EXHIBIT 11

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. RIPPLE LABS, INC., BRADLEY GARLINGHOUSE, and CHRISTIAN A. LARSEN, Defendants.	Case No. 20 Civ. 10832 (AT)

BRIEF OF *AMICUS CURIAE* TAPJETS, INC. IN SUPPORT OF DEFENDANT RIPPLE LABS, INC. MOTION FOR SUMMARY JUDGMENT

STRATFORD LAW FIRM, LLC
Debra L. Feit, Esq.
401 East Las Olas Blvd.; Suite 1400
Fort Lauderdale, FL 33301
(954) 995-5400
debra@slglf.com

Attorney for Amicus Curiae TapJets, Inc.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

INTRODUCTION

TapJets, Inc. ("TapJets") respectfully submits this *Amicus Curiae* Brief in support of the Motion for Summary Judgment filed by the Defendants in the above referenced case. TapJets files this *Amicus Curiae* Brief pursuant to the Court's Order of October 11, 2022 [Dkt. 659]. In accordance with this Court's Individual Rules of Practice, Section III.D, TapJets is including the Affidavit of Eugene Kesselman, Founder and CEO of TapJets, Inc., as Exhibit "A" hereto (herein referenced as "Aff."), in support of the factual statements made in this Brief, with citations thereto to support the facts recited in this *Amicus Curiae* Brief. TapJets believes that this *Amicus Curiae* Brief complies with the Court's October 11, 2022 Order and the Court's Individual Rules of Practice, including Rule III.D.

INTEREST OF *AMICI CURIAE*

TapJets, Inc ("TapJets") is a private jet charter service that distinguishes itself within the industry by developing and operating a digital platform that includes proprietary technology. Aff. at ¶ 1. TapJets is the only company in the world that allows for instant booking and dispatch of private jet flights in North America and Europe. Aff. at ¶ 2. TapJets is a for-profit Corporation duly organized under the laws of the state of Texas on December 8, 2015, whose principal address is 3707 Cypress Creek Parkway, Suite 103, Houston, Texas 77068. TapJets is also registered as a foreign for-profit corporation in the state of Florida. Aff. at ¶ 3.

Eugene Kesselman is the director of TapJets. Aff. at ¶ 1. Neither TapJets nor Kesselman has any connection, financial or otherwise, to any of the Defendants. Aff. at ¶ 26. No other person or entity other than TapJets or its counsel has funded any part of this *Amicus* Brief. TapJets' counsel has authored this brief in its entirety. TapJets' sole interest in this litigation is the preservation of the use of XRP as a fiat currency substitute when the limitations inherent in the banking system under which fiat currency operates and fiat currency itself fails; if TapJets permanently loses its ability to accept XRP as a fiat currency substitute, TapJets will lose significant income, including but not limited to, the investment in technology that was developed to accept XRP as a form of payment, significant business growth opportunities, as well as valuable good will. Aff. at ¶ 6, 7, 10.

TapJets' mission is to change the way people book and utilize private jets for their personal and business needs. Aff. at ¶ 2. This mission is accomplished by returning the power of flight to the air traveler through the development of innovative technology, including the ability to instantly book a private jet anywhere in the world to anywhere in the world. Aff. at ¶ 2, 10. TapJets operates by connecting Travelers with the nearest suitable private jet aircraft that is operated by a FAR Part 135 certified air carrier. Aff. at ¶ 2.

Before TapJets innovated in this area, the process to book private jet travel required the travel facilitator (similar to a travel agent) to obtain quotes, negotiate and coordinate back and forth amongst brokers, operators, travelers, airports, handlers, and all others involved in the process. Aff. at ¶ 9, 10. With TapJets' proprietary technology, this process is now reduced to an instant on-line booking that is as easy as "calling an Uber". Aff. at ¶ 10. One of the most significant improvements in the process is that the traveler has the ability to book a flight and head to the private airport for their departure within minutes of booking. Aff. at ¶ 10.

However, TapJets' innovation in selling immediate air travel creates a business dilemma for TapJets and its travelers: by anyone's definition, TapJets sells an expensive service. Aff. at ¶ 2. A cross country flight on a private jet can cost upwards of $60,000 USD with transatlantic flights costs reaching in hundreds of thousands of dollars. The dilemma is how to pay for the flight so that the funds are instantly available to TapJets when wire transfers can take hours are sometimes days and credit card transactions take time to clear and are subject to high fees and charge-backs. Aff. at ¶¶ 23.

It is standard practice in the industry that all parties involved in facilitating the flight, service, aircraft, fuel, and the like are paid *before* the flight takes off. Aff. at ¶ 11. And in turn, TapJets requires immediate payment and <u>clearing of the funds</u> before TapJets will confirm the booking of the travel to the customer. Aff. at ¶ 9. Generally, during bank hours, i.e. Monday through Friday from 9am to 5pm, a transfer of funds via wire transfer is possible and an acceptable form of payment; if travel is booked after or before normal banking hours or merely too late in the business day, traditional fiat currency may not be available to secure the booking. Aff. at ¶¶ 13, 14, 15. Many banks settle wire transfers once a day, generally, at the end of the day: Thus, a Traveler wishing to book a 3pm flight earlier on the same day to be paid by a wire transfer, most likely will not be able to complete the purchase because of the bank's delay in the completion of the wire transfer. Aff. at ¶¶ 13, 14, 15. Moreover, some banks require the individual account holder to complete the wire transfer in the bank in person. This means that the Traveler must first present themselves at a bank branch that offers wire transfers, provide acceptable identification, and complete the order for the wire before the bank will queue the wire transfer for completion at some time in the future. Aff. at ¶ 16. Given that TapJets will only book the Traveler's flight after payment is received, the banking policies regarding wire transfers is a major obstacle for TapJets. Aff. at ¶ 16 .

TapJets calls this the "Friday Night Problem" because the limitations in fiat currency and the banking system become most problematic when a Traveler wishes to book weekend travel, such as on Friday night. The inherent limitations in sending a wire transfer simply does not accommodate the Friday night Traveler. Aff. at ¶ 15. Significantly, the Friday Night Problem has become more apparent in recent months now that the commercial airlines have become so grossly unreliable, with often delayed and cancelled flights. Aff. at ¶ 17. There are Travelers who have to be at their intended destination: When commercial airlines fail, many travelers turn to TapJets for alternative transportation. For many, the limit in the fiat currency system is a barrier to entry. Aff. at ¶¶ 8 - 16 .

Significantly, TapJets plays in medical transport. Aff. at ¶ 8. First, TapJets plays a role in transporting deceased persons from the location of the death to the location of the selected final resting place. Aff. at ¶ 8. For many reasons, commercial airlines may not be convenient for this, but the need is the most prevalent among those whose religious needs and beliefs require immediate burial. Aff. at ¶ 8. Second, TapJets immediacy in the booking and completing travel is vital when the Traveler is transporting organs, including blood, intended to be used in human organ transplants or donor transportation on short notice. Aff. at ¶ 8. Conversely, TapJets services are also vital when the individual is traveling for medical procedures. Aff. at ¶8 .

Cryptocurrency, including XRP, is/was the solution to the Friday Night Problem. Aff. at ¶ 7. XRP was a time-proven and trusted form of cryptocurrency that was preferred by TapJets' customer base (see below). Aff. at ¶¶ 18-20 . XRP offered travelers the ability to pay for the air travel instantly, solving the Friday Night Problem. Aff. at ¶¶ 22-23. When a Traveler tendered XRP for travel, TapJets treated these funds as it would fiat currency – TapJets then used these funds to pay its vendors for services rendered. Aff. at ¶ 21. The technology developed and employed by XRP was fast, safe, and secure to be used as an instant form of payment and was trusted to be stable enough to complete high dollar transactions. Aff. at ¶ 6, 7, 18, 19, 22.

In response to the Friday Night Problem and the cryptocurrency solution, on May 15, 2018, TapJets' director Eugene Kesselman asked TapJets' Twitter followers to choose the forms of cryptocurrency that TapJets would accept.[1] Aff. at ¶ 18-19. TapJets' Twitter Poll received a total of 57,054 votes while the poll was live, with an overwhelming majority, 43.9% of the votes, or 25,046 unique, recorded votes, in favor of XRP. Aff. at ¶ 19. XRP overwhelmingly received the most votes with the next form of cryptocurrency, which garnered significantly less votes than XRP. Aff. at ¶ 18-19. Moreover, since XRP offered streamlined cross-border payments, XRP simplified a major limitation inherent in the traditional banking systems, which serves to create a barrier to cross-border purchases, such as charter air travel. Aff. at ¶ 18-19. Since TapJets offers international flights, the ability to offer simplified cross-border payments is vital to TapJets' services and upheld its business mission. Aff. at ¶ 8, 18-19.

