale* court decision, and the recent approval of the BTC spot ETPs.

The significance of the ETH spot ETPs

While ETH currently trades below its ATH and is overshadowed by the dominance of BTC and the launching of BTC spot ETPs, several potential catalysts loom large. Most potently, the Dencun upgrade and the potential approvals of the ETH spot ETPs, with the earliest possible approval by 23 May 2024. Speculations suggest that if approved, the price of ETH could at least double by the end of this year.

As observed, BTC's ATH has been fuelled by strong ETF inflows, which are mostly driven by institutional investors. This may indicate a similar trajectory for ETH, or perhaps even more accelerated due to its small market cap. It is anticipated that increased institutional and governmental exposure via sovereign wealth funds or central banks acquiring crypto ETPs can further normalise the asset class and relevantly, normalise regulations.

That said, questions remain as to the future value proposition for Ethereum and its projected market value, particularly in light of the current traction of layer-2 scaling solutions and data availability layers. For more, check out and subscribe to my blog The Cryptophobic Cryptophile, where I regularly share my views on global crypto regulations, tokenomics, and the market.

Reading guide

For casual readers, refer to the Executive Summary in each part for a concise overview of the key legal issues, where I emphasise their effects on the approval chances of the ETH spot ETPs.

For a deeper dive, explore the specific sections that intrigue you!

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Disclaimer: My personal views in this paper are not legal nor financial advice. None of my views are reflective of the views of individuals whom I work with in my official capacities. I may be holding or trading assets discussed herein. Always do your own research and due diligence.

Part 1

Registration of ETPs: Implications of Registering as a Product under the Investment Company Act of 1940 ('40 Act) or the Securities Act of 1933 ('33 Act)

1 Executive Summary

1.1 Note the SEC's decision regarding the Grayscale Ethereum Futures ETF

While the SEC had rejected Bitcoin futures ETFs registered under the '33 Act in the past, this had to be seen against the approval of the Teucrium Bitcoin Futures Fund (registered as '33 Act ETF). Recently, Bitcoin spot ETFs registered under '33 Act were also approved. As for ETH, it is noted that the Grayscale Ethereum Futures ETF is registered under '33 Act and pending approval. This product is largely being seen as a "trojan horse"—should it be rejected, the SEC will have to explain its differential treatment between (i) the futures ETFs of BTC and ETH, and more broadly (ii) the '40 Act ETFs and '33 Act ETFs; should it be approved, this gives Grayscale leverage that its ETH spot ETP (to be converted from the Grayscale Ethereum Trust), which is registered under the '33 Act, should similarly be approved.[1]

1.2 Drawing on the approval of BTC spot ETPs, subject to the nature of BTC versus ETH

With the benefit of hindsight (predominantly the decision of the United States Court of Appeals for the District of Columbia Circuit in *Grayscale*, which will be discussed in Part 3), it may be a forceful argument that since BTC spot ETPs registered under the '33 Act had been approved, so should the ETH spot ETFs registered under the '33 Act. But this is clearly subject to the caveat that the SEC accepts the nature of a BTC spot ETP and an ETH spot ETP as materially similar to justify such extrapolation, which brings me (partly) to my discussion of ETH's classification in Part 2.

1.3 The distinction between '33 Act ETFs and '40 Act ETFs is arguably rendered illusory

Zooming out, one must ask whether the distinction between '33 Act ETFs and '40 Act ETFs is material in the context of ETH-based ETF and ETP proposals. For instance, in Grayscale Ethereum Trust's and iShares Ethereum Trust's notices of filing,[2] they argued that because the distinction is immaterial,[3] as such (i) the application of '40 Act should not be a reason barring the approval of spot BTC/ETH ETPs; and (ii) the fact that the futures ETFs are registered under '40 Act instead of '33 Act is not a justifiable basis for differentiating them from spots BTC/ETH ETPs and thereby treating the latter differently.

1 https://cointelegraph.com/news/grayscale-eth-futures-etf-trojan-horse-spot-eth-etf

2 https://www.federalregister.gov/documents/2023/10/27/2023-23703/self-regulatory-organizations-nyse-arca-inc-notice-of-filing-of-proposed-rule-change-to-list-and#citation-28-p73902;

https://www.federalregister.gov/documents/2023/12/11/2023-27062/self-regulatory-organizations-the-nasdaq-stock-market-llc-notice-of-filing-of-proposed-rule-change

3 Their reasons are: while accepting that the '40 Act has certain added investor protections that the '33 Act does not require, these protections do not seek to allay harms arising from underlying assets (i.e. BTC/ETH spot/futures) or markets of assets that ETFs hold (i.e. CME BTC/ETH futures market, or, spot BTC/ETH markets), such as the potential for fraud or market manipulations. And these are the core determinant when the SEC considers whether to approve the listing of a new product of trading under the Securities Exchange Act of 1934. Instead, the protections under the '40 Act seek to remedy certain abusive practices in the management of investment companies such as ETFs and serve to place certain restrictions related to accounting, borrowing, custody, fees, and independent boards.

In any event, I note that this issue was not raised nor addressed by the Court in *Grayscale*, which accepted that Grayscale's Bitcoin spot ETP (registered under '33 Act) is a similar product to the approved Bitcoin futures ETPs (*inter alia*, the Teucrium Bitcoin Futures Fund, which is registered under '33 Act). Seen in this light, it may be arguable that such distinction is indeed rendered nugatory by virtue of *Grayscale*.

2 ETFs Listing Process [4]

2.1. The Exchange must submit a detailed rule proposal containing information of the ETF [5] and a description of trading rules and halts that may apply;

2.2. Within 15 days of the Exchange's posting the proposal on its website, the SEC is required to publish notice of the proposed rule change on the Federal Register. The comment period is typically 21 days;

2.3. Within 45 days after Federal Register publication, the SEC must act on the proposal by:

2.3.1. Approving or disapproving the proposal;

2.3.2. Extending the time for action by an additional 90 days; or

2.3.3. Instituting proceedings to determine whether to approve or disapprove the proposal, which extends the period for action to 180 days after Federal Register publication

2.4. The final deadline for SEC action is 240 days after the Federal Register publication date (*per* 17 CFR §242.608(b)(2)(i)). **In other words, by 23 May 2024, the SEC has to make a decision regarding the VanEck spot Ethereum ETF.**

3 The Regulations of '40 Act ETFs and '33 Act ETFs [6]

The differential treatment between '40 Act ETFs and '33 Act ETFs arguably stems from the disparate underlying regulatory regime.

Generally speaking, all ETPs are regulated under the '33 Act and the Securities Exchange Act of 1934.

Depending on their particular structures, ETPs may **additionally** be subject to regulatory requirements and oversight by different SEC divisions or the Commodity Futures Trading Commission (CFTC) and may offer different levels of investor protection.

4 https://www.ici.org/doc-server/pdf%3Appr_17_etf_listing_standards.pdf

5 For example, descriptions concerning the strategy and components of the ETFs, creation and redemption of shares, and the calculation of NAV: https://www.ici.org/doc-server/pdf%3Appr_17_etf_listing_standards.pdf

6 https://www.finra.org/investors/investing/investment-products/exchange-traded-funds-and-products

Most ETPs are structured as ETFs but may be registered differently:

- **Vast majority of ETFs are '40 Act ETFs:** They are organised and registered as investment companies under the '40 Act,[7] which is enforced and regulated by the SEC.[8] Investment companies (defined as, *inter alia*, an issuer that is engaged or proposes to engage in investing/owning/trading in securities)[9] must register with the SEC before they can offer their securities in the public market;

- **Only <2%of ETFs are registered under '33 Act:** These ETFs invest primarily in commodities, currencies, and futures, and are regulated as commodity pools by the CFTC under the Commodity Exchange Act and by the SEC under the '33 Act [10]; and

- **'33 Act ETFs are dubbed as "riskier investments"** [11] **:**'40 Act "provides a host of investor protections, including those related to organisational structure and investment activities".[12] In comparison, '33 Act provides for less governance oversight such as by omitting the requirement of having a board of directors.[13] Further, '40 Act ETFs must have a specific structure that precludes physical products whereas '33 Act allows for a broader range of offerings holding a variety of assets.[14] Hence, '33 Act ETFs are dubbed as "riskier investments".

4 Table 1: Registration and Approval of BTC/ ETH ETPs

BTC futures ETFs	BTC spot ETPs
• Since the Fall of 2021, the SEC had approved BTC futures ETFs registered as '40 Act ETFs • In April 2022, notably, the SEC approved the Teucrium Bitcoin Futures Fund, which is registered as '33 Act ETFs	• Recently approved by the SEC • Registered under '33 Act [15] (including GBTC's conversion to a spot BTC ETP)[16]

7 As of June 30 2018, over 98% of assets, according to Morningstar, Inc.: https://corporate.vanguard.com/content/dam/corp/research/pdf/exchange-traded-funds-clarity-amid-the-clutter-us-isgetfc_022019_online.pdf

8 https://www.govinfo.gov/content/pkg/COMPS-1879/pdf/COMPS-1879.pdf

9 https://www.govinfo.gov/content/pkg/COMPS-1879/pdf/COMPS-1879.pdf

10 https://www.finra.org/investors/investing/investment-products/exchange-traded-funds-and-products

11 https://www.etftrends.com/etf-strategist-channel/the-40-act-vs-33-act-etf-battle/

12 https://corporate.vanguard.com/content/dam/corp/research/pdf/exchange-traded-funds-clarity-amid-the-clutter-us-isgetfc_022019_online.pdf

13 https://www.etftrends.com/etf-strategist-channel/the-40-act-vs-33-act-etf-battle/

14 https://www.theblock.co/post/170562/a-new-bitcoin-futures-etf-signals-possible-step-forward-in-u-s-regulation

15 https://www.winston.com/en/blogs-and-podcasts/non-fungible-insights-blockchain-decrypted/road-to-bitcoin-investment-for-sec-registered-investment-advisors-cleared-with-secs-approval-of-11-spot-bitcoin-etfs#_ftnref1

