



DIVISION OF
ENFORCEMENT

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
100 PEARL STREET, SUITE 20-100
NEW YORK, NY 10004-2616

March 14, 2022

VIA ECF

Hon. Sarah Netburn
United States Magistrate Judge
Southern District of New York

Re: SEC v. Ripple Labs, Inc. et al., No. 20-cv-10832 (AT) (SN) (S.D.N.Y.)

Dear Judge Netburn:

In light of Judge Torres' order denying Individual Defendants' motions to dismiss (the "Order," D.E. 441), Plaintiff Securities and Exchange Commission ("SEC") respectfully submits this letter supplementing its (i) motion for partial reconsideration and clarification of the Court's January 13, 2022 Opinion & Order as applied to drafts of former Director Hinman's speech and related internal communications (D.E. 429) and (ii) opposition to Defendant Garlinghouse's motion challenging the SEC's assertion of the deliberative process privilege ("DPP") (D.E. 434). For the reasons set forth below, the Order answers any question as to whether the SEC's internal documents are relevant to the Individual Defendants' scienter. They are not. Accordingly, the Order merits resolution of the two pending motions in the SEC's favor, regardless of whether the DPP applies to the documents (as it does, for the reasons described in the SEC's briefs on these motions).

As this Court recognizes, the parties have long disputed what the SEC must establish to prove that Defendants possessed "the necessary state of mind" to prevail on the aiding and abetting claims. *See, e.g.*, D.E. 413 at 19 ("The parties again spar over the recklessness standard...."). The Individual Defendants have maintained that, to prevail on the aiding and abetting claims against them, the SEC must show that they knew or recklessly disregarded the legal status of XRP under *Howey*. *E.g.*, D.E. 111 at 8 (urging dismissal of aiding and abetting claims because the SEC had not pled "that Mr. Garlinghouse knew or recklessly disregarded that XRP was an investment contract" (emphasis omitted)). The SEC, by contrast, has argued that, to establish aiding and abetting a strict liability violation like the one at issue here, it need only show that the Individual Defendants knew or recklessly disregarded *the facts* underlying the primary violator's offense. *E.g.*, D.E. 299 at 1-2 (SEC's opposition to motion to compel DPP documents, summarizing this dispute).

The Individual Defendants have consistently relied on their incorrect formulation of the aiding-and-abetting scienter standard to seek discovery. *E.g.*, D.E. 364 at 2 (motion to compel DPP documents, arguing that "the SEC must show the status of XRP as a security throughout the entire charged period...was 'so obvious that [the Individual Defendants] must have been aware of it'"); D.E. 424 at 2-3 (motion to compel production of meeting notes, arguing that the meeting with Commissioner Roisman left Garlinghouse believing that

XRP was in “legal ‘purgatory’”). Indeed, counsel for Garlinghouse acknowledged that Defendants’ motion to compel production of internal SEC documents (as to which the SEC asserted the DPP) is premised upon the argument that the SEC must prove that Individual Defendants knew or recklessly disregarded that Ripple’s conduct was illegal, and he acknowledged the key role that this argument has played in discovery throughout this case. *See* Hearing Tr. (Aug. 31, 2021) at 4-5 (excerpt attached hereto as Exhibit A) (“[I]f the underlying law was unclear at the time even to the SEC, then the alleged violation could not have been ‘so obvious, that the defendant must have been aware of it.’ It’s that ‘so obvious’ point...that is really one of the key linchpins for why we’ve been arguing since April, and your Honor has accepted, that the SEC’s internal documents and the way the SEC was looking at the issue of XRP, Bitcoin and Ether, and whether, to the SEC, there was certainty, there was clarity, about whether or not those digital assets were securities because of the objective recklessness standard.”).¹

In denying Individual Defendants’ motion to dismiss the aiding and abetting claims, Judge Torres expressly rejected Individual Defendants’ proposed scienter standard and resolved this dispute in the SEC’s favor. First, Judge Torres held that the SEC does not need to prove that Individual Defendants knew or recklessly disregarded that Ripple’s offers and sales of XRP violated Section 5 of the Securities Act of 1933. *See* D.E. 441 at 15-16 (“Notably, the SEC need not demonstrate that the Individual Defendants were aware that Ripple’s scheme *was* illegal” (emphasis in original)). Second, Judge Torres rejected the argument that “the SEC must show that they knew or recklessly disregarded that Ripple’s actions were somehow otherwise ‘improper.’” *Id.* at 16-18. Instead, Judge Torres ruled that, to prove the necessary mental state for aiding-and-abetting liability, the SEC must simply show that Individual Defendants knew or recklessly disregarded *the facts* that constitute a Section 5 violation. *See id.* at 15 (“Knowledge means awareness of the *underlying facts*, not the labels that the law places on those facts.” (emphasis added) (quoting *SEC v. Falstaff Brewing Corp.*, 629 F.2d 62, 77 (D.C. Cir. 1980))). The Court applied that standard in holding that the SEC had alleged sufficient facts to plead Individual Defendants’ state of mind for the aiding-and-abetting claims. *See* D.E. 441 at 18 (“[T]he SEC has plausibly alleged that the Individual Defendants had knowledge of or recklessly disregarded *the facts* that allegedly made Ripple’s sale of XRP amount to the unregistered sale of securities....”) (emphasis added)).