Thus, before being forced to suspend its acceptance of XRP, TapJets' acceptance of XRP was based solely upon its traveler's preferences as a fiat currency substitute solving a problem created by the limitations of the traditional banking system. Aff. at ¶ 18-19. TapJets' acceptance of XRP was based solely on XRP's simplification of services and transparency in payment as compared to other forms of currency, fiat or otherwise. Aff. at ¶ 22. The acceptance cryptocurrencies, including XRP, has become vital to TapJets ongoing business. Aff. at ¶¶ 1-28. The benefit in XRP was the immediacy of the payment, stability of the payment platform, and ease of use of XRP protocol for integration with TapJets', or other software, platforms. Aff. at ¶ 22.

[1] The Twitter poll and its results can be viewed here: https://twitter.com/tapjets/status/997512392115343360.

After accepting XRP as payment, TapJets then used exchanges to convert the XRP to FIAT currency (USD). Aff. at ¶ 5. After this instant litigation was filed by the SEC against the Defendants, the exchanges stopped accepting XRP. Aff. at ¶ 5. On or about March 3, 2021, TapJets reluctantly and without choice suspended the acceptance of XRP pending the outcome of the litigation. Aff. at ¶ 5. TapJets publicly made a statement on its site regarding this event. Aff. at ¶ 5. If exchanges are not able to reinstate XRP at the conclusion of this litigation, then all technology investments made to build the platforms designed specifically to accept XRP will be a total loss to TapJets and TapJets will sustain damages. Aff. at ¶ 5, 6.

In essence, TapJets disrupts the aviation industry by implementing advanced technology, which included XRP, as a fiat currency equivalent when the limitations imposed on fiat currency by a central banking system would otherwise prevent TapJets from engaging in commerce. Aff. at ¶¶ 1-28. For fiscal year 2021, 48% of TapJets' total bookings were paid by digital currency. Aff. at ¶ 23. TapJets projects that the revenue from digital currencies will continue to grow each year at a rate of 10% and is increasing over fiscal year 2022. Aff. at ¶ 24. However, TapJets believes that the loss of the ability to accept XRP is skewing these numbers and projections downward. Aff. at ¶¶ 3–28.

SUMMARY OF LEGAL ARGUMENT

TapJets relies upon the acceptance of XRP to facilitate commercial transactions when fiat currency or credit card transactions are inadequate or impossible. Aff. at ¶ 13. XRP was the fiat currency substitute of choice of those individuals consuming TapJets' services. Aff. at ¶ 18-19. XRP enabled low-cost, instantaneous transfer of funds from the traveler to TapJets or TapJets to its vendors. Aff. at ¶ 10, 17 ,23. The choice to accept XRP was based solely on organic market demand – as evidenced by the Twitter Poll. Aff. at ¶ 18-19. Once TapJets was paid in XRP, TapJets did not hold the XRP as in investment, but rather used the XRP as it would fiat currency as a form of payment in exchange for goods and services from other like-minded vendors or converted it to fiat currency on a qualified exchange. Aff. at ¶¶ 5, 21, 25, 26, 27. Accordingly, TapJets has no expectation of a profit in its acceptance of XRP. *SEC v. W. J. Howey Co*., 328 U.S. 293 (1946).

Legal Argument

Introduction – The "Howey" Test

Under the test announced in *SEC v. W. J. Howey Co*., 328 U.S. 293 (1946), an "investment contract" exists when: "(i) an investment of money, (ii) in a common enterprise, (iii) with profits to be derived solely from the efforts of others." *Tcherepnin v. Knight,* 389 U.S. 332 (1967). TapJets writes this *amicus* brief because the third prong of the *Howey* Test is not satisfied given TapJets' use of XRP as a fiat currency substitute. TapJets used XRP in the same way it uses fiat currency Aff. at ¶¶ 5, 21, 25, 26, 27; (1) TapJets did not make an investment of money in XRP, instead it received XRP as a form of payment of its product and services. Aff. at ¶ 23; (2) TapJets is not in common enterprise with Ripple Laps or XRP, the use of protocol or technology was limited to being able to accept the payment in the form of XRP. Aff. at ¶¶ 25-26; (3) TapJets had no expectation of profit in XRP by its acceptance of XRP. Aff. at ¶¶ 21, 27. Specifically, the ease of use of XRP protocol and underlying technology reduced TapJets' cost revelated to accepting the payment. Aff. at ¶¶ 22, 23. The cost of processing XRP payment was approximately 0.3% of the transaction cost, where similar fees charged by banks and credit card processors are in 2.5% range. Aff. at ¶ 23. Accordingly, and as explained herein, TapJets accepted XRP as a fiat currency substitute and at no time relied upon XRP as an investment for which TapJets expects future returns. Aff. at ¶¶ 6 – 28.

The "Character in Commerce" Test

Rather, the dispositive argument lies in the test announced in *SEC v. C. M. Joiner Leasing Corp*., 320 U.S. 344 (1943): "[T]he test rather is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect." *Id.* at 352-53. (articulating the "character in commerce test").

TapJets sells aviation travel. Aff. at ¶ 8. Travelers consume the air travel. Travelers who use XRP to pay for aircraft services are motivated by a desire to use or consume air travel. Aff. at ¶ 9. TapJets, in turn, used XRP to pay its vendors for goods or services and was motivated by a desire to use or consumer the item or service purchased. Aff. at ¶¶ 18-22. "When a purchaser is motivated by a desire to use or consume the item purchased… the securities laws do not apply." *United Hous. Found, Inc. v. Forman*, 421 U.S. 837 (1975). TapJets' Travelers are motivated by a desire to use or consume air travel: TapJets is motivated by a desire to sell its services and grow its company. Aff. at ¶¶ 18-22. Under the holding of *Forman*, the securities laws do not apply to the TapJets' transactions.

TapJets accepted XRP without consideration of risk of loss in XRP after acceptance. Aff. at ¶¶ 22-28. *Marine Bank v. Weaver*, 455 U.S. 551 (1982) (limiting the *Howe*y test where the "investor" must assume a risk of loss for the asset to be a security). The case of *Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 756 F.2d 230 (2nd Cir. 1985) is instructive. In *Gary Plastic*, the issue before the court was whether an investment program in certificates of deposit ("CD Program") sold by Merrill Lynch was a security under the law. Gary Plastic appealed summary judgment in favor of Merrill Lynch. In the summary judgment, the court held that the CD Program was not a security. In reversing the summary judgment, the appellate court stated:

> investors such as Gary Plastic expect profits derived solely from the efforts of Merrill Lynch and the banks. Plaintiff's investment in the CD program was motivated by the expectation of a return of cash investment….

Id. at 240. The court held that the CD Program was a security under the *Howey* Test because the gravamen in the issue was **the expectation of Gary Plastics** (and others similarly situated) when investing in the CD Program and **not** the intent of Merrill Lynch in its selling of the CD Program: "The Plaintiff's decision to invest is obviously made in reliance upon the efforts, knowledge and skill of Merrill Lynch." *Id*. at 241.

Here, TapJets is not investing in XRP. Aff. at ¶¶ 22-28. TapJets was not holding XRP for long- or short-term capital gains. Aff. at ¶¶ 22-28. TapJets' acceptance of XRP as payment for its services was not "made in reliance upon the efforts, knowledge or skill" of any issuer of XRP. TapJets was not motivated by (or even "bank on") the expectation of a return of cash investment on their acceptance of XRP. TapJets' use of XRP did not satisfy the third prong of the *Howey* test. Indeed, the third prong of the *Howey* Test cannot be satisfied. Moreover, under the terms that TapJets accepted XRP, XRP's character in commerce is not akin to a security, under whatever definition of security is applied.

CONCLUSION

As explained above, TapJets accepts cryptocurrencies, including when it was able to accept XRP, because cryptocurrencies offer flexibility, convenience, security, and ease of use to Travelers that traditional forms of fiat currency inherently cannot offer. TapJets in turn used XRP in exchange for goods and services offered by its vendors or converted the XRP into fiat currency. Neither TapJets nor Eugene Kesselman holds or held XRP for investment purposes with the expectation that the value of XRP will or would increase over time based upon the actions or skill of any third party. TapJets was forced to suspend acceptance of XRP on or about March 3, 2021, due to this instant litigation filed by the SEC, when the exchanges contemporaneously stopped accepting XRP; without the ability to convert XRP to fiat currency, XRP became worthless to TapJets. However, TapJets has invested a significant amount of its resources to build a proprietary platform to accept and process XRP and will suffer significant financial damages if the SEC prevails in this case, not only in lost sales but also in lost costs incurred in building the platform.