16 https://www.grayscale.com/blog/legal-topics/gbtcs-s-3-filing-explained

ETH futures ETPs

- In October 2023, the SEC approved ETH futures ETFs registered as '40 Act ETFs [17]
- Notably, in September 2023, the Grayscale Ethereum Futures ETF was submitted via form19b-4 and registered as '33 Act ETF. [18] The SEC's decision is currently delayed [19]

ETH spot ETPs

The ETPs currently seeking approval are stipulated in the **table below**. For brevity, I highlight that:

- Grayscale Ethereum Trust, which seeks to convert to a spot ETH ETP (arguably akin to the GBTC conversion), is not registered as a '40 Act ETP
- iShares Ethereum Trust is also not registered as a '40 Act ETP
- Hashdex Nasdaq Ethereum ETF (holding both spot and futures contracts ETH) filed for futures and spot Ether holdings under the '33 Act [20]

Issuer *(Ticker)*	Company	Asset	Exchange	Custodian	Index/Pricing Provider	SEC Next Deadline	SEC Final Deadline
			"Physically" Backed				
VanEck Ethereum ETF	VanEck	Ethereum	CBOE	Gemini??	Market Vectors	12/25/23	5/23/24
ARK 21Shares Ethereum ETF	21Shares & ARK	Ethereum	CBOE	Coinbase	S&P Dow Jones	12/26/23	5/24/24
Hashdex Nasdaq Ethereum ETF	Hashdex	Ethereum	Nasdaq	N/A	Nasdaq	1/1/24	5/30/24
Grayscale Ethereum Trust *Conversion (ETHE)*	Grayscale	Ethereum	NYSE	Coinbase	Nasdaq??	12/6/23	6/18/24
Invesco Galaxy Ethereum ETF	Invesco & Galaxy	Ethereum	CBOE	Coinbase	Bloomberg	12/23/23	7/5/24
iShares Ethereum Trust	BlackRock	Ethereum	Nasdaq	Coinbase	CF Benchmarks	~1/25/24	~8/7/24
Fidelity Ethereum Fund	Fidelity	Ethereum	CBOE	Fidelity	Fidelity/CoinMetrics	~1/21/24	~8/3/24

Note: Dates are estimates and deadlines, so they may come earlier.
Source: Bloomberg Intelligence, SEC.gov
Bloomberg

ETH ETPs Filed for SEC's Approval [21]

[17] For examples, ETFs filed by Volatility Shares, Bitwise Asset Management, VanEck, Roundhill Investments, ProShares: https://www.wsj.com/livecoverage/stock-market-today-08-02-2023/card/money-managers-run-to-file-ether-futures-etfs-cMeuLeUi1KPAI9hpKbt4

[18] https://www.federalregister.gov/documents/2023/10/27/2023-23703/self-regulatory-organizations-nyse-arca-inc-notice-of-filing-of-proposed-rule-change-to-list-and

[19] https://www.sec.gov/files/rules/sro/nysearca/2023/34-98944.pdf

[20] https://cointelegraph.com/news/crypto-ether-mixed-etf-nasdaq-hashdex

[21] https://cryptorank.io/news/feed/c58ad-bloomberg-experts-timeline-ethereum-etf

Part 2

The Classification of ETH: Security or Commodity?

1 Executive Summary

It is clear that across the industry, be it the regulatory or prosecutorial authorities, or the Judiciary, there lacks consensus as to the classification of ETH. That said, it is worthwhile to pinpoint that as of the date of writing, allegedly, ETH has never been explicitly labelled as securities by the SEC in its lawsuits against crypto issuers or exchanges.[1] **Table 1 (non-exhaustively) summarises the stance adopted by stakeholders in the industry.**

An examination of ETH's nature must predicate upon an analysis of the *Howey* test (from which the SEC derives the definition of "investment contract", as a type of security),[2] and its application to digital assets. To this end, I discuss the relatively controversial and landmark cases of *Ripple*, *Terraform* and most recently, *Coinbase*. In **Table 2**, apart from highlighting the gist of the ruling, I have extracted the reasonings of the courts in respect of the 4 key issues which I find pivotal for any subsequent crypto-assets related cases, namely:

- Significant holdings on the *Howey* test;
- Purported distinction between institutional and secondary market sales;
- The due process (or fair notice) defences; and
- The SEC's regulatory ambit: major question doctrine and the *Chevron* deference.

For each key issue above, in Section 4, I will elaborate and comment on the relevant court holdings. In particular, as to the implications of these holdings on the filings of ETH ETPs, below is the gist of my analysis:

1.1 Significant holdings regarding the *Howey* test

To reconcile with the reasonings of the Courts in *Ripple*, *Terraform* and *Coinbase*, I would argue that ETH, as a token, cannot **in and of itself** be qualified as an investment contract. As the application of *Howey* demands that the Court must consider the totality of circumstances surrounding the offers and sales of ETH. In other words, the classification of ETH must depend on the circumstances, such that one must pinpoint to a specific transaction / scheme involving the sale and distribution of ETH as opposed to subscribing to the broad notion that ETH is a security (or what not).

Thus, the practical reality will then be: if the SEC seeks to adopt a broad-brush approach in classifying ETH, it is likely that such decisions will be litigated. As of the date of writing, given that the SEC has never formally listed ETH as a security in any lawsuits, it may be suggested that its equivocal status is one that can only be resolved in due course. **Should the classification of ETH be material to the approval of its spot ETPs, it is likely that there will only be a significant court determination after the first deadline of 23 May 2024 (which is that for the VanEck spot Ethereum ETF).**[3]

[1] Note that in Consensys's recent complaint against the SEC, it was revealed that the agency is investigating whether Consensys's current offers and sales of ETH are securities transactions and has requested that Consensys make a "proffer" to the SEC to state why Consensys believes its ETH sales are not securities transactions. In this respect, *Coinbase* contended that ETH is not a security as (i) it represents no claim on the proceeds or revenues of the Ethereum network; (ii) it provides no interest in the profits or assets of any enterprise; (iii) its value is not driven by the efforts of a centralised promoter; and (iv) no governing board manages ETH or defines its characteristics or terms of use (see paras. 6, 11, 36-37):
https://storage.courtlistener.com/recap/gov.uscourts.txnd.389154/gov.uscourts.txnd.389154.1.0.pdf

[2] The *Howey* test defines investment contract as an investment of money in a common enterprise, with a reasonable expectation of profits to be derived from the efforts of others. In contrast, commodities feature none of that and broadly speaking, its valuation is based on the trading price available in the market, which is affected by factors such as supply and demand.

[3] I note that as of the date of writing, the industry is largely expecting that VanEck's ETF will be denied. Should that be the case, I envisage that the contentious issues in subsequent litigations will include, inter alia: (i) whether ETH is "indistinguishable" from BTC; (ii) whether the correlation analysis of ETH spot and futures markets is similar to that for BTC (as agreed by the Court of Appeal in Grayscale that there is 99.9% of correlation between BTC's spot market prices and CME futures contract prices; for more on the decision's implications, please check out my Substack:
https://cryptophobiccryptophile.substack.com/p/crypto-laws-deciphered-1-btc-etps); and (iii) if (ii) is answered in the affirmative, whether a surveillance-sharing agreement with the CME futures market is sufficient in detecting and deterring fraud and manipulation (bearing in mind SEC's Commissioner Caroline A. Crenshaw's dissenting statement subsequent to the approval of the spot BTC ETPs).

1.2 Ruling on the due process (or fair notice) defences

Parties have in the past argued that the SEC's enforcements violated due process. Moving forward, as to the ease of mounting a fair notice / due process defense in the future, *Ripple* seems to suggest that there may be inconsistencies in the SEC's enforcement actions against sales **other than institutional sales.**

However, this favourable position has to be viewed against *Terraform*, which sets out an arguably low threshold for the provision of fair notice by the SEC and reinforced that the SEC's position has consistently been one of "depending on the token's particular characteristics, some may qualify as securities". Thus, it may be increasingly difficult to mount the argument that certain SEC's lawsuits against cryptocurrencies are inconsistent with the SEC's non-bifurcated view. In particular, this is further reinforced by the judgment in *Coinbase*, which stressed that the SEC "is not announcing a new regulatory policy, but rather is simply engaging in a fact-intensive application of an existing standard [in the determination of what amounts to investment contracts]".

1.3 SEC's regulatory ambit: major question doctrine and the *Chevron* deference

Assuming that a case concerning the SEC's classification of ETH is litigated in court, the prosecuted party may invoke the major question doctrine, which in gist, suggests that unless there is clear congressional authorisation, the courts do not give deference when the interpretation is a major question. It is noted that in *Terraform* and *Coinbase*, the Judges did not consider cryptocurrencies as an industry of vast economic and political significance. Should the Judges decide in the affirmative, parties may leverage the existence of pending digital asset bills in Congress to counter any suggestion of "clear congressional authorization". Nonetheless, this position has to be viewed against Judge Failla's *obiter* in *Coinbase*, stating that such Congressional consideration does not "on its own, alter the SEC's mandate to enforce existing law" and "until the law changes, the SEC must enforce, and the judiciary must interpret, the law as it is."

Another judicial proceeding that bears watching is the SCOTUS's ruling in *Loper Bright Enterprises v. Riamondo.* The case concerns whether the *Chevron* principle should be overruled. *Chevron* opines that when legislative delegation to an administrative agency on a particular issue or question is not explicit but rather implicit, a court may not substitute its own interpretation of the statute for a reasonable interpretation made by the administrative agency. I note that the SEC has never relied on *Chevron* as the source of its interpretative power (arguably because the SEC's stance has been that the Congress's decision to use the general term of "investment contract" is **explicitly** delegating SEC a broad interpretative power capable of capturing digital assets). Nonetheless, should the SEC be cornered into invoking *Chevron*, **subject to an interpretation of Judge Failla's *obiter* above**, the prosecuted party may rely on the pending bills as an illustration of Congress taking the matter into their own hands, thus falling far short of delegation.