In light of Judge Torres’ Order, it is clear that the SEC’s internal documents—reflecting its staff’s thinking about XRP, Bitcoin, Ether, or any other digital asset—have no relevance to the Individual Defendants’ scienter. Nonpublic SEC documents cannot shed any light on whether Individual Defendants knew or consciously disregarded *the facts* that constitute Ripple’s alleged violation. The only relevant facts to discover as to the Individual Defendants’ scienter are facts showing their “general awareness of their overall role in Ripple’s illegal scheme.” D.E. 441 at 15. The drafts of Director Hinman’s speech, related communications, and Commissioner Roisman’s counsel’s meeting notes—internal

¹ *See also* D.E. 103 at 3, 9 & Hearing Tr. (Apr. 6, 2021) at 51 (excerpt attached hereto as Exhibit B), as clarified by D.E. 163 at 6 (discovery orders relying on Individual Defendants’ formulation of the applicable scienter standard, as explained by Garlinghouse’s counsel).

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documents reflecting deliberations by SEC staff regarding the application of the securities laws to digital asset offerings—are irrelevant to this question.

The Court should not order the production of the SEC’s internal documents—regardless of whether they are protected by DPP, as the SEC’s briefs and supporting papers on the pending motions show they are—where Defendants cannot show that the internal documents are relevant to any of their defenses.² For these additional reasons, the SEC respectfully requests that the Court grant its motion for partial reconsideration and clarification (D.E. 429) and deny Garlinghouse’s motion challenging the SEC’s DPP assertion (D.E. 434).

Respectfully submitted,

/s/ Mark R. Sylvester

Mark R. Sylvester

cc: Counsel for All Defendants (*via* ECF)

² Judge Torres’ order denying the SEC’s motion to strike Ripple’s fair notice defense reaffirms this Court’s conclusion that the SEC’s internal documents have no relevance to the fair notice defense. *See* D.E. 440 at 10 n.5 (Judge Torres stating that “the evaluation of any fair notice defense is objective”); D.E. 413 at 18 (this Court explaining same).

EXHIBIT A

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1 UNITED STATES DISTRICT COURT
2 SOUTHERN DISTRICT OF NEW YORK

3 -----x
4 SECURITIES AND EXCHANGE
5 COMMISSION,

6 Plaintiff,

7 v.

20 CV 10832 (AT) (SN)
Remote Conference

8 RIPPLE LABS INC., et al.,

9 Defendants.

-----x
New York, N.Y.
August 31, 2021
12:16 p.m.

10
11 Before:

12 HON. SARAH NETBURN,

Magistrate Judge

13
14 APPEARANCES

15 SECURITIES AND EXCHANGE COMMISSION
16 BY: JORGE G. TENRERIRO

17 CLEARY GOTTlieb STEEN & HAMILTON LLP
Attorneys for Defendant Garlinghouse
18 BY: MATTHEW C. SOLOMON

19 PAUL WEISS RIFKIND WHARTON & GARRISON LLP
Attorneys for Defendant Larsen
20 BY: MARTIN FLUMENBAUM

21 DEBEVOISE & PLIMPTON LLP
Attorneys for Defendant Ripple Labs, Inc.
22 BY: MICHAEL K. KELLOGG

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1 regarding the SEC's assertion primarily of the deliberative
2 process privilege, and I have reviewed the SEC's response
3 letter filed on August 17th and the reply letter by the
4 defendants filed on August 23rd.

5 I know that there is also a motion pending in
6 connection with the Slack messaging. I don't intend to address
7 that today. And I believe another motion was recently filed by
8 the defendants, which I don't believe is fully briefed, and so
9 we will certainly not be addressing that either.