RESPECTFULLY SUBMITTED this 14th Day of October, 2022

/s/ Debra L. Feit
Debra L. Feit, Esq.
Florida Bar No.: 104452
Counsel for Amicus Curiae TapJets, Inc.
401 East Las Olas Blvd.; Suite 1400
Fort Lauderdale, FL 3301
T: 954-995-5400
debra@slgfl.com

EXHIBIT 12

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, Plaintiffs, v. RIPPLE LABS, INC., BRADLEY GARLINGHOUSE, and CHRISTIAN A. LARSEN, Defendants, and JORDON DEATON, JAMES LAMONTE, TYLER LAMONTE, MYA LAMONTE, MITCHELL MCKENNA, KRISTIANA WARNER, and ALL SIMILARLY SITUATED XRP HOLDERS, Proposed Intervenors	Civil Action No. 20 Civ. 10832 (AT)

BRIEF FOR AMICI CURIAE INVESTOR CHOICE ADVOCATES NETWORK AND PHILLIP GOLDSTEIN IN SUPPORT OF DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes

Other Authorities

STATEMENT OF INTEREST

Amici are Phillip Goldstein and Investor Choice Advocates Network ("ICAN"). Mr. Goldstein is a sophisticated businessman and investor, who currently serves as a manager at Bulldog Investors, focusing on investments in undervalued assets of all kinds that will deliver risk-adjusted returns to clients. Mr. Goldstein believes the United States Securities and Exchange Commission (the "SEC") has a tendency to expand its authority beyond its statutory limits. ICAN is a nonprofit organization that advocates for expanding access to markets—including markets for digital assets—for underrepresented investors and entrepreneurs who do not share the same access and market power as those with more assets and resources.

Amici have a significant interest in limiting the scope of the SEC's regulatory power to those functions authorized by statute and permissible under the United States Constitution. As an active market participant and an organization speaking on behalf of underrepresented market participants, *amici* also have a significant interest in ensuring the SEC's power to regulate securities does not improperly hamper the ability of individuals and organizations seeking to engage in the sort of digital asset transactions that Congress has not elected to regulate. The Court's possible expansive interpretation and application of the Securities Act of 1933 ("Securities Act") and other federal securities laws to digital assets will have far-reaching consequences on the separation of powers and on digital asset and blockchain innovation across the country.

PRELIMINARY STATEMENT

Amici submit this brief urging the Court to grant Defendants' motion for summary judgment. Defendants' motion focuses on the textual interpretation of the Securities Act—specifically, on the meaning of the word "security"—and presents reasons for the Court to interpret the statute as not encompassing the digital assets, including virtual currencies, at issue in this case. *Amici* support their arguments and will not repeat them here. This brief instead aims to highlight why the SEC's efforts to assert regulatory control over digital assets is an impermissible and unauthorized exercise of regulatory power, and provides an analysis of the significant political and economic impact that broadening the SEC's authority will have on *amici*, other similarly situated parties, and every potential participant in burgeoning digital asset markets in the absence of proper statutory authorization.

The Supreme Court's recent decision in *W. Virginia v. Env't Prot. Agency*, 142 S. Ct. 2587 (2022) (hereinafter, "*West Virginia*"), which addressed an analogous question about an agency's authority, jurisdiction, and power to regulate, provides strong precedent for this Court to rule in Defendants' favor. Central to the Supreme Court's decision in *West Virginia* was the "major questions" doctrine, which provides that a court *will not* defer to an agency's interpretation of a statute when the issue presented is one of deep economic or political significance. The doctrine reflects the settled principle that Congress "speak[s] clearly" when it intends to confer sweeping regulatory power upon federal agencies and does not vaguely or implicitly delegate authority to settle major policy questions. *See Utility Air Regulatory Grp. v. Env't Prot. Agency*, 573 U.S. 302, 324 (2014).

Over the past three years, members of Congress have introduced more than a dozen bills attempting to provide statutory authority for regulating digital assets and related topics. The remarkable level of activity in Congress (and even comments by the SEC and other parts of the Executive Branch) make clear what the SEC is not willing to concede: whether, by whom, and how to regulate the digital assets industry is an issue of deep economic and political significance. It is indisputably a "major question." Congress has explicitly authorized the SEC to regulate an enumerated list of financial instruments such as "stocks," "bonds," and "debentures." "Digital assets" is notably absent from that enumerated list. The SEC is now seeking to regulate an entire industry by expanding one ambiguous term on that list, "investment contract," beyond any reasonable interpretation of that term. This is a bridge too far. Congress never authorized the SEC to regulate digital assets, and, therefore, the Court should not infer that Congress would allow the SEC to do so here in the absence of specific statutory authority.

ARGUMENT

I. BACKGROUND

In specific instances, Congress has delegated regulatory authority to certain federal agencies. However, in what has become known as the "major questions doctrine," the Supreme Court has held that when an agency seeks to use its delegated authority to regulate an issue of major national significance, that agency's authority to do so must be supported by clear, and not vague or ambiguous, statutory authorization. *See*, *e.g.*, *MCI Telecomms. Corp*. v. AT&T Co., 512 U.S. 218 (1994) (rejecting Federal Communication Commission's waiver of tariff requirement); *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120 (2000) (rejecting Food and Drug Administration's regulation of tobacco industry based on statutory authority over "drugs" and "devices"); *Gonzales v. Oregon*, 546 U.S. 243 (2006) (rejecting Attorney General's regulation of assisted suicide drugs under his statutory authority over controlled substances).

Most recently, in *W. Virginia v. Env't Prot. Agency*, 142 S. Ct. 2587, 2620 (2022), the Supreme Court ruled that Section 111(d) of the Clean Air Act did not give the Environmental Protection Agency ("EPA") broad authority to regulate certain greenhouse gas emissions. In his concurring opinion, Justice Gorsuch observed that "when agencies seek to resolve major questions, they at least act with clear congressional authorization and do not 'exploit some gap, ambiguity, or doubtful expression in Congress's statutes to assume responsibilities far beyond' those the people's representatives actually conferred on them." *W. Virginia*, 142 S. Ct. at 2620

(2022) (Gorsuch, J., concurring) (*citing NFIB v. Osha*, 142 S. Ct. 661, 669 (2022)) (internal quotations and citations omitted). The Court ultimately found that no such authorization existed under the Clean Air Act.

In determining that the EPA's decision constituted a "major question" in *West Virginia*, the Supreme Court observed that the EPA's decision would have "vast economic and political significance" involving "billions of dollars of impact" (*W. Virginia*, 142 S. Ct. at 2604) "representing a 'transformative expansion in [its] regulatory authority' . . . that Congress had conspicuously and repeatedly declined to enact itself." *W. Virginia*, 142 S. Ct. at 2610. In describing the EPA's regulatory decision, the Supreme Court could just as easily have been describing the SEC's attempt to expand its authority over digital assets despite the vast economic and political significance such a decision would have and in the absence of Congressional delegation to do so.

II. THE SEC IS RELYING ON A VAGUE TERM TO REGULATE DIGITAL ASSETS

The SEC treats the term "investment contract" as though it were infinitely flexible and applicable to all manner of investments. But, the statutory source for the term "investment contract" gives no indication that Congress meant this term to be a catch-all phrase to capture financial transactions unrelated to "any interest or instrument commonly known as a 'security.'" Indeed, "investment contract" is just one item on a very specific list of investment vehicles that Congress set forth in the Securities Act to delineate one limit of the federal securities laws:

> The term "security" means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, **investment contract**, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange

relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. § 77(b)(a)(1) (emphasis added).

Nothing in the definition of "security" above provides sufficient support for the claim that digital assets are securities. The SEC, instead, relies primarily on the "flexibility" of the term "investment contract" to argue that its definition can be expanded to encompass digital assets, thus making them subject to regulation. *See* Dkt. 640 at 5. However, "investment contract" should be interpreted in the context of the laundry list of instruments in which it appears and would have to be much more than merely "flexible" to regulate an entirely new industry based on technology and ideas that did not exist in 1933 when Congress included the term in the Securities Act.

As noted by the Supreme Court, Congress rarely grants regulatory authority through "modest words," "vague terms," or "subtle device[s]." *Whitman v. American Trucking Assns., Inc.*, 531 U.S. 457, 468 (2001). Nor does it "typically use oblique or elliptical language to empower an agency to make a 'radical or fundamental change' to a statutory scheme." *West Virginia*, 142 S. Ct. at 2609 (*citing MCI Telecomm. Corp. v. American Tel. & Tel. Co.*, 512 U.S. 218, 229 (1994)).