The key takeaways on this issue are elaborated in **Sub-sections 4.4.1.-4.4.4**.

2

Table 1: Stance Adopted by Stakeholders in the Industry

Stance	(Non-exhaustive) Signals
ETH as security	• Consensys, a major backer of the Ethereum blockchain, recently filed a complaint against the SEC in the United States District Court for the Northern District of Texas,[1] challenging, *inter alia*, "the SEC's determination that ETH is a security, subject to SEC jurisdiction". Importantly, it was revealed that an internal Formal Order issued by SEC's Director of the Division of Enforcement had announced an investigation into "Ethereum 2.0" in March 2023, which authorised staffs to investigate and subpoena parties involved in the buying and selling of ETH. The SEC affirmed its issuance in April 2023. Consensys claimed that "[t]he Formal Order predicates this delegation on the SEC's information showing possible offers and sales, since at least 2018, of '**certain securities, including, but not limited to ETH**, as to which no registration statement was or is in effect… and for which no exemption was or is available.'" [2] (note: SEC's formal orders are not conclusory and do not represent SEC's official stance) [April, 2024] • SEC's stance has always been: all cryptocurrencies other than bitcoin are securities[3] (note: this has to be viewed against the list of cryptocurrencies explicitly named as securities by the SEC in lawsuits,[4] which excludes ETH) [January, 2024]
Equivocal	• When asked about the potential for a spot Ethereum ETF down the road, **Gary Gensler** reiterated that the approval is "cabined to one non security commodity token called bitcoin" [5] [January, 2024] • **KuCoin**,[6] in its settlement with the New York Attorney General, albeit admitted that **some** of the tokens it bought and sold were either securities or commodities, did not admit that ETH was security (which was contended by the Attorney General in the lawsuit) [December, 2023]

1 This was pursuant to a Wells Notice issued by an SEC staff on 10 April 2024, which stated his/her intent to imminently recommend that SEC bring an enforcement action against Consensys for violating the federal securities laws through its MetaMask Swaps and MetaMask Staking products: https://storage.courtlistener.com/recap/gov.uscourts.txnd.389154/gov.uscourts.txnd.389154.1.0.pdf

2 https://twitter.com/leomschwartz/status/1784945831088468338/photo/1

3 https://www.theblock.co/post/272417/spot-ethereum-etf-approval-chance-jpmorgan

4 As of June 2023, at least 68 cryptocurrencies are labeled by the SEC in its latest suits against Binance and Coinbase, among others, BNB, BUSD, SOL, ADA, MATIC, ATOM, ICP, NEAR, FIL, AXS, MANA: https://cointelegraph.com/news/sec-labels-61-cryptocurrencies-securities-after-binance-suit

5 https://www.theblock.co/post/272413/gensler-sees-bitcoin-etf-irony-in-light-of-satoshis-mission-says-he-respects-sen-warren-and-the-law

6 https://decrypt.co/209479/kucoin-leaving-new-york-after-22-million-nyag-settlement-wont-call-ethereum-security

Stance	(Non-exhaustive) Signals
Equivocal	• In *Terraform*'s motion to dismiss proceedings,[7] SEC insisted that its position as to the classification of crypto-currencies has always been: some crypto-currencies, **depending on their particular characteristics**, may qualify as securities [July, 2023] • In the House Committee Congress Hearing, Gary Gensler, when asked directly whether ETH is a security or commodity, reiterated the *Howey* test and opined that "it depends on the facts and the law" and he would not "want to pre-judge". When asked whether an asset can both be a commodity and a security, Gensler said that "… actually all securities are commodities under the Commodity and Exchange Act. It is that we are excluding commodities, **but I would agree that a security cannot also be an excluded commodity and an included commodity…"** [8] **[April, 2023]** • **William H. Hinman**, the former Director of SEC's Division of Corporation Finance opined that ETH is not a security due to its "sufficiently decentralized" blockchain network[9] (note: this was his personal views and Cointelegraph reported that Hinman purportedly worked for a law firm which was a member of the advocacy organisation Enterprise Ethereum Alliance)[10] [June, 2018] • **Note the possibility of ETH being classified as a "non-security and non-commodity 'monetary instrument"**: As revealed in the Hinman Documents,[11] a SEC's attorney noted that **tokens on a sufficiently decentralised network might exist in a "regulatory gap" where the tokens "are not security because there is no 'controlling group'" but "there may be a need for regulator to protect purchasers"**,[12] this is similarly suggested by a JPMorgan strategist[13] [June, 2023]
ETH as commodity: explicit stance	• Rostin Behnam, CFTC's chair, testified in a hearing before the House Committee on Agriculture that "[b]oth Bitcoin and **Ether are commodities**"[14] [6 March 2024] Earlier on, he also hinted that **"it's not a coincidence that [ether] futures were listed on CFTC"**[15] [June, 2023] • Judge Katherine Failla (who is also the judge in the recent *Coinbase* case), in dismissing a class action against Uniswap, apparently termed ETH as a "crypto commodity" while noting that "Congress and the courts" have yet to make a definitive ruling as to whether to classify cryptocurrencies as securities or commodities . [August, 2023]

7 https://fingfx.thomsonreuters.com/gfx/legaldocs/gdvzwygzmpw/frankel-secvterra--MTDopinion.pdf

8 https://www.congress.gov/event/118th-congress/house-event/115751/text

9 https://www.sec.gov/news/speech/speech-hinman-061418: Hinman further explained that a sufficiently decentralised network was one "where purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts." In that situation, Hinman said, "the ability to identify an issuer or promoter to make the requisite disclosures becomes difficult, and less meaningful."

10 https://twitter.com/sentosumosaba/status/1485863080147886080 ; https://cointelegraph.com/news/hinman-docs-xrp-sec

11 https://www.dropbox.com/s/sxco4v0heqo3hc2/Hinman%20Exhibits%20By%20Number%20Part%201.pdf?dl=; https://www.dropbox.com/s/zpzgpds7k02v2a3/Hinman%20Exhibits%20By%20Number%20Part%202.pdf?dl=0

12 https://cointelegraph.com/news/hinman-docs-xrp-sec

13 https://www.theblock.co/post/235092/jpmorgan-ethereum-eth-other-category

14 https://cointelegraph.com/news/cftc-rostin-behnam-warns-conflict-sec-prometheum-eth-custody

15 https://twitter.com/EleanorTerrett/status/1666088587438481411?s=20 ; https://coingape.com/cftc-ethereum-crypto-news-binance-coinbase/

Stance	(Non-exhaustive) Signals
ETH as commodity: implicit stance	• In SEC's recent lawsuits targeting crypto exchanges (e.g. Coinbase, Kraken), **ETH is not named as a security**[16] [January, 2024] • As recently observed by Brian Quintenz, ex-CFTC Commissioner and a16z crypto's global Head of Policy, SEC had arguably accepted that ETH was not security when approving the ETH futures ETFs in October 2023 (notably after the Merge); because if ETH were in fact a security, then the CFTC-listed futures contracts (on which the ETFs were based) would be illegal, as any derivatives on Ethereum would be considered security futures contracts and subject to different rules, listed on different exchanges and subject to joint SEC/CFTC jurisdiction[17] • Observation: **Gensler** has stated that for tokens employing proof of stake consensus mechanism, the investing public has expected return from staking, thus falling within *Howey*'s definition of investment contract, and therefore a security. Nonetheless, he has not taken any action after the Merge in September 2022 (i.e. Ethereum's transition from proof of work to proof of stake)[18] • Observation: When the CME Group applied for permission to launch the first Ethereum futures contracts in February 2021, it claimed ETH was a commodity. This was not objected by the SEC (note: Gensler was appointed in April 2021)[19]

16 https://cointelegraph.com/news/how-will-ethereum-price-react-to-bitcoin-etf-approval

17 https://twitter.com/BrianQuintenz/status/1770541125847416943

18 https://www.coindesk.com/consensus-magazine/2023/09/26/gary-gensler-is-wrong-about-proof-of-stake-tokens/

19 https://www.ccn.com/news/sec-views-ethereum-commodity/

3 Table 2: Summary of the Key Issues in *Ripple*, *Terraform* and *Coinbase*

	Ripple (Southern District Court of New York, Judge Analisa Nadine Torres)	Terraform (Southern District Court of New York, Judge Jed Saul Rakoff)	Coinbase (Southern District Court of New York, Judge Katherine Polk Failla)
Gist of the ruling	• XRP is **not in and of itself** a "contract, transaction [,] or scheme" that embodied the Howey requirements of an investment contract • Ripple's sales of XRP to **institutional investors** (primarily institutional buyers and hedge funds) pursuant to written contracts, constituted an illegal securities offering • Secondary market sale, i.e. Ripple selling XRP utilising trading algorithms on digital asset exchanges via blind bid/ask transactions (**"Programmatic Sales"**), was not security transaction	• Transactions involving LUNA, wLUNA and MIR were investment contracts under *Howey* for similar reasons • **Transactions involving UST in combination with the Anchor Protocol were investment contracts:** As the Anchor Protocol permitted UST holders to pool their tokens with other depositors with the goal of generating returns based on interest charged by Terraform to the Anchor Protocol's borrowers • **Rejected the Defendants' argument that their distributions of LUNA, wLUNA and MIR were not public offerings because they only sold the tokens to sophisticated investors:** The Court held that the Defendants would need to show that they intend the tokens to "come to rest with" sophisticated investors, who did not intend a further distribution	• At least some crypto-asset transactions on Coinbase's Platform and through Prime constitute investment contracts: Particularly, in finding "common enterprise", the Judge noted that "when a customer purchases a token on Coinbase's platform, she is not just purchasing a token, which in and of itself is valueless; rather, she is buying into the token's digital ecosystem, the growth of which is necessarily tied to value of the token" • Coinbase, through its **Staking Program**, engages in the unregistered offer and sale of securities; Coinbase does not act as an unregistered broker through its **Wallet** Service