10 Why don't I begin. Mr. Solomon, will you be taking
11 the lead on behalf of your team?

12 MR. SOLOMON: Yes, I will, your Honor.

13 THE COURT: Let me ask you a pointed question, and
14 I'll ask the same question to Mr. Tenreiro as well: In your
15 opinion – I want to focus first on the aiding and abetting
16 charge against the individual defendants – is the standard for
17 that charge an objective standard or a subjective standard?
18 Meaning is the question whether or not your client was
19 objectively reckless or is the question whether your client was
20 subjectively reckless? And if you could point to the law that
21 you think supports your position, I would appreciate it.

22 MR. SOLOMON: Of course, your Honor.

23 The standard is, for recklessness, one of objective,
24 not subjective. And in our motion to dismiss, we cited a lot
25 of law on that. I think *Apuzzo* is the formative Second Circuit

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1 case on that, and there are numerous other cases in the
2 Southern District of New York that also apply that same
3 objective standard. The Dodd-Frank Act, again, amended aiding
4 and abetting, which originally required knowledge, and now it
5 requires knowledge and recklessness. Another case that I would
6 cite for that proposition that aiding and abetting -- reckless
7 aiding and abetting is an objective standard is *Novak v.*
8 *Kasaks*, and that's 216 F.3d 300 -- that's a Second Circuit case
9 from 2000 -- and that's the case, again, that stands for the
10 proposition that if the underlying law was unclear at the time
11 even to the SEC, then the alleged violation could not have been
12 "so obvious, that the defendant must have been aware of it."
13 It's that "so obvious" point, your Honor, that we've been
14 coming to the Court with, and we came to Judge Torres on the
15 motion to dismiss, that is really one of the key linchpins for
16 why we've been arguing since April, and your Honor has
17 accepted, that the SEC's internal documents and the way the SEC
18 was looking at the issue of XRP, Bitcoin and Ether, and
19 whether, to the SEC, there was certainty, there was clarity,
20 about whether or not those digital assets were securities
21 because of the objective recklessness standard. That means it
22 is relevant, highly relevant, and ultimately highly probative,
23 that we get discovery into the SEC's thinking on that, because,
24 as a key market participant, the SEC's views go into the
25 objective analysis. And, again, I would commend your Honor to

EXHIBIT B

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1 UNITED STATES DISTRICT COURT
2 SOUTHERN DISTRICT OF NEW YORK

3 SECURITIES and EXCHANGE
4 COMMISSION,

5 Plaintiff,

6 v.

20 Civ. 10832 (AT)(SN)
Remote Proceeding

7 RIPPLE LABS, INC., et al.,

8 Defendants.

9
10 New York, N.Y.
April 6, 2021
2:00 p.m.

11 Before:

12 HON. SARAH NETBURN,

13 U.S. Magistrate Judge

14
15 APPEARANCES

16 SECURITIES and EXCHANGE COMMISSION

17 Attorneys for Plaintiff SEC

18 BY: JORGE G. TENREIRO

19 DUGAN BLISS

20 DAPHNA A. WAXMAN

JON A. DANIELS

LADAN STEWART

21 CLEARY GOTTlieb STEEN & HAMILTON, LLP

22 Attorneys for Defendant Bradley Garlinghouse

23 BY: MATTHEW SOLOMON

24 PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP

25 Attorneys for Defendant Christian A. Larsen

BY: MARTIN FLUMENBAUM

MICHAEL GERTZMAN

MEREDITH DEARBORN

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1 clarity.

2 Okay. Thank you everybody for your arguments. I
3 appreciate them. As I have come to expect from this group of
4 lawyers, they were excellent and the papers that you submitted
5 as well were excellent. And I recognize that this is
6 high-stakes litigation and that people are quite invested in
7 the outcome of the issues including the individual defendants
8 who face serious individual liability.

9 I have reviewed the letters and have listened
10 carefully to the argument. I am going to grant, in large part,
11 the defendant's motion. I think that the discovery related to
12 Bitcoin and Ether is relevant. I think it is relevant to the
13 Court's eventual analysis with respect to the *Howey* factors,
14 but I also think it is relevant as to the objective review of
15 defendants' understanding in thinking about the aiding and
16 abetting charge or aiding and abetting count. I also think it
17 is relevant to the fair notice defense that Ripple is raising.
18 So, for all of those reasons, I think discovery into Bitcoin
19 and Ether is appropriate and I am going to authorize it. I am
20 going to authorize discovery both as to exclusively Bitcoin or
21 Ether communications as well as XRP communications between the
22 SEC and third-parties, and by that I am excluding all market
23 participants and the other government agencies. I am not
24 including SEC-to-SEC internal communications in that ruling.
25 And so, the SEC is obligated to review the discovery request.