In *West Virginia*, the EPA similarly relied upon a vague statutory term to establish authority for its actions. The Supreme Court rejected the agency's reliance, finding that the phrase "system of emission reduction" was an "empty vessel" that could encompass "almost anything[.]" *West Virginia*, 142 S. Ct. at 2614. The Court also held that, under its precedents, the issue presented was a major question because the EPA "'claim[ed] to discover in a long-extant statute an unheralded power' representing a transformative expansion in [its] regulatory authority." *Id.* at 2610 (*citing Utility Air Regulatory Group v. Env't Prot. Agency*, 573 U.S. 302, 324 (2014)).

Similarly, here, the term "investment contract" cannot be said to confer the type of authority the SEC wishes to yield. The Securities Act does not define the term "investment contract." Instead, the Supreme Court—not Congress—has laid out a four-part test (the "*Howey* test") for determining whether certain transactions or schemes qualify as investment contracts, which are in turn subject to regulation. *See SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). To be sure, the *Howey* test is "flexible" and "capable of adaption to meet the countless and variable schemes derived by those who seek the use of money of others on the promise of profits." *Howey*, 328 U.S. at 299. But even the Supreme Court in 1946 surely was not suggesting that Congress intended the term "investment contract" to be a catch-all phrase designed to be applied to all instruments that, as discussed below, share isolated characteristics of currencies and commodities, among other things. The SEC nevertheless claims—as the EPA impermissibly did—to have discovered "an unheralded power" which would vastly transform and expand its regulatory authority.

Digital assets encompass a range of instruments—including centralized intermediaries that transact in digital assets and decentralized protocols that record digital asset transactions. The XRP token in question here does not have the "'character in commerce'" of a security. *Glen-Arden Commodities, Inc. v. Costantino*, 493 F.2d 1027, 1034 (2d Cir. 1974) (*citing SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943))—in most transactions, no contractual relationship was formed, nor did holding XRP give the recipient equity or stock in any business. The phrase "investment contract" becomes so broad as to be meaningless if, as the SEC suggests, it encompasses an instrument without a contract, without rights granted to the purchaser, and without obligations on the issuer.

The Court should not permit the SEC to transform a general and vague term into one that is so flexible it empowers the SEC to regulate an entire (and entirely new) industry. Such regulation involves a major question and exceeds the SEC's current statutory authority.

III. CONGRESS HAS PREVIOUSLY CONSIDERED AND IS STILL CONSIDERING VARIOUS OPTIONS AND FEDERAL AGENCIES TO REGULATE DIGITAL ASSETS

The United States Congress has repeatedly considered regulation of digital assets through proposed legislation. Yet, almost every time legislation has been proposed, Congress has failed to enact it. In *West Virginia*, the Supreme Court acknowledged that "[a]gencies have only those powers given to them by Congress," and "enabling legislation" is generally not an "open book to which the agency [may] add pages and change the plot line." *West Virginia*, 142 S. Ct. at 2609. As Justice Gorsuch noted in his concurrence:

> Permitting Congress to divest its legislative power to the Executive Branch would "dash [this] whole scheme." *Department of Transportation v. Association of American Railroads*, 575 U.S. 43, 61, 135 S.Ct. 1225, 191 L.Ed.2d 153 (2015) (Alito, J., concurring). Legislation would risk becoming nothing more than the will of the current President, or, worse yet, the will of unelected officials barely responsive to him. See S. Breyer, Making Our Democracy Work: A Judge's View 110 (2010).

Id. at 2618 (Gorsuch, J., concurring). The Supreme Court has found it telling when Congress has "considered and rejected" bills authorizing something akin to the agency's proposed course of action. *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 144 (2000).

Congress has introduced several bills over the last four years that would have authorized federal agencies—including, critically, agencies other than the SEC—to regulate digital assets. Yet, Congress has failed to enact this legislation time after time. The following describes some, but not all, of those legislative efforts.

First, the Token Taxonomy Act (H.R. 2144) was introduced on April 9, 2019 and would specify that digital tokens, such as those used in virtual currencies, are ***not securities*** for regulatory purposes. The bill also provided for the tax treatment of digital assets, including by excluding from gross income any gains from digital asset transactions up to $600, retroactive to January 1, 2017. It was referred to the Committee on Financial Services and the Committee on Ways and Means, but did not leave either committee. This bill has been reintroduced in the 117th Congress as H.R. 1628 on March 8, 2021. It was referred to both committees again and has not yet left either committee.

Second, the Digital Asset Market Structure and Investor Protection Act (H.R. 4741) was introduced on July 28, 2021 and would have granted the Commodities Futures Trading Commission ("CFTC") authority over digital assets, which (1) are created electronically or digitally through software code; (2) are programmed with rules that govern the creation, supply, ownership, use, and transfer of the asset; (3) have a secure transaction history; and (4) are capable of being transferred through a decentralized method without an intermediate custodian. The bill would have also granted the Securities and Exchange Commission ("SEC") authority over the regulation of digital asset securities, digital assets that provide the holder with (1) equity or debt interest in the issuer, (2) rights to certain payments from the issuer, (3) voting rights in the major corporate actions of the issuer, or (4) liquidation rights in the event of the issuer's liquidation. XRP does not meet this latter definition of a digital asset security. The bill was referred to the Subcommittee on Commodity Exchanges, Energy, and Credit and has not left the committee.

Third, the U.S. Virtual Currency Market and Regulatory Competitiveness Act of 2019 (H.R. 923) was introduced on January 30, 2019 and would direct the CFTC to report on virtual currency markets and U.S. competitiveness. The bill was referred to the Subcommittee on Commodity Exchanges, Energy, and Credit and has not left the committee.

Fourth, the Crypto-Currency Act of 2020 (H.R. 6154) was introduced on March 9, 2020 and would establish the CFTC as the primary regulator of cryptocommodities; FinCEN and the Office of the Comptroller of the Currency would be the primary regulators of cryptocurrencies and the SEC would be the primary regulator of cryptosecurities and synthetic stablecoins. The bill was referred to the Committee on Financial Services and has not left the committee.

Fifth, the Eliminate Barriers to Innovation Act of 2021 (H.R. 1602) was introduced on March 8, 2021 and would require the SEC and the CFTC to jointly establish a working group on digital assets. The bill was passed in the House and has been languishing in the Senate Committee on Banking, Housing, and Urban Affairs since April 2021.

Sixth, the Lummis-Gillibrand Responsible Financial Innovation Act (S. 4356) was introduced on June 7, 2022 and would make a distinction between digital assets that are either securities or commodities by looking at the purpose of the asset, and provide the CFTC with primary authority over most types of digital assets and digital asset activities. Digital asset securities would remain primarily regulated by the SEC. The bill would also permit digital asset trading platforms to register with the CFTC as Digital Asset Exchanges, and provide for safeguarding of customer assets in the event of Digital Asset Exchange insolvency. The bill would create disclosure requirements on digital asset service providers that will ensure that consumers understand the products they are purchasing, and create a structure for the taxation of digital assets. The bill has not left the Committee on Banking, Housing, and Urban Affairs.

Seventh, the Digital Commodities Consumer Protection Act of 2022 (S. 4760) was introduced on August 3, 2022 and would provide the CFTC authority to regulate digital commodities. The bill has been referred to the Committee on Agriculture, Nutrition, and Forestry and has not left the committee.

Eighth, the Digital Commodity Exchange Act of 2022 (H.R. 7614) was introduced on April 28, 2022. The bill would authorize the CFTC to register and regulate trading venues offering spot or cash digital commodity markets as digital commodity exchanges. The bill would also provide the CFTC with exclusive jurisdiction over any agreement, contract, or transaction involving a contract of sale of a digital commodity in interstate commerce, and would provide that each futures commission merchant hold customer money, assets, and property in a manner to minimize the customer's risk of loss or unreasonable delay in the access to the money, assets, and property of the customer. The bill was referred to the Subcommittee on Commodity Exchanges, Energy, and Credit and has not left the subcommittee.

Ninth, the Central Bank Digital Currency Study Act of 2021 (H.R. 2211) was introduced on March 26, 2021 and would require the Board of Governors of the Federal Reserve System, (Fed) in consultation with the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Department of the Treasury (Treasury), the SEC, and CFTC, to study the impact of the introduction of a central bank digital currency. The bill was referred to the Committee on Financial Services and has not left the committee.

Tenth, the Special Measures to Fight Modern Threats Act, (H.R. 7128) and (S. 3876) was introduced on March 17, 2022 and would authorize the Secretary of the Treasury to place prohibitions or conditions on certain transmittals of funds. H.R. 7128 has been referred to the House Committee on Financial Services. S. 3876 has been referred to the Committee on Banking, Housing, and Urban Affairs. Neither bill has left its respective committee.

Eleventh, the Digital Commodities Consumer Protection Act of 2022 was introduced on August 3, 2022 and would provide the CFTC with the authority to regulate digital commodities.