	Ripple (Southern District Court of New York, Judge Analisa Nadine Torres)	Terraform (Southern District Court of New York, Judge Jed Saul Rakoff)	Coinbase (Southern District Court of New York, Judge Katherine Polk Failla)
Significant holdings regarding the *Howey* Test **[See Section 4.1]**	• **Rejected the Defendant's essential ingredients test**, which hinges on the existence of a contract between promoter and investor • Reiterated the flexible nature of the *Howey* test, which centred on **substance over form** • In applying *Howey*, the Court held that XRP, is **not in and of itself** an "investment contract", the focus should be on the **economic reality and the totality of circumstances** surrounding the sale and distribution of XRP	• Court must analyse the **substance and not merely the form** of the parties' economic arrangement and decide if, under the totality of the circumstances, that transaction or scheme meets the three requirements of *Howey* • **An enforceable written contract** between transacting parties is **not required** for an "investment contract" to exist under *Howey* • A product that at one time is not a security may, as circumstances change, become an investment contract that is subject to SEC regulation • **Declined to erect an artificial barrier between the tokens and the investment protocols** with which they are closely related for the purpose of determining the applicability of the securities laws	• Formal contract is not required for "an investment contract" to exist under *Howey*, the emphasis is on **substance over form** • Common enterprise can be demonstrated through **horizontal commonality** • Profits can be manifested in the form of the increased market value of their tokens

	Ripple (Southern District Court of New York, Judge Analisa Nadine Torres)	Terraform (Southern District Court of New York, Judge Jed Saul Rakoff)	Coinbase (Southern District Court of New York, Judge Katherine Polk Failla)
Purported distinction between institutional and secondary market buyers **[See Section 4.2]**	• Noted that as Programmatic Sales were blind bid/ask transactions, programmatic buyers could not have known if their payments of money went to Ripple or any other sellers of XRP. **This economic reality is analogous to a secondary market purchaser who did not know to whom or what it was paying its money** • Nonetheless, the Court highlighted **that it did not need to address whether secondary market sales of XRP constitute offers and sales of investment contracts** (as this is not raised by the parties) • Reiterated that whether a secondary market sale constitutes offer or sale of an investment contract would **depend on the totality of circumstances and the economic reality** of that specific contract, transaction, or scheme	• **Rejected the "approach" adopted by the Court in *Ripple*,** i.e. of drawing a distinction between institutional and secondary market sales and suggesting that tokens sold on the latter do not amount to securities, on the basis that such reading is not supported by *Howey* • Opined that whether a purchaser bought the tokens via institutional or secondary market sales will have **no impact** on the determination of the third *Howey* prong, i.e. whether a reasonable individual is led to expect profits from the defendants' efforts	• Transactions in crypto-assets on the secondary market are **not categorically excluded** from constituting investment contracts • Adopted *Terraform*'s reasoning that the **manner of sale has no impact** on the reasonable expectations of primary and secondary investors • Unlike the transaction of commodities / collectibles, when a customer purchases a token on Coinbase's platform, she is not just purchasing a token (which is valueless) but **buying into the token's digital ecosystem** (which is intermingled with the token's value)

	Ripple (Southern District Court of New York, Judge Analisa Nadine Torres)	Terraform (Southern District Court of New York, Judge Jed Saul Rakoff)	Coinbase (Southern District Court of New York, Judge Katherine Polk Failla)
Due process (or fair notice) defences [See Section 4.3]	• **In the the context of institutional sales**, *Howey* is a clear test and *Howey*'s progeny provides guidance on how to apply that test, the SEC's approach is also consistent with prior enforcement actions • Commented that SEC's theories as to other sales, such as Programmatic Sales, may be potentially inconsistent with its prior enforcements	• For all intents and purposes, affirmed *Howey*'s definition of "investment contract" was and remains a binding statement of the law • Affirmed that the SEC's position all along is: **depending on the token's particular characteristics, some may qualify as securities** • Set out the test for due process	• Held that the SEC is not announcing a new regulatory policy but engaging in a fact-intensive application of an existing standard in determining the existence of "investment contract"
SEC's regulatory ambit: major question doctrine and the Chevron deference [See Section 4.4]	N/A	• An industry subject to regulation is of "vast economic and political significance" only if it resembles the industries that the SCOTUS has previously said to have met this definition • Crypto-currency industry falls far short of being a "portion of the American economy" bearing "vast economic and political significance" • Congress's decision to use general descriptive terms like "investment contract" in the Securities Exchange Act was **intended to empower the SEC to interpret the statue's terms to capture digital assets**	• Adopted Judge Rakoff's reasoning in *Terraform* • Noting that Congressional consideration of new legislation implicating cryptocurrency does not on its own alter the SEC's mandate to enforce existing law

	Ripple (Southern District Court of New York, Judge Analisa Nadine Torres)	Terraform (Southern District Court of New York, Judge Jed Saul Rakoff)	Coinbase (Southern District Court of New York, Judge Katherine Polk Failla)
Binding effect	Even though it is expected that courts around the country will give considerable weight to this opinion, it is not binding on other courts within the Southern District of New York or U.S. Court of Appeals for the Second Circuit, or on other federal courts across the country [1]		
History of judicial proceedings	• Summary Judgment (July 2023) • Dismissed interlocutory appeal against the holdings in the Summary Judgement (October 2023) • Determination of remedy and/or damages for XRP sales to institutional buyers (potentially by Summer 2024)	• Judgment on motion to dismiss (July 2023) • Summary Judgment (Dec 2023) • Jury trial (March 2024) • Verdict: Terraform Labs and Do Kwon found liable for fraud (April 2024)	• Judgment on motion to dismiss (March 2024) • Coinbase sought interlocutory appeal to the Court of Appeals for the Second Circuit on the basis of *inter alia*, a controlling question of law, namely, whether an investment contract can exist absent any post-sale obligation (April 2024) • Should the application be granted, the case will be put on hold pending resolution of the matter form the Second Circuit • Should the application be rejected, the District Court will proceed with the discovery stage, summary judgment and trial in 2025

[1] https://www.hklaw.com/en/insights/publications/2023/07/sec-v-ripple-when-a-security-is-not-a-security

4 Analysis and Commentaries on the Key Issues in *Ripple*, *Terraform* and *Coinbase*

4.1 Significant Holdings Regarding the *Howey* Test

I. *Ripple*

4.1.1. Rejected the Defendant's essential ingredients test [1]

The Defendant's essential ingredients test postulates that:

(i) There has to be a contract between the investor and the promoter which establishes the investor's **rights** as to an investment;

(ii) Contract imposes post-sale **obligations** on the promoter to take specific actions for the investor's benefits; and

(iii) Grants the investor **a right to share in profits** from the promoter's efforts to generate a return on the use of investor funds.

The Court rejected a stringent **obligation** imposed on the promoter to generate profits from the investor's funds. Rather, the *Howey* test is concerned with the investor's **expectation** of profits (actualised or not) from the efforts of others instead of a **right** to share in profits.

4.1.2. Reiterated the flexible nature of the *Howey* test, which centred on substance over form [2]

Howey test is intended to embody a flexible rather than static principle, one that is capable of adaptation to meet the countless and variable scheme devices by those who seek the use of money of others on the promise of profits. **Court should analyse the economic reality and the totality of circumstances surrounding the offers and sales of the underlying assets.**

Commentary

With such expansive definition, this may be an ammunition for the SEC to argue that they are interpreting *Howey* within the permissible ambit, strengthening claims that there are no ambiguities surrounding the term "investment contract" and that the interpretative power should lie in the agency themselves as opposed to the courts, and/or in other words, the SEC has not acted *ultra vires* by virtue of exercising such interpretative power deferred to them by the Congress.

[1] *SEC v Ripple*, Summary Judgment (13 July, 2013), pp.11-13
[2] *SEC v Ripple*, Summary Judgment (13 July, 2013), p.13

4.1.3. Application of *Howey*: XRP is not in and of itself an "investment contract" [3]

The digital token, XRP, is **not in and of itself** an "investment contract". The focus should be on the transactions and schemes involving the sale and distribution of XRP, *inter alia*:

> "Each transaction must be analyzed and evaluated on the basis of the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole."; and
>
> "Even if XRP exhibits certain characteristics of a commodity or a currency, it may nonetheless be **offered or sold** as an investment contract."

The Court drew the analogy with *Howey*, stating that the orange groves, being the subject of the investment contract, was a standalone commodity, which was not itself inherently an investment contract. Depending on the totality of circumstances surrounding the sale of the orange groves, they may be sold as investment contracts.

As to the nature of a digital token in itself, while the Court did not make an explicit ruling in this regard, when the Court analysed the XRP token, the holding in *Telegram* was specifically cited. In particular:

> "[T]he security in this is not simply the [**digital token**,] Gram, which **is little more than alphanumeric cryptographic sequence**…"

Commentary

The implication is: the SEC cannot blanketly argue that ETH is a security simply because it is an "investment contract'. Instead, the imposition of status must hinge on the nature of transactions / schemes involving the sale and distribution of ETH, e.g. ETH being distributed as a financial return from staking service programs **may** amount to an investment contract. In any event, I reckon that one will need to have a use case to illustrate why ETH qualifies as securities, and it appears that ETH has not been named as a "security" in any of SEC's lawsuits against a crypto exchange or issuer. Thus, even if the SEC openly calls ETH as a security, it is still a moot point to be debated in later lawsuits.