The number of pending bills in committee—any of which can be presented to Congress—demonstrates that Congress is keenly interested in the area of digital assets. Until a consensus is reached, the SEC has no authority to fill what it apparently perceives as a vacuum.

IV. THE SEC'S ATTEMPT TO REGULATE DIGITAL ASSETS EXCEEDS ITS TRADITIONAL AUTHORITY PREVIOUSLY DELEGATED BY CONGRESS

As recently as October 12, 2022, SEC Commissioner Hester Peirce commented on the lack of traditional SEC authority to regulate the new class of digital assets. At a Security Traders Association conference, Commissioner Peirce noted, "[c]rypto is something that's new and I think consequential enough that it would make sense for Congress to spend some time on." *SEC's Peirce Calls for Crypto Legislation to Guide Regulation*, Bloomberg Law, (Oct. 12, 2022).

Also, at a congressional hearing in May 2021, SEC Chair Gary Gensler voiced concerns regarding the lack of a regulatory framework for digital asset exchanges.[1] He stated that the lack of oversight represents a "gap in our system" that denies traders basic investor protection. Gensler emphasized the importance of bringing the same protections found in traditional securities markets to digital asset exchanges. He added that "none of the exchanges trading crypto tokens has registered yet as an exchange with the SEC. Altogether, this has led to substantially less investor protection than in our traditional securities markets, and to correspondingly greater opportunities for fraud and manipulation." There were a number of memorable exchanges in the May 2021 hearing:

[1] GAME STOPPED? WHO WINS AND LOSES WHEN SHORT SELLERS, SOCIAL MEDIA, AND RETAIL INVESTORS COLLIDE, PART III, House Committee on Financial Services, May 6, 2021.

> Mr. McHenry: Let's pivot to something that you spent some time out of government understanding. I think what we all have tried to seek is greater collaboration across agencies on the regulatory framework for digital assets, cryptocurrencies, notably. This includes more engagement from industry and appropriate regulators. In 2019, SEC staff produced the framework for investment contract analysis of digital assets.
>
> Since then, the staff has sought feedback on a number of issues, most recently on the evolving standards and the best practices for custody. This is progress, but I believe more concrete steps are necessary to further the crypto market. As you look at this issue, what steps can you outline to bring regulatory clarity so that we can have a vibrant digital asset marketplace with legitimate money and the rule of law?
>
> Mr. Gensler: Thank you for asking that. And I think that this market, which is close **to $2 trillion**, the crypto asset market, is one that could benefit from greater investor protection within the SEC's current authorities, our authorities around securities, and around asset managers and products that might invest in these cryptocurrencies. As you mentioned, we put out a comment, I think it was in October or November, asking for feedback on custody. I would hope that we would move forward and provide greater clarity around custody. **I do think that working with Congress, and I think it is only Congress that could really address it, it would be good to consider**, if you would ask my thoughts, to consider whether to bring greater investor protection to the crypto exchanges. And I think if that were the case, because right now the exchanges trading in these crypto assets do not have a regulatory framework either at the SEC, or our sister agency, the Commodity Futures Trading Commission, that could instill greater confidence. (emphasis added).

Thus, while the SEC Chair has recognized the SEC's "current authorities" provide some guidance, "only Congress" (and not the SEC or the courts) can address the absence of a regulatory framework for either the SEC or the CFTC (or any another agency) to regulate aspects of the $2 trillion crypto asset market. Another member of the Committee, Warren Davidson observed, "Now with you at the helm of this agency, I think it is an opportune time for the SEC to work with Congress on creating this regulatory framework that is bipartisan and clear."

At another hearing before the House Committee on Financial Services, on October 5, 2021, Rep. McHenry, the Ranking Member of the Committee asked Mr. Gensler the following:

> You have not been shy in the press, so I hope we can have a frank and transparent conversation here today. On digital assets, you have made, in my view, a number

of concerning and contradictory public statements regarding crypto assets and other innovative technology. When you were here in May, you stated that there was a need for additional legislation to appropriately regulate and define digital assets and digital asset exchanges.

Then, just a few weeks ago, when you testified before the Senate Banking Committee, you stated there was, 'a great deal' of clarity in the law. You implied that many digital asset exchanges are underregistered security exchanges and even threatened one digital asset exchange by name.

So, which is it? Does the SEC want more legislative authority, or is it about to unleash a regulatory tsunami under existing laws?

To be frank, I have strong concerns about how you will regulate in the digital asset space and whether the law is on your side. I believe it is time for Congress to step up and provide clear guidelines that will not allow an SEC Chair to change the law by interview or statement or a statement posted on the Commission's website.

Rep. Maloney asked Mr. Gensler a follow-up question in response to which the SEC Chair acknowledged (with some equivocation) the need for Congressional action:

Mrs. Maloney. Okay. Do you believe the SEC has all the authority that it needs to regulate this cryptocurrency if you should decide to do it or does Congress need to give you more authority to be able to regulate the cryptocurrency?

Mr. Gensler. Thank you, and it is a question that the ranking member asked in a little bit different way earlier, which is, I think our statutes are clear, and Congress painted with a broad brush what is a security, but I think working with Congress, there are some gaps and there are some places that we can work, whether it is our relationship with our sibling agencies in the market regulatory space but also as it relates to, for instance, what has come to be known as stable value coins and how to think through that with the bank regulatory regime as well.

Rather than unequivocally responding, "Yes, the SEC has all the authority it needs," the Chair demurred and instead discussed gaps in the framework. When asked by Rep. Himes whether Congress should use existing regulations for exchanges, Mr. Gensler again noted the need for Congressional action:

It will be for Congress to decide, and some were quoting my testimony of prior years. Congress could decide, but we have two really great market regulators, the SEC and the CFTC, and I have been honored to Chair each of them, and we have different authorities, derivatives, commodities, and securities. I don't think that we need another regulator. There are things that could be done to ensure the smoothness between the two agencies, and CFTC Chair Rostin Behnam and I have been talking about that, even if Congress doesn't act.

Mr. Gensler referenced Rostin Behnam, the Chairman of the CFTC; however, Mr. Behnam in his recent testimony to the Senate Committee on Agriculture, Nutrition, and Forestry stated that, "the unique characteristics of the growing digital asset industry necessitated a comprehensive federal regulatory regime."[2] In recent testimony before the same committee, the CFTC Chief noted, "As I have publicly stated several times, including to this committee, and as has been recognized by federal courts, many digital assets constitute commodities. As recognized by the [Digital Commodities Consumer Protection Act], the CFTC's expertise and experience make it the right regulator for the digital asset commodity market."

In the absence of clear statutory authority, the potential for disagreements between federal regulators has occasionally resulted in publicly aired friction between the SEC and CFTC. In July of this year, following the SEC's filing of what it characterized as an insider trading case involving digital assets, *SEC v. Wahi*, CFTC Commissioner Caroline Pham issued a statement that read in part:

> The case *SEC v. Wahi* is a striking example of "regulation by enforcement." The SEC complaint alleges that dozens of digital assets, including those that could be described as utility tokens and/or certain tokens relating to decentralized autonomous organizations (DAOs), are securities.
>
> The SEC's allegations could have broad implications beyond this single case, underscoring how critical and urgent it is that regulators work together. Major questions are best addressed through a transparent process that engages the public to develop appropriate policy with expert input—through notice-and-comment rulemaking pursuant to the Administrative Procedure Act. Regulatory clarity comes from being out in the open, not in the dark.

[2] Rostin Behnam, Chairman, CFTC, Testimony of Chairman Rostin Behnam Regarding "Examining Digital Assets: Risks, Regulation, and Innovation" before the U.S. Senate Committee on Agriculture, Nutrition, and Forestry (Feb.9, 2022), Testimony of Chairman Rostin Behnam Regarding "Examining Digital Assets: Risks, Regulation, and Innovation" | CFTC.

> Twelve years ago on this day, the Dodd-Frank Act became law. Since that time, the CFTC has faithfully carried out its expanded anti-fraud mission and has aggressively pursued wrongdoing in every one of our markets and all over the world. Given the overriding public interest and the open questions on the legal statuses of various digital assets, such as certain utility tokens and DAO-related tokens, the CFTC should use all means available to fulfill its statutory mandate to vigorously enforce the law and uphold the Commodity Exchange Act. This responsibility has been entrusted to us by the Congress and the American people.

Statement of Commissioner Caroline D. Pham on *SEC v. Wahi* (July 21, 2022)

(https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement072122)

Likewise, on September 15, 2022, Senator Toomey, the Ranking Member of the U.S. Senate Committee on Banking, Housing, and Urban Affairs ("Committee"), noted:

> Given the novel nature of these tokens, Congress ought to step in to provide clarity. In particular, we need to revisit the definition of "security" as part of a larger effort to tailor a regulatory framework that is calibrated to the unique risks and activities of the crypto market.

Opening Statement, Full Committee Hearing (Sept.15, 2022).

Similarly, Senator John Hickenlooper recently noted in a letter to the SEC Chair, "Applying the old rules to the new market could inadvertently cause financial services to be more expensive, less accessible" and "recognizing that some digital assets are securities, others may be commodities, and others may subject to a completely different regulatory regime."[3] Thus, even members of Congress recognize the traditional framework relied upon by the SEC is inadequate for the regulation of cryptocurrencies.

V. CONCLUSION

For all the foregoing reasons, the Court should grant Defendants' motions for summary judgment and deny the Plaintiff's cross-motion for summary judgment.

[3] https://www.hickenlooper.senate.gov/press_releases/hickenlooper-calls-on-sec-to-regulate-cryptocurrencies/.

Dated: October 18, 2022

Respectfully submitted,

/s/ Avi Weitzman
Avi Weitzman
Nicolas Morgan (*pro hac vice forthcoming*)
Anuva V. Ganapathi (*pro hac vice forthcoming*)

Counsel for Amici Curiae
PAUL HASTINGS
200 Park Avenue
New York, New York 10166
Tel.: (212) 318-6000

EXHIBIT 13

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

--x

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

-against-

RIPPLE LABS, INC., BRADLEY GARLINGHOUSE, and CHRISTIAN A. LARSEN,

Defendants.

--x

Civil Action No. 1:20-cv-10832

Hon. Analisa Torres

BRIEF OF AMICUS CURIAE, SPEND THE BITS, INC.
IN SUPPORT OF DEFENDANT RIPPLE LABS, INC.'S MOTION FOR SUMMARY JUDGMENT

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Other Authorities

Case 4:18-cv-06753-PJH Document 216-1 Filed 02/23/23 Page 4 of 15

INTEREST OF AMICUS CURIAE

SpendTheBits, Inc. ("STB") is a foreign for-profit company based out of Alberta, Canada and founded by Jaskaran (Jay) Kambo. STB designed an application to transfer Bitcoin on the decentralized, open-source blockchain technology of the XRP Ledger ("XRPL") without Ripple's knowledge, consent or assistance. Like many other people in the crypto-space, Jay experienced long delays and unnecessary costs in the transfer of his Bitcoin on the Bitcoin Network. Determined to find a solution, Jay began exploring alternate payment options to improve the transaction speed and costs associated with using Bitcoin as a medium of exchange. Because XRP is the native token of the XRPL, STB utilizes XRP in the operation of its application. The app is designed to burn 0.00005 XRP with each transaction, which takes just three to five seconds to complete. *See* @Spend_The_Bits, Twitter https://twitter.com/spend_the_bits (Demonstrating how the STB app works, utilizing the XRPL).

The STB app is a digital payment platform where users can send, spend, and receive Bitcoin using PayString id, similar to email. Kambo Aff. ¶ 2. PayString id is a universal payment identifier assigned to users that allow for the generic transfer of value between users in a similar manner to how information is transferred between different user emails (e.g., Hotmail to Yahoo). Paystring id utilizes one master address to represent any number of sub-addresses on any generic payment network, centralized or decentralized, while preserving the privacy of user account numbers on the respective networks. *See generally* "Understanding, Deploying, and Using PayString." *PayString*, https://paystring.org/universal-payment-identifier-faqs/.

STB has been built/deployed on layer one of the XRPL. STB is an application layer that is designed to bridge any Layer 1 blockchain or payment rail to any other payment rail. Kambo Aff. ¶ 7.

The value proposition is that using the STB application, Bitcoin transfers can be finalized in a matter of seconds using the STB platform. More generically, by deploying a user's value (e.g., Bitcoin, USD, etc.) onto the XRPL as a representative IOU, users get all of the benefits of sending and receiving digital assets quickly, efficiently & eco-friendly for any form of payment. The cost of processing Bitcoin payments with STB is approximately 0.1% for most transactions, as compared to fees of approximately 3.5% - 5% when processed by banks or credit cards. This results in significant savings that are passed onto the consumer. Kambo Aff. ¶ 17.

Because of the Securities and Exchange Commission's ("SEC") allegations in this lawsuit, STB has not launched in the United States. However, STB is taking steps to register and launch in El Salvador, where Bitcoin is legal tender. While the SEC is supposed to concern itself with investments, the wide net it has cast in this litigation has hooked XRP purchasers, users, and developers alike. If this Court deems XRP a security, STB would be prevented from launching in the U.S., depriving U.S. consumers from benefiting from the innovation and cost savings STB offers. Thus, STB has a strong interest in this case and provides yet another, distinguishable example that undermines the integrity of the SEC's claims regarding XRP.

FACTUAL BACKGROUND

In September 2019, Jay Kambo began building the STB application on the XRPL. Kambo Aff. ¶ 28. At that time, Jay was unfamiliar with the company named Ripple and its executives. Kambo Aff. ¶ 30. In November 2020 the STB app was listed on the Android Play Store and on the IOS App Store in January 2021. Kambo Aff. ¶ 28. Between those two milestones, the SEC sued Ripple and two of its executives. ECF 4. The SEC alleged XRP itself represents an investment contract and specifically targeted XRP in the secondary market - which directly threatens anyone owning XRP. *See* ECF 46 ("The nature of XRP itself made it the common thread among Ripple, its management, and all other XRP holders."); ECF 153 at 24 ("The XRP traded, even in the secondary market, is the embodiment of those facts, circumstances, promises, and expectations, and today represents that investment contract."); *and, Hr'g Tr.* 44:7-16 (Mar. 19, 2021) ("Presumably under this theory then, every individual in the world who is selling XRP would be committing a Section 5 violation based on what you just said.") (Netburn, J.). The SEC has also alleged that XRP lacks utility. *Hr'g Tr.* 51:15-16 ("Now, the court referenced a utility for XRP. We dispute whether that utility actually exists, your Honor."); ECF 46 at 63 ("**No Significant Non-Investment "Use" for XRP Exists**") (original emphasis). It also claims the only reason for **anyone** to buy XRP was for a speculative investment purpose. ECF 46 ¶ 353 ("The very nature of XRP in the market—as constructed and promoted by Ripple— compels reasonable XRP purchasers to view XRP as an investment."). Such far-fetched assertions about open-source software code completely disregard the hundreds of use cases created for XRP, unrelated to any of Ripple's efforts. *See* "Use Cases & Featured Projects." *XRPL.org*, https://xrpl.org/uses.html (listing companies and developers "around the world that leverage the XRP Ledger to solve interesting problems across a variety of industries and use cases."). STB, like many others, acquired XRP for the sole purpose of utilizing it as a bridge or exchange token on the XRPL. Kambo Aff. ¶ 35.

The XRPL is an open-source, permission-less and decentralized distributed ledger blockchain technology. "Why XRP is the most misunderstood cryptocurrency", *panos.writeas.com*, https://panos.writeas.com/why-xrp-is-the-most-misunderstood-cryptocurrency. The XRPL utilizes a consensus protocol, relying on validator nodes to record and verify transactions. *Id.* The XRPL implements a form of the Federated Byzantine Agreement (FBA) consensus algorithm. *Id*. Validator nodes are nodes running as a validator server, meaning "they are configured to participate in the consensus process for validating transactions and the governance of the network." *Id*. Currently, there exists over 170 validators and 900 nodes operating around the world run by a broad range of individuals, universities, institutions and exchanges. *Id*. For consensus to be reached in the XRPL Network, a minimum of 80% of the validators *must* agree. *Id*. Ripple runs 6 validators thus, controlling less than 4% of all validators within the network - giving Ripple no power over the network. *Id.*

The SEC conceded that "[s]tripped down, XRP is just computer code." ECF 640 at 10. The XRPL's "computer code" is open-source software - meaning anyone from around the world can access and use the XRPL. ECF 643 at 7 (citations omitted). To transact on the XRPL, you need an address and a secret key and some XRP. "Get Credentials." *XRPL.org*, https://xrpl.org/issue-a-fungible-token.html#1-get-credentials. Thus, any person, developer, or business, can submit transactions on the XRPL. *Id.* Any person can access the XRPL and transfer value in the form of fiat currencies, NFTs, or other cryptocurrencies to friends, family or loved ones, without the need to utilize an intermediary such as a bank or money transmitter (e.g., Western Union or MoneyGram). "Direct XRP Payments" *XRPL.org*, https://xrpl.org/direct-xrp-payments.html. When accessing the XRPL to transfer value over the internet, XRP is not being viewed or utilized as an investment. Rather, it is being utilized as a utility tool for payments.