[3] *SEC v Ripple*, Summary Judgment (13 July, 2023), pp.14-15

II. *Terraform*

4.1.4. Reiterated that the *Howey* test centred on substance over form [4]

Similar with the Court in *Ripple*, the Court held that in deciding whether a given transaction or scheme amounts to a "investment contract" under *Howey*, the Court must analyse the "substance" and not merely the "form" of the parties' economic arrangement and decide if, under the "totality of the circumstances" that transaction or scheme meets the three requirements in *Howey*. For instance, the fact that the Anchor Protocol did not exist at the time when UST and LUNA were first launched is immaterial. **A product that at one time is not a security may, as circumstances change, become an investment contract that is subject to the SEC's regulations.**

In this connection, the Court further noted that there need not be a formal common-law contract between transacting parties for an "investment contract" to exist, on the basis that:

> "By stating that 'transaction[s]' and 'scheme[s]' -- and not just 'contract[s]' -- qualify as investment contracts, **the Supreme Court made clear in Howey that Congress did not intend the term to apply only where transacting parties had drawn up a technically valid written or oral contract under state law** … Instead, Congress intended the phrase to apply in much broader circumstances: **wherever the 'contracting' parties agree -- that is, 'scheme' -- that the contractee will make an investment of money in the contractor's profit-seeking endeavor."**

The Court acknowledged that the defendant cited the statement of an SEC staff member that a "token … all by itself is not a security, just as the orange groves in Howey were not", and further added that this does not preclude the SEC from asserting herein that "a token constitutes an investment contract **when it is joined with a promise of future profits or the like to be generated by the offerors"**.

4.1.5. Declined to erect an artificial barrier between the tokens and the investment protocols [5]

To that end, the Court declined to erect an artificial barrier between the tokens and the investment protocols with which they were closely related. Instead, the court held that it would apply *Howey* and evaluate:

> "Whether the crypto-assets and the '**full set of contracts, expectations, and understandings centered on the sales and distribution of [these tokens]**' amounted to an 'investment contract'."

Commentary

This sentence cannot be viewed in vacuum to suggest that the Court is against the notion that a token, cannot be "in and of itself" an investment contract, as regards will have to be given to the **context** of which the Court is making such comment.

I argue that the Court is merely reinforcing its position that the *Howey* analysis cannot **only** be applied to the token themselves, but instead, as repeatedly emphasised by the Court here and also in *Ripple*, the analysis should be primarily concerned with the "totality of circumstances

[4] *SEC v Terraform*, Judgment on motion to dismiss (31 July, 2023), pp.24-32
[5] *SEC v Terraform*, Judgment on motion to dismiss (31 July, 2023), pp.32

surrounding the offers and sales" of the token at issue. Seen in this light, the latter approach requires that each transaction must be analysed and evaluated "on the basis of the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole". We can further see that the Court purported to apply this test to its ensuing observation, by virtue of: [6]

(i) Commenting that "the original UST and LUNA coins, as originally created and when considered in isolation, might not then have been, by themselves, investment contracts";

(ii) More tellingly, stating that "the term 'security' also cannot be used to describe any crypto-assets that **were not somehow intermingled with one of the investment 'protocols,' did not confer a 'right to ... purchase' another security, or were otherwise not tied to the growth of the Terraform blockchain ecosystem"**; and

(iii) "Where a **stablecoin** is designed exclusively to maintain a one-to-one peg with another asset, there is no reasonable basis for expecting that the tokens -- if used as stable stores of value or mirrored shares traded on public stock exchanges -- would generate profits through a common enterprise. **So, in theory, the tokens, if taken by themselves, might not qualify as investment contracts".**

III. *Coinbase*

4.1.6. The appropriate question: whether transactions in which a particular token is implicated qualify as investment contracts [7]

As a matter of background, it is not disputed that Coinbase carried out the functions of an exchange, broker and clearing agency with respect to transactions in the 13 third-party crypto-assets, and that it is not registered with the SEC in these capacities. Thus, the motion is primarily concerned with whether any of the transactions involving the crypto-assets qualifies as an investment contract. **Further, the SEC did not contest that the implicated tokens, in and of themselves, are not securities.**

4.1.7. Reiterated that the *Howey* test centred on substance over form [8]

Having reviewed the rulings in *Telegram* and *Terraform*, the Court noted that:

(i) There need not be a formal contract between transacting parties for an investment contract to exist under *Howey*; and

(ii) When conducting the *Howey* analysis, courts are not to consider the crypto-asset in isolation, but evaluate whether the crypto-assets and the **"full set of contracts, expectations, and understandings" surrounding its sale and distribution** amount to an investment contract. In doing so, courts examine how, and to whom, issuers or promoters market the crypto-asset.

6 *SEC v Terraform,* Judgment on motion to dismiss (31 July, 2023), pp.33
7 *SEC v Coinbase,* Judgment on motion to dismiss (27 March, 2024), p.30
8 *SEC v Coinbase,* Judgment on motion to dismiss (27 March, 2024), pp.42-47

4.1.8. A common enterprise between crypto purchasers and crypto developers could be demonstrated through horizontal commonality [9]

Referring to *Telegram*, horizontal commonality is established when "investors' assets are pooled and the fortunes of each investor [are] tied to the fortunes of other investors as well as to the success of the overall enterprise." On the basis that:

> "Token issuers, developers, and promoters frequently represented that **proceeds from crypto-asset sales would be pooled to further develop the tokens' ecosystems** and promised that these improvements would **benefit all token holders by increasing the value of the tokens themselves.**";

the Court found that the SEC has adequately pleaded that investors and issuers were joined in a common, profit-seeking enterprise. This is because:

> "The ability of a Crypto-Asset purchaser to profit, therefore, is **dependent on both the successful launch of the token and the post-launch development and expansion of the token's ecosystem.** If the development of the token's ecosystem were to stagnate, all purchasers of the token would be equally affected and lose their opportunity to profit."

Moreover, the Court held that **profits can be manifested in the form of the increased market value of their tokens** instead of strictly confining to receiving a pro-rata distribution of profits.

4.1.9. Purchasers of the Crypto-Assets Had a Reasonable Expectation of Profits from the Efforts of Others [10]

The Court noted that the test is an objective one, focusing on the promises and offers made to investors. Applying the test, the Court held that:

> "… issuers and promoters of the Crypto-Assets — through websites, social media posts, investor materials, town halls, and other fora — repeatedly encouraged investors to purchase tokens by advertising the ways in which **their technical and entrepreneurial efforts would be used to improve the value of the asset, and continued to do so long after the tokens were made available for trading on the secondary market.**"

In this connection and relevant to the discussion on the manner of sale (as will be discussed in Sub-section **4.2.** regarding *Coinbase*'s ruling in this respect below), the Court further highlighted that:

(i) Coinbase conceded that the aforementioned encouragement by issuers and promoters **reached not only the purchasers in the primary market at the ICO, but also those potential investors in the secondary market** (the Court opined that such marketing makes sense as the success of the token in the resale market and capital contributions from both institutional and retail purchasers affect the profitability[11]);

(ii) There were allegations of communications, marketing campaigns, and other public statements to the effect that **token issuers would employ deflationary strategies to reduce the total supply of tokens and thereby affect the token price**; and

[9] *SEC v Coinbase,* Judgment on motion to dismiss (27 March, 2024), pp.48-51
[10] *SEC v Coinbase,* Judgment on motion to dismiss (27 March, 2024), pp.51-54
[11] *SEC v Coinbase,* Judgment on motion to dismiss (27 March, 2024), p.55

(iii) Crypto-Asset issuers publicised to investors in the primary and secondary markets that **profits from the continued sale of tokens would be fed back into further development of the token's ecosystem, which would, in turn, increase the value of the token**.

As such, an objective investor **in both the primary and secondary markets** would perceive these statements as promising the possibility of profits solely derived from the efforts of others.

4.2 Purported Distinction Between Institutional and Secondary Market Buyers

I. *Ripple*

Commentary

The controversy lies in: whether the Court's reasoning underlying the holding that Programmatic Sales are not investment contract,[12] can be applied to secondary market sales generally.

My take

In short, I would argue that, on its face, where secondary market purchasers "did not know to whom or what it was paying its money",[13] it is indeed difficult to argue that they could reasonably expect profits solely from the efforts of a **specific** party (e.g. Ripple in this case). However, a closer reading of *Ripple*'s judgments will suggest that this seemingly straightforward conclusion is subject to the facts that:

[12] The Court held that programmatic buyers could not reasonably expect that Ripple would use the capital it received from its sales to improve the XRP ecosystem and thereby increase the price of XRP

[13] *SEC v Ripple,* Summary Judgment (13 July, 2023), p.23

(i) It arguably requires a **"vast majority"** of secondary market purchasers who do not know their payments of money go into the prosecuted party (e.g. Ripple); or

(ii) It can be **established as a fact** that these secondary market purchasers did not invest their money into the prosecuted party at all.