Independent developers and users of the XRPL, with no connection to Ripple, can propose changes to the XRPL's source code and those changes can be implemented over Ripple's objection, assuming 80% consensus is met. "Why XRP is the most misunderstood cryptocurrency", *panos.writeas.com*, https://panos.writeas.com/why-xrp-is-the-most-misunderstood-cryptocurrency. There are literally hundreds, if not thousands, of XRPL developers, with no connection to Ripple, running applications on the XRP Ledger. *Id*. In short, the SEC fundamentally misunderstands the nature of open permission-less decentralized distributed ledger computer networks that are open to the world. There are tutorials available to teach and instruct even the most non-technical individuals on how to utilize the technology. *See* "Tutorials" *XRPL.org*, https://xrpl.org/tutorials.html#main-page-header. The SEC is simply wrong when it asserts that STB lacks the technical skill to contribute to the XRP ecosystem. *See* ECF 46 ¶ 285 ("In contrast to Ripple, investors in XRP cannot take most or any of the steps that Ripple has taken to grow the XRP ecosystem and increase demand for XRP. Most, if not all, XRP investors simply lack the technical expertise and the resources to do so."). In fact, anyone can learn how to code on the XRPL without a technical background. *See* "Learn to code on the XRP Ledger" *XRPL.org,* https://learn.xrpl.org/# (describing how to "[l]earn how to get up and running on the XRP Ledger. This includes setting up an account, sending XRP, creating Trustlines, and more."). Hence, anyone can access the XRPL and do the following: Create trustlines and send currency; establish accounts that send transactions and hold XRP; make direct XRP payments; make cross-country payments and automatically deliver a different currency than they send by converting them; create deferred payments that can be cancelled or cashed by the intended recipients; use source and destination tags to indicate specific purposes for payments from and to multi-purpose addresses; and, to use a cryptographic escrow as a smart contract to ensure a recipient gets paid only if they successfully perform a service. *See generally XRPL.org,* https://xrpl.org/. Even more significant, ***anyone*** can create tokens or a non-fungible token ("NFT"), *representing* digital value on the XRPL. "Tokens." *XRPL.org,* https://xrpl.org/label-tokens.html.

Other than speed, costs, and energy output, quite possibly the most significant attribute of the XRPL, attracting users and developers from around the world, is the XRPL's decentralized exchange ("DEX"). Unlike the Bitcoin Network, the XRPL contains the world's first established DEX. "Behind the Scenes of the XRPL Dex." *DEV Community*, https://dev.to/ripplexdev/behind-the-scenes-of-the-xrpl-dex-4jb.

The DEX enables the user on the ledger to buy, sell or trade any asset—including Bitcoin, Ether, stable-coins, XRP, DogeCoin, and other digital assets and even physical units of value such as gold. *Id*. This allows users of the DEX and the XRPL to trade well-established commodities (e.g., Gold and Bitcoin) and other commodity-like assets (XRP, Ether, etc.) without using an intermediary such as a bank or other financial institution. *Id.* For example, a DEX user in the United States can issue an NFT for sale in USD while a buyer may purchase it using a foreign currency like the South Korean KRW. *Id.* The DEX automatically charts the least expensive trading path between the two currencies—for example, from KRW to XRP and then to USD – with XRP acting as the *bridge currency* between the two fiat currencies.

STB acquired XRP to activate the XRPL wallet via a third-party platform where Jay Kambo had previously obtained other cryptocurrencies, such as Bitcoin, XLM or Ether. Kambo Aff. ¶ 5. STB burns a fraction of a penny's worth of XRP in order to transfer Bitcoin via the XRPL. Kambo Aff. ¶ 15. Not only is 100% of STB revenue from Bitcoin but STB never received any incentives, compensation or XRP from Ripple to build the STB application. Kambo Aff. ¶ 31. Ripple and its executives did not provide any input, influence, control or consent to the development, launch or use of STB. Kambo Aff. ¶ 32. The SEC's position that XRP is an investment contract with Ripple, is destroyed by the way STB, and others like it, build applications on the XRPL.

ARGUMENT

Defendants' Motions for Summary Judgment should be granted because XRP is not an investment contract within the meaning of the law. Furthermore, STB demonstrates one of many non-investment use cases for XRP; that are not a part of a common enterprise with Ripple; and do not rely on the efforts of Ripple.

I. Securities laws do not apply

STB's acquisition and consumptive use of XRP demonstrates that XRP does not constitute an investment contract. The Securities Exchange Act of 1934 gave the SEC broad authority over the **securities** industry but "[w]hen a purchaser is motivated by a desire to use or consume the item purchased… the securities laws do not apply." *United Hous. Found, Inc. v. Forman*, 421 U.S. 837 (1975). In contrast to an investment intent, an individual may acquire an asset with "a desire to use or consume the item purchased." *Id.* at 852–53. Simply put, a transaction does not fall within the scope of the securities laws when a reasonable purchaser is motivated to purchase by a consumptive intent. *Id*. Therefore, based on XRP's functional utility, independent of Ripple, XRP serves as a commodity, and therefore, not subject to the securities laws. However, when the securities laws *do* apply, the precedent is pretty clear. According to the U.S. Supreme Court, an "investment contract" is "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293, 298–99 (1946). The *Howey* test is used to determine whether an investment contract exists and considers only three factors: whether there has been (1) an investment of money (2) in a common enterprise (3) with the expectation of profit from the sole efforts of another. *Id.*

II. The Howey analysis

STB acquired a diminutive amount of XRP to use so its application users can utilize Bitcoin in place of fiat. Kambo Aff. ¶ 5. This acquisition was for consumptive use which is not considered an investment and therefore, pursuant to *Forman*, securities law shouldn't even apply. Nonetheless, when applying the *Howey* test to this case, it is clear the second and third factors cannot be met. The SEC cannot prove there is a common enterprise and tries to argue that XRP represents the investment contract because it embodies all of Ripple's efforts. ECF 153 at 24. The SEC cannot satisfy the *Howey* test with such sweeping allegations that implicate XRP purchasers who had no knowledge of Ripple, who purchased XRP on the secondary market, and who developed use cases independent of Ripple's efforts.

A. There is no common enterprise here

The second factor of the *Howey* test is whether a common enterprise existed. Ripple's vision of XRP utility involved improvements to the banking infrastructure and the financial system. ECF 46 ¶¶ 67, 243, 266, 358, 362. STB, on the other hand, is a peer-to-peer payment platform that is actually fulfilling the original goal of Bitcoin by creating a platform for instant Peer-to-Peer transactions. *See generally* "Bitcoin: A Peer-to-Peer Electronic Cash System" *Bitcoin.org*, https://bitcoin.org/bitcoin.pdf. While the CEO of Ripple, Brad Garlinghouse has taken the position that you can't buy coffee with XRP (ECF 640 at 43, 57), STB is designed to facilitate such purchases. This alone illustrates the exact opposite of a common enterprise.

STB is not in any sort of common enterprise with Ripple or its executives. Kambo Aff. ¶ 34. The STB app is well suited to facilitate payments in Bitcoin to bricks-and-mortar and online merchants because transactions are confirmed quickly, securely, and efficiently, unlike the current case with the Bitcoin blockchain, where transactions are slow to process and inefficient resulting in significant pain points of volatility, settlement time, and payment finality for retail merchants. Kambo Aff. ¶ 23. The SEC alleges that the "fortunes of XRP purchasers are…dependent on the success of Ripple's XRP strategy," (ECF 46 ¶ 291), but STB is a perfect example of a different strategy that adds value to XRP independent of Ripple's vision. In order for a common enterprise to be exist, "the fortunes of each investor depend upon the profitability of the enterprise as a whole." *Revak v. SEC Realty Corp.*, 18 F. Supp. 3d 81, 87 (2d Cir. 1994). If Ripple were to fail and cease to exist, STB would continue its business operations, unhindered, in Canada, El Salvador, and anywhere Bitcoin adoption progresses. The fortunes of Jay Kambo and STB depend on two things: Bitcoin adoption and the efforts of STB, not Ripple.

B. There is no expectation of profits from Ripple's efforts

The SEC has fought to keep XRP purchasers, users, and developers from sharing their perspective, knowledge and/or use cases in this Court. ECF 153, 189, 556, 657. This is likely because such truth destroys its assertions that users and developers independent of Ripple don't have the ability or resources to grow the XRP ecosystem; that they can't develop a use for the token without Ripple's support. ECF 46 ¶¶ 285-86.

When STB began building its app on the XRPL, it was unaware of Ripple and its executives. Kambo Aff. ¶ 30. It was completely funded by using the personal company founder funds and never received any incentives, XRP or compensation of any kind from Ripple. Kambo Aff. ¶ 31. STB created and developed its app on the XRPL without any effort of Ripple or its executives.