Elaboration of my take

At the outset, it is pivotal to emphasise that in *Ripple*, the Court noted that:

> "The court does not address whether secondary market sales of XRP constitute offers and sales of investment contracts because that question is not properly before the court" and
>
> reiterated the test that: "Whether a secondary market sale constitutes offer or sale of an investment contract would depend on the **totality of circumstances and the economic reality** of that specific contract, transaction, or scheme".[14]

In addressing this controversy, the starting point is that the Court, in reaching its conclusion that the third prong of *Howey* test was not met, seemed to have centred its reasoning on the fact that the **programmatic buyers were not aware of Ripple's existence** at all, which was evidenced / manifested by the following: [15]

(i) Since the Programmatic Sales were blind bid/ask transactions, programmatic buyers **could not have known if their payments of money went to Ripple** or any other sellers of XRP;

(ii) Since 2017, Ripple's programmatic sales represented **less than 1%** of the global XRP trading volume and vast majority of the individuals who purchased XRP from digital asset exchanges **did not invest their money in Ripple at all**;

(iii) While acknowledging that "it may certainly be the case that many programmatic buyers" purchased XRP with an expectation of profit, but they did not derive that expectation from **Ripple's efforts** (as opposed to other factors such as "general cryptocurrency market trends"), **"particularly because none of the programmatic buyers were aware that they were buying XRP from Ripple"**; and

[14] *SEC v Ripple,* Summary Judgment (July 13, 2023), p.23
[15] *SEC v Ripple,* Summary Judgment (July 13, 2023), pp.23-25

(iv) Even if **some** may have purchased XRP with the expectation of profits to be derived from Ripple's efforts but the **inquiry is an objective one focusing on the promise and offers made to investors** instead of the precise motivation of each individual participant. Here, the Court found that Ripple did not make any promises or offers because Ripple did not know who was buying the XRP and the purchasers did not know who was selling it. Further, the SEC failed to provide evidence that Ripple's promotional materials amongst institutional buyers were distributed more broadly to the general public such as XRP purchasers on digital asset exchange. **In fact, many programmatic buyers were entirely unaware of Ripple existence.**

In relation to the nature of a **secondary market purchaser**, it was mentioned by the Court (arguably in *obiter*) when substantiating its point that "programmatic buyers could not have known if their payments of money went to Ripple or any other sellers of XRP". **The Court suggested that such situation is analogous to a secondary market purchaser**: [16]

> "An Institutional Buyer knowingly purchased XRP directly from Ripple pursuant to a contract, but the economic reality is that a programmatic buyers stood in the same shoes as a secondary market purchaser **who did not know to whom or what it was paying its money**."

Seen in this light, I would argue that, on its face, where secondary market purchasers "did not know to whom or what it was paying its money", it is indeed difficult to argue that they could reasonably expect profits solely from the efforts of a **specific** party (e.g. Ripple in this case). However, a closer reading of the judgment will suggest that this seemingly straightforward conclusion is subject to the following:

(i) **It arguably requires a "vast majority" of secondary market purchasers who do not know their payments of money go into the prosecuted party (e.g. Ripple):**

- This can be shown / illustrated by contrasting the prosecuted party's promises and offers made to institutional buyers versus that to the secondary market buyers. For instance, whether the communications, marketing campaign or promotional materials made by the prosecuted party (e.g. Ripple), which amount to representations that the token's price is connected to the prosecuted party's efforts, are similarly made / distributed to the secondary market buyers; and

- Importantly, the Court noted that when compared with institutional buyers, **a reasonable programmatic buyer, who was generally less sophisticated, would not have an expectation of profit informed by Ripple's public statements** (which were across many social media platforms and news sites, and sometimes inconsistent);

or

(ii) It can be **established as a fact** that these secondary market purchasers did not invest their money into the prosecuted party at all. For example, by demonstrating that the secondary market sales only account for a minimal percentage of the global trading volume of the token.

[16] *SEC v Ripple*, Summary Judgment (July 13, 2023), p.23

Hence, *Ripple's* seemingly favourable outcome to exchanges which are running secondary market sales **should be taken with a pinch of salt**, bearing in the mind the forgoing. To put it best, the more the facts resemble with that of "programmatic sales", the more applicable the decisions of *Ripple* are.

I note that my interpretation herein is consistent with the Judge's ruling in the interlocutory appeal. In particular, the Court stressed that its finding of Ripple's programmatic sales not amounting to investment contracts are not of "precedential value for [other digital asset cases]".[17] In passing, the Court stressed that the Court's finding are confined to the "unique facts and circumstances of [Ripple's] case" and "the other enforcement actions cited by the SEC involve different digital assets and different companies, which offers and sold those digital assets under different factual circumstances and economic reality". The Court further highlighted that its ruling **could not be extrapolated to suggest that generally, offers and sales on secondary market and/or more broadly, on digital asset exchanges by digital asset issuers, could not fulfil the third prong of *Howey* test,** i.e. create a reasonable expectation of profits based on the efforts of others.

II. *Terraform*

In *Terraform*, the Court "rejects the approach recently adopted by [the judge] in a similar case, [*Ripple*]"[18]

In framing *Ripple*'s approach, the Court appeared to have generalised it as one of:

> "[D]rawing a distinction between these coins based on their manner of sale, such that coins sold directly to institutional investors are considered securities and those sold through secondary market transactions to retail investors are not."

Based on this premise, the Court argued that *Howey* did not make such a distinction between purchasers and that:

> "**[A] purchaser bought the coins directly from the defendants or, instead, in a secondary resale transaction has no impact** on whether a reasonable individual would objectively view the defendants' actions and statements as evincing a promise of profits based on their efforts".

[17] *SEC v Ripple,* Judgment denying the SEC's interlocutory appeal against the holdings in the Summary Judgment (3 October, 2023), pp.6-9

[18] *SEC v Terraform,* Judgment on motion to dismiss (31 July, 2023), pp.40-41

Commentary

My take

With respect, the Court in *Terraform* had expansively interpreted the ruling in *Ripple* beyond its original reasoning -- which, as explained above, (i) falls far short of suggesting offers and sales of digital assets on secondary market can never fulfil the third prong of *Howey* test and therefore incapable of being classified as "securities" and (ii) that *Ripple*'s ruling is confined to the facts surrounding the Programmatic Sales of XRP.

Elaboration of my take

In fact, this reading is consistent with the subsequent response by the Court in *Ripple* in denying to certify for interlocutory appeal. Of importance is that:

(i) **The Court stated that there is no conflict with the reasoning in *Terraform***, notably:

> "[The ruling] did not turn on the fact that Programmatic Sales were 'sold through secondary market transactions to retail investors' [but] based on the totality of circumstances, that an objective, reasonable Programmatic Buyer was not led to expect profits from the efforts of Ripple."

(ii) **In fact, having differentiated the facts of *Terraform* from *Ripple*, the reasonings of both Courts can in substance be reconciled through their similar application of *Howey*** (albeit to different set of facts, and therefore amounting to different outcomes which are not solely premised on whether the tokens are sold to institutional investors or secondary market purchasers):

a. In *Terraform* it is accepted as true [19] that "**the defendants embarked on a public campaign to encourage both retail and institutional investors** to buy their crypto-assets by touting the profitability of the crypto-assets and the managerial and technical skills that would allow the defendants to maximise returns on the investor" [20] whereas in *Ripple*, the undisputed record was that many of *Ripple*'s key promotional materials were only distributed to Institutional Buyers and not more broadly to Programmatic Buyers;

[19] For the purpose of motion to dismiss proceedings, all well-plead allegations must be taken as true: *SEC v Terraform*, Judgment on motion to dismiss (31 July, 2023), p.2

[20] These included Do Kwan's specific and repeated statements in public interviews, *Terraform*'s public statements / press releases / social media posts stating that for example, buying LUNA means investing in *Terraform*'s ecosystem, which in turn increases the value of LUNA due to *Terraform*'s efforts to build it into a successful blockchain and to create trading opportunities in its tokens; by depositing and pooling UST tokens with other depositors in the Anchor Protocol, holders of UST can expect to gain "stablecoin yield" from *Terraform*: *SEC v Terraform*, Summary Judgment (28 December, 2023)

b. In *Terraform*, as part of the defendants' public campaign, the defendants said that sales from purchases of **all** crypto-assets -- no matter where the coins were purchased -- would be fed back into the blockchain and would generate additional profits for all crypto-assets holders,[21] whereas in Ripple, Programmatic Sales represented less than 1% of the global XRP trading volume; and

c. In *Terraform*, the Court then **presumed** [22] that the foregoing representations **would "have reached individuals who purchased their crypto-assets on secondary markets** … [and] [s]imply put, secondary-market purchasers had every bit as good a reason to believe that the defendants would take their capital contributions and use it to generate profits on their behalf" [23]

Nonetheless, I am sceptical of the following as opined by the Court in *Terraform*:

> "[A] purchaser bought the coins directly from the defendants or, instead, in a secondary resale transaction has **no impact** on whether a reasonable individual would objectively view the defendants' actions and statements as evincing a promise of profits based on their efforts" [24]

This is because if one:

(i) Notes that in *Ripple*'s interlocutory appeal, the Court in fact did not explicitly resile from its *obiter* that "programmatic buyers stood in the same shoes as a secondary market purchaser who did not know to whom or what it was paying its money"; and

(ii) Accepts my interpretation all along and considers that the Court in its Summary Judgment did draw on such characteristic as a thread in concluding that programmatic buyers were not aware of Ripple's existence, and therefore failed the third prong of *Howey*, then it is unclear how purchasing in secondary market can be said to **have no impact at all** on one's expectation of profits from specific defendant(s). This issue is indeed left to be resolved but arguably, may nonetheless be subsumed under the determination of "economic reality" and "totality of circumstances surrounding the offers and sales of the digital assets" in a specific case.

III. *Coinbase*

Rejected the distinction between institutional and secondary market as material to the determination of investment contracts under *Howey* [25]

Coinbase argued that securities on its exchange platform are secondary market trades that lack contractual obligations between Coinbase and the token purchasers. Therefore, these transactions in tokens do not constitute "investment contracts" and are therefore not "securities".[26]

[21] Note that Terraform also sold both LUNA and MIR tokens to secondary market purchasers on Binance and other crypto trading exchanges; *SEC v Terraform*, Summary Judgment (28 December, 2023), p.45; *SEC v Terraform*, Judgment on motion to dismiss (31 July, 2023), p.42

[22] For the purpose of motion to dismiss proceeding, all reasonable inferences therefrom must be draw in the SEC's favour: *SEC v Terraform*, Judgment on motion to dismiss (31 July, 2023), p.2

[23] *SEC v Terraform,* Judgment on motion to dismiss (31 July, 2023), p.42

[24] *SEC v Terraform*, Judgment on motion to dismiss (31 July, 2023), p.41

[25] *SEC v Coinbase,* Judgment on motion to dismiss (27 March, 2024), pp.54-60

[26] *SEC v Coinbase,* Judgment on motion to dismiss (27 March, 2024), p.31

The SEC argued that purchasers of crypto assets on exchange are also investing in the network or ecosystem behind it, indicating there is a value proposition behind the crypto purchase that makes it a security.

The Court held that transactions in crypto-assets on the secondary market are not categorically excluded from constituting investment contracts as:

(i) *Howey* does not recognise such a distinction as a necessary element in its test of whether a transaction constitutes an investment contract. Rather, the Court must consider the "economic reality" of the transaction;

(ii) The Court adopted *Terraform*'s reasoning and held that the **manner of sale has no impact on the reasonable expectations of primary and secondary investors**, given that the crux in both scenarios are "whether a reasonable individual would objectively view the [issuers'] actions and statements as evincing a promise of profits based on their efforts"; whilst noting that it is theoretically possible for **developers of a crypto-asset to intentionally avoid promoting that asset to retail purchasers**, that was not the case here; and

(iii) As the risk of manipulation, fraud and other abuses can be found in both markets, the federal securities laws should apply to both.

As a side note, *Coinbase* argued that since the transfer of a crypto-asset from one investor to another does not involve the transfer of any contractual undertaking, no sale of an investment contract can take place. The Court was of the opinion that such requirement is merely formalistic and cannot be fairly read into the *Howey* test. In ruling so, the Court reiterated again that it is the economic reality surrounding the offer and sale of an asset that matters, and that reality includes the promises and undertakings underlying the investment contract. Contrast with the transactions of commodities like gold or collectibles like Beanie Babies, which can be independently consumed or used, the Court stated that:

> "When a customer purchases a token on *Coinbase*'s platform, she is not just purchasing a token, which in and of itself is valueless; rather, **she is buying into the token's digital ecosystem, the growth of which is necessarily tied to value of the token.**"

The Court further suggested that this is evidenced by the facts as mentioned in Part 4.1.9. above, which fulfilled the element of "common enterprise" in *Howey*. As such, the Court concluded that:

> "**a crypto-asset is necessarily intermingled with its digital network** — a network without which no token can exist".

Commentary

By embracing Judge's Rakoff's reasoning in *Terraform* and adopting an "ecosystem" approach, the Court has effectively proffered an expansive view in the application of the *Howey* test. Notably, by placing emphasise on the "ecosystem", without proper limitations as to its scope, can present itself as a slippery slope and unduly expand SEC's regulatory ambit. Looking forward, it is envisaged that this may well be a matter poised to be resolved in the appellate court or even in the SCOTUS.

4.3 Due Process (or Fair Notice) Defences

I. *Ripple*

4.3.1. Rejected Ripple's due process defences in the context of institutional sales [27]

In rejecting Ripple's **due process defences** (i.e. that the laws provided insufficient notice that his or her behaviour at issue was prohibited), the Court echoed that **in the context of institutional sales**, *Howey* is a clear test for determining what constitutes an investment contract and *Howey*'s progeny **provides guidance** on how to apply that test to a variety of factual scenarios. The Court further noted that the SEC's approach is consistent with prior enforcement actions relating to the sale of other digital assets pursuant to written contracts and for the purpose of fundraising.

Commentary

While in the future, it may be difficult for parties to mount a fair notice attack on the SEC's enforcement actions, the effect of the Court's opinion is only confined to institutional sales. In fact, it is pivotal that Torres J left the question open as to other sales in the case, i.e. Programmatic Sales, distribution of the token as a form of payment for services, and Ripple's CEOs offering and selling of XRP in their individuals capacities. Notably, the Court stated that:

> "Because the Court finds that only the Institutional Sales constituted the offer and sale of investment contracts, the Court does not address Defendants' asserted fair notice defense as to the other transactions and schemes. **The Court's holding is limited to the Institutional Sales because the SEC's theories as to the other sales in this case potentially inconsistent with its enforcement in prior digital asset cases"** [28]

II. *Terraform*

4.3.2. Rejected *Terraform*'s due process defences & indirectly affirmed that the SEC's position had always been: depending on the token's particular characteristics, some may qualify as securities

The Defendants argued that the SEC had long maintained that cryptocurrencies were not securities. Nonetheless, in the present case, the SEC for the first time claimed that all cryptocurrencies were securities and enforced this understanding against the Defendants without any prior indication that it had changed its view. This deprived the Defendants of their constitutional right to "fair notice" and, by implication, the opportunity to conform their behaviour to the SEC's regulations.[29]

[27] *SEC v Ripple,* Summary Judgment (13 July, 2023), pp.29-30
[28] *SEC v Ripple,* Summary Judgment (13 July, 2023), fn 20
[29] *SEC v Terraform,* Judgment on motion to dismiss (31 July, 2023), p.24

The SEC opined that they had never taken either of the black-and-white positions that the Defendants ascribed to the SEC. Rather than stating that all crypto-currencies were securities or that none of them were, the SEC insisted that it had broadcast the same position on this issue all along: that some crypto-currencies, depending on their particular characteristics, may qualify as securities.[30]

Commentary

For the purpose of the due process argument, I observe that:

(i) Unlike the Court in *Ripple*, as opposed to confining the holding that *Howey* is clear enough at least **in the context of institutional sales**, the Court in *Terraform* has, for all intents and purposes, affirmed the legality of the *Howey* test, stating that "*Howey*'s definition of 'investment contract' was and remains a binding statement of the law";

(ii) The Court has affirmed that the SEC's position was not "cryptocurrencies are not securities" as alleged by the Defendants, but accepted and found that the position adopted by the SEC all along was that some crypto-currencies may qualify as securities. Thus, contrary to the Defendants' allegation, the instant lawsuit was not inconsistent with the SEC's long-standing view; and

(iii) The Court has notably set out the test for due process (in *obiter*), which is arguably a low threshold for the SEC to pass, namely: [31]

> "**So long as the SEC has** through its regulations, written guidance, litigation, or other actions (e.g. high-profile lawsuits against other crypto-currency companies) -- **provided a reasonable person operating within the defendant's industry fair notice that their conduct may prompt an enforcement action by the SEC**, it has satisfied its obligations under the Due Process Clause."; and
>
> "The question whether 'fair notice' has been provided **should be assessed from the perspective of a reasonable person *in the defendant's industry*** rather than from that of a member of the general public."

Seen in this light, it is arguable that the Court in *Terraform* had adopted a more pro-SEC stance when it comes to the due process arguments.

[30] *SEC v Terraform,* Judgment on motion to dismiss (31 July, 2023), p.25

[31] *SEC v Terraform*, Judgment on motion to dismiss (31 July, 2023), p.27 and fn 5

III. *Coinbase*

Coinbase argued that the SEC has violated due process, abused its discretion, and abandoned its own earlier interpretations of the securities laws.[32] Notably, "announcing the purported regulatory authority [over digital assets] by means of punitive enforcement actions, rather than by notice-and-comment rulemaking, is a violation of due process and an abuse of the agency's discretion".[33]

Judge Failla rejected Coinbase's arguments on the basis that:[34]

(i) "An examination of the broader timeline of the SEC's positions regarding cryptoassets reveals that the **SEC provided Coinbase (and similarly situated actors) fair notice** — through written guidance, litigation, and other actions — that the sale or offering of certain crypto-assets could prompt an enforcement action by the SEC";

(ii) The Court further noted that aware of SEC's positions, Coinbase "conducted risk assessments that acknowledged the potential application of the federal securities laws to Coinbase's products and services", such as releasing "Coinbase Crypto Asset Framework" in 2018; and

(iii) Thus, "the SEC is **not announcing a new regulatory policy**, but rather is simply engaging in a **fact-intensive application of an existing standard**—an application that Coinbase also conducted—to determine whether certain transactions involving crypto-assets meet the characteristics of an 'investment contract.'"

Relevant to the common criticism of the SEC's "regulation by enforcements", it is arguable that the Judge did leave open the possibility that **notice-and comment rulemaking** may be a better, fairer and more effective method when compared with the former **in an appropriate case**:

> "While it may be true that in cases where an agency purports to promulgate new regulatory authority, notice-and comment rulemaking may offer a 'better, fairer, and more effective' method of implementing agency policy than punitive enforcement actions, **such is not the case here."** [35]

[32] https://www.crypto-law.us/wp-content/uploads/2023/07/CB-Answer-to-Complaint.pdf

[33] https://assets.ctfassets.net/c5bd0wqjc7v0/4oVJN5EioULD0QnSyg01b8/2b1f34594a800c727fb61a384f37e74a/SEC_v._Coinbase__Coinbase_Answer_to_Complaint__As-Filed_.pdf; p.8

[34] *SEC v Coinbase,* Judgment on motion to dismiss (27 March, 2024), pp.35-39

[35] *SEC v Coinbase,* Judgment on motion to dismiss (27 March, 2024), p.39

4.4 SEC's Regulatory Ambit: Major Question Doctrine and the *Chevron* Deference

I. Key takeaways

4.4.1. The *Chevron* deference

It has been said that *Chevron* is about "what the Congress wants",[37] it is a doctrine of judicial deference given to administrative actions. In gist, when a legislative delegation to an administrative agency on a particular issue or question is not explicit but rather **implicit**, a court may not substitute its own interpretation of the statute for a reasonable interpretation made by the administrative agency.

4.4.2. Relevance of the *Chevron* deference on the SEC's regulatory power towards digital assets

In the context of digital assets, an application of the *Chevron* deference connotes that: where the Congress makes a law involving securities (e.g. the Securities Exchange Act of the 1934), then the administrative agency charged with enforcing securities laws, i.e. the SEC, is allowed to interpret those laws. **As long as the interpretation is "reasonable", the judicial branch will defer to the agency's interpretation.**

In the recent Supreme Court case of *Loper Bright Enterprises v. Riamondo*, the attorney for *Loper* argued that the ***Chevron* deference contributed to gridlocks as it assumes ambiguities as delegation, which cannot necessarily be equated with**. He argued that such ambiguities in the legislations are deliberately built-in as a strategic move to gain sufficient votes in the Congress, so that they can eventually be passed. Hence, arguably, it is doubtful whether such ambiguities can be considered as implicit delegation by the Congress to the executive agencies, which is a separate matter. Moreover, it also begs the question of whether in light of the ambiguities, by virtue of the executive agencies resolving the ambiguities on its own volition, one can retrospectively suggest that there is in fact implicit delegation. The upshot is that the gridlock issue as discussed below should be viewed in light of the foregoing.

The Attorney then cited the SEC's treatment of cryptocurrencies as a "concrete example" of the gridlock that the *Chevron* deference has contributed to. In gist, he argues that: but for the *Chevron* deference, "the uniquely 21st century phenomenon of cryptocurrency would have been addressed by [the] Congress", nonetheless, this is hindered by the SEC purportedly "sucking [cryptocurrencies] into its regulatory ambit", by relying on (i) federal laws passed almost a century ago (e.g. the Securities Act of 1933) and (ii) the ambiguous term of "investment contract".[38]

[37] https://twitter.com/KhurramDara/status/1748016784471458297 (in Loper Bright Enterprises, at 1:40 per SCOTUS Justice Elena Kagan)

[38] "There's an agency [SEC] head out there that thinks that he already has the authority to address this uniquely 21st century problem with a couple of statutes passed in the 1930s. And he's going to wave his wand and say the words "investment contract" are ambiguous and that's going to suck all of this into my regulatory ambit even though that same person when he was a professor said this is probably a job for the CFTC": https://twitter.com/KhurramDara/status/1748016784471458297

Commentary

While parties have invoked the major question doctrine in disputing the SEC's regulatory ambit, the SEC has never argued that its interpretative power is derived from the *Chevron* deference. Should the SEC rely on *Chevron* and the SCOTUS end up limiting / overruling *Chevron*, it may limit / narrow the interpretative power delegated to the SEC and more broadly, its regulatory ambit.

SCOTUS's decision on *Loper* is expected in Summer 2024.[39]

4.4.3. The *Chevron* deference has to be viewed against the Major Question Doctrine ("MQD")

The MQD provides that where an agency claims the "power to regulate a significant portion of the American economy" that has "vast economic and political significance," it must point to "clear congressional authorization" for that power. To that end, the MQD stops agency action when it applies, even if a statute potentially gives them power to do what they want, allegedly until Congress authorizes the action clearly and anew.[40] Thus, as stated by SCOTUS in *West Virginia v EPA*, 597 U.S. 697, 716 (2022), the MQD is rooted in the doctrine of separation of power such that "one branch of government" should not "arrogate to itself power belonging to another" and it is presumed that that "Congress intends to make major policy decisions itself". Note that MQD is rarely invoked and has only served as the basis in 5 SCOTUS decisions, an example of which is the striking down of an FDA regulation would have led to the complete prohibition of tobacco products in the US.[41]

In both *Terraform* and *Coinbase*, the defendants' lawyers sought to argue that given the ambiguous definition of security and the significance of the cryptocurrencies market, the Congress in fact has not granted the SEC to regulate cryptocurrencies. Should the Court accept the SEC's definition of security, that would have "legislative implications" and "affect the whole industry".[42]

Commentary

An interpretation of the Congressional intention is relevant to both the construction of the MQD and the *Chevron* deference. For the MQD, where at issue is a "major question" the agency must point to "clear congressional authorization" for its interpretative power; whereas in *Chevron*, in determining the reasonableness of the agency's interpretation, the Congressional action or inaction in response to that interpretation can be a useful guide.

In this regard, the fact that there are digital asset bills pending in Congress (such as the Digital Asset Market Structure Bill, Financial Innovation and Technology for the 21st Century Act, Digital Commodity Exchange Act), may arguably go against claims that the Congress intends to delegate the regulations of crypto-currencies to the SEC. However, this had to be seen against Judge Failla's recent *dicta* in *Coinbase*:

39 https://www.scotusblog.com/2024/01/supreme-court-to-hear-major-case-on-power-of-federal-agencies/

40 https://hls.harvard.edu/today/what-critics-get-wrong-and-right-about-the-supreme-courts-new-major-questions-doctrine/

41 *SEC v Terraform*, Judgment on motion to dismiss (31 July, 2023), p.20

42 https://www.wsj.com/finance/regulation/judge-questions-secs-claim-to-regulate-coinbase-ae2f240c

> "**Nor does Congressional consideration of new legislation implicating cryptocurrency, on its own, alter the SEC's mandate to enforce existing law**, notwithstanding Defendants' arguments to the contrary … Until the law changes, the SEC must enforce, and the judiciary must interpret, the law as it is." [43]

In any event, the judges in *Terraform* and *Coinbase* are reluctant to invoke the MQD (See **Sub section II. Relevant rulings in *Terraform* and *Coinbase*** below).

4.4.4. Inter-relationship of MQD and *Chevron* deference

I am of the opinion that how MQD and the *Chevron* deference interact with each other is still a matter to be settled. While I do not intend to dive into the details, I note the difficulty of ascertaining the "hierarchy" between them, in particular:

(i) Whether the MQD is subsumed under *Chevron* in the sense that it is only **one of the considerations** in determining whether to defer to the agencies' construction; or

(ii) Whether *Chevron* is subject to the MQD in the sense that at the outset, if there is a major question then the Court should not defer the interpretation to the agency unless there is "clear congressional authorization".

Save to say that recently, the same concern has also been expressed by a Harvard Law School scholar.[44]

Should interpretation (ii) be adopted, it will mean that the **MDQ effectively limits the situations to which the *Chevron* deference applies**, i.e., the agency gets zero deference if it is trying to do something really new or disruptive without express authorisation from Congress.[45]

II. Relevant rulings in *Terraform* and *Coinbase*

Ruling on MQD in *Terraform*

The Defendant argued that the MQD operated to prevent the SEC from alleging the company's digital assets to be "investment contracts".

The Court held that the determination of whether an industry subject to regulation is of "vast economic and political significance" should not be resolved in a vacuum. It is only if it resembles with the industries that the SCOTUS has previously said meet this definition. The Court found that:

[43] *SEC v Coinbase,* Judgment on motion to dismiss (27 March, 2024), p.35

[44] https://hls.harvard.edu/today/what-critics-get-wrong-and-right-about-the-supreme-courts-new-major-questions-doctrine/

[45] As acknowledged by the SCOTUS in *Loper Bright Enterprises*: https://theconversation.com/a-supreme-court-ruling-on-fishing-for-herring-could-sharply-curb-federal-regulatory-power-205371

> "With this standard in mind, **the crypto-currency industry — though certainly important —- falls far short of being a 'portion of the American economy' bearing 'vast economic and political significance'** *Id.* Put simply, it would ignore reality to place the crypto-currency industry and the American energy and tobacco industries -- the subjects of West Virginia and Brown & Williamson, respectively —- on the same plane of importance. If one were to do so, almost every large industry would qualify as one of 'vast economic and political significance' and the **doctrine would frustrate the administrative state's ability to perform the function for which Congress established it: the regulation of the American economy."** [46]

The Court also found that the SEC's decision to require truthful marketing of certain crypto-assets based on its determination that certain of such assets are securities did not represent a "transformative expansion in its regulatory authority" that, absent "clear congressional authorization", "Congress could [not] reasonably be understood to have granted." This is because it aligns with: [47]

(i) The SEC's role: which is not to exercise vast economic power over the securities markets, but simply to assure that they provide adequate disclosure to investors;

(ii) The Congress's expectations that:

a. The SEC is to regulate "virtually any instrument that might be sold as an investment," "in whatever form they are made and by whatever name they are called, including novel devices like the digital assets at issue here";

b. Having used general descriptive terms like investment contract in the Securities Exchange Act, the Congress intended that the statue would embody a flexible principle and "not to limit the SEC's authority to enumerated categories, but, on the contrary, to empower the SEC to interpret the statue's terms to capture these new schemes"; and

(iii) The SCOTUS's instruction that:

> "'The reach of the [Exchange] Act does not stop with the obvious and commonplace, but must extend to '[n]ovel, uncommon, or irregular devices, whatever they appear to be,' that are 'widely offered [and sold]' in a way that 'established their character' as a security."

Hence, the Defendants cannot wield a doctrine intended to be applied in **exceptional** circumstances as a tool to disrupt the routine work that Congress expected the SEC and other administrative agencies to perform.

Ruling on MQD in *Coinbase* [48]

It was reported that a Coinbase lawyer argued the MQD would require the dismissal of the SEC's complaint against Coinbase. As the Congress has not granted the SEC the authority to regulate crypto but the agency has taken matters into its own hands. It furthered that if the court were to accept the SEC's definition of security in the Coinbase case, that would have "legislative implications" and "affect the whole industry".

[46] *SEC v Terraform,* Judgment on motion to dismiss (31 July, 2023), pp.21-22
[47] *SEC v Terraform*, Judgment on motion to dismiss (31 July, 2023), pp.22-23
[48] *SEC v Coinbase,* Judgment on motion to dismiss (27 March, 2024), pp.33-35

The Court's ruling, in gist, held that the MQD is inapplicable and adopted the reasoning in *Terraform*. It stressed that:

(i) While certainly sizable and important, the cryptocurrency industry falls far short of being a portion of the American economy bearing vast economic and political significance;

(ii) The SEC is exercising its Congressionally bestowed enforcement authority and the very concept of enforcement actions evidences **the SEC's ability to develop the law by accretion**, in particular:

> "Using enforcement actions to address crypto-assets is simply the latest chapter in a long history of giving meaning to the securities laws through iterative application to new situations."

Further, as mentioned in my commentary in Sub-section 4.4.3. above, Judge Failla pinpointed that the existence of digital asset bills pending in Congress does not alter the SEC's mandate to enforce existing law, arguably weakening any rhetoric purporting to suggest that the SEC lacked clear regulatory authority (as granted by the Congress).