At present, the focus for STB is bridging the Bitcoin layer one mainnet using the transactional properties of the XRPL. Kambo Aff. ¶ 7. STB as an application allows user onboarding without requiring the use of any particular currency, although at present STB only facilitates Bitcoin payments. Once the user account creation process is completed the user funds their STB Bitcoin provided wallet with Bitcoin from another wallet on the Bitcoin blockchain. Kambo Aff. ¶ 8. STB utilizes a third-party gateway, Bitgo, as a Bitcoin custodian for all deposits and withdrawals of Bitcoin using BitGo's Application Programming Interface (API). Kambo Aff. ¶ 9. BitGo, Inc. is a digital asset trust, custodial, and security company headquartered in Palo Alto, California. Kambo Aff. ¶ 9. None of this involves any efforts of Ripple or its executives.

STB queries secondary market exchanges to determine the exchange rate between Bitcoin and XRP. Using the exchange rate an amount of Bitcoin equivalent to 10 XRP is deducted from the users STB Bitcoin wallet in order to activate the XRPL wallet and allow for ledger fees. Kambo Aff. ¶ 10-12. STB then creates an equivalent amount of Bitcoin IOUs on the XRPL using the remaining Bitcoin in the user's STB Bitcoin wallet. These IOUs have a legal obligation for redemptions with the third-party custodian, BitGo, Inc. None of this involves any efforts of Ripple or its executives. This obligation is also true for STB to STB wallet transfers. For example, a user can transfer 1 BTC worth of value from their STB wallet to another user's STB wallet using the XRPL, and ultimately if desired, redeem with the BitGo, Inc. gateway. Once the user has BTC in the wallet, each transaction is facilitated using STB, and by extension, the XRPL burns a fraction of XRP as a fee mandated by the security algorithm inherent to the XRPL decentralized network. Kambo Aff. ¶ 13-15. None of this involves any effort of Ripple or its executives.

The settlement time for the Bitcoin Layer 1 blockchain is approximately 1 hour, which lends itself to significant volatility. The core competitive advantage of STB in the payments space is the ability to make payments in Bitcoin equivalent IOUs within 3 - 5 seconds, eliminating the majority of the volatility risk. Final settlement of an equivalent amount of Bitcoin is facilitated by the third-party gateway, BitGo, Inc., at the time of withdrawal from their STB account back to the user's personal Bitcoin Layer 1 wallet. Kambo Aff. ¶ 16. None of this involves any effort of Ripple or its executives. In fact, if STB were to scale, it could, in theory, become a competitor to Ripple's ODL system that also runs on the XRPL.

III. Decentralized blockchain technology is not a security

The XRPL is a decentralized public blockchain that is maintained by "a diverse set of software engineers, server operators, users and businesses." "How The XRP Ledger Works" *XRPL.org*, https://xrpl.org/xrp-ledger-overview.html. Not Ripple. STB and others like it, have independently developed applications on the XRPL without the knowledge, consent or efforts of Ripple or its executives. Those applications utilize XRP as the native token of the XRPL, disproving the SEC's contention that speculative investment is the main reason anyone would purchase XRP. See ECF 46 ¶ 353. STB purchased XRP from a third party to create an application on the XRPL (Kambo Aff. ¶ 5) in order to solve a problem related to Bitcoin transfers. "It is well established that Bitcoin is not considered a security" (*S.E.C. v. Telegram Group*, 448 F. Supp. 3d 352, 358 (S.D.N.Y. 2020)) but the SEC wants this Court to rule that technology used to transfer it, is. America is supposed to be a land of opportunity, a place of innovation and a country for the people but it seems through its efforts to persecute Ripple, the SEC has done more to restrict opportunity, hinder innovation and harm the very people it alleges to serve; the impact of which is felt well beyond the American border.

CONCLUSION

For the foregoing reasons, STB respectfully requests this Court grant Defendants' Motion for Summary Judgement.

Dated: Brooklyn, New York
October 21, 2022

ALISME LAW LLC

By: /s/ Joam Alisme
Joam Alisme (JA 5431705)
300 Cadman Plaza W, 12th Fl
Brooklyn, New York 11201
(917) 970-1212
joam@alismelaw.com

Attorney for Amicus Curiae SpendTheBits, Inc.

EXHIBIT 14

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, *Plaintiff*, - against - RIPPLE LABS INC., BRADLEY GARLINGHOUSE, and CHRISTIAN A. LARSEN, *Defendants*.	20 Civ. 10832 (AT) (SN)

AMICUS CURIAE BRIEF OF COINBASE, INC.
<u>IN SUPPORT OF THE DEFENDANTS' FAIR NOTICE DEFENSE</u>

CAHILL GORDON & REINDEL LLP
Nola B. Heller
Samson A. Enzer

32 Old Slip
New York, New York 10005
(212) 701-3000
nheller@cahill.com
senzer@cahill.com

Attorneys for *Amicus Curiae* Coinbase, Inc.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes

Other Authorities

INTERESTS OF *AMICUS CURIAE*[1]

Coinbase, Inc. ("Coinbase") was founded in 2012 with the radical idea that anyone, anywhere, should be able to easily and securely send and receive Bitcoin, the first cryptocurrency. Coinbase has since built a trusted online trading platform for buying, selling, and storing Bitcoin and many other digital assets through an intuitive user experience. Coinbase is the largest cryptocurrency trading platform in the United States by trading volume, and its parent company, Coinbase Global, Inc., is the only publicly traded U.S. company with a suite of businesses offering end-to-end financial infrastructure and technology for cryptocurrency transactions. As of last reporting, Coinbase's trading platform enables approximately nine million monthly transacting retail users, 14,500 institutions, and 245,000 ecosystem partners to participate in the rapidly evolving cryptoeconomy, with some $96 billion in assets on its platform and $217 billion in quarterly trading volume.

Coinbase strives to be the most trusted cryptocurrency trading platform in the world. To deliver on this objective, Coinbase seeks to foster common sense regulatory oversight and full compliance with the law. For example, Coinbase was among the first entities to obtain a BitLicense from the New York Department of Financial Services in 2017, it is registered with the Financial Crimes Enforcement Network, and it maintains some form of licensure in nearly every state in America. Because cryptocurrency is new to many regulators, Coinbase has also sought to play a supporting role in the development of pragmatic regulations for the cryptocurrency industry, including by publishing a proposed regulatory framework for digital assets, and petitioning the SEC to engage in notice-and-comment rulemaking for digital asset securities.[2]

---

[1] No person other than *amicus* or its counsel authored this brief in whole or in part, or made any monetary contribution intended to fund the preparation or submission of this brief.

[2] *See* Coinbase, *Digital Asset Proposal: Safeguarding America's Financial Leadership* (Oct. 24, 2021)

For the reasons explained in that petition, existing securities laws have failed to keep pace with the rapidly evolving digital asset ecosystem and the ways in which digital asset securities are offered, sold, traded, custodied, and cleared.[3] As a result, Coinbase and virtually all other U.S. cryptocurrency trading platforms do not facilitate trading in digital assets that qualify as "securities" under current law, but many would consider doing so once new rules are in place governing transactions in digital asset securities.[4] Rather than engage in rulemaking, the current SEC administration has sought to expand the SEC's jurisdiction over the cryptocurrency industry through ad hoc enforcement actions alleging on a retrospective basis that already-trading digital assets — previously understood by the market to be commodities regulated by the Commodity Futures Trading Commission ("CFTC") or other non-securities — are actually securities subject to SEC regulation. To manage the uncertainty created by this approach, Coinbase and many other U.S. market participants trying in good faith to comply with existing legal restrictions engage in a burdensome asset-by-asset analysis to determine whether each asset is sufficiently unlikely to be considered a security.

The due process issues raised in this SEC enforcement action — in which the SEC publicly alleged for the first time through litigation that digital "XRP" tokens sold by Ripple Labs and two Ripple officials (collectively, "Ripple") were offered as unregistered securities in violation of the 1933 Securities Act — should be rare but will only multiply in the absence of SEC rulemaking for

available at https://www.coinbase.com/blog/digital-asset-policy-proposal-safeguarding-americas-financial-leadership; Coinbase, *Petition for Rulemaking — Digital Asset Securities Regulation* (July 21, 2022) *available at* https://www.sec.gov/rules/petitions/2022/petn4-789.pdf. Whenever sources are quoted or cited throughout this submission, internal quotation marks, citations, and brackets are omitted unless otherwise noted.

[3] *See* Coinbase, *Petition for Rulemaking*.

[4] *See id.*

digital assets. The absence of formal rulemaking has led to unexpected enforcement actions like this one that create market uncertainty and profoundly disadvantage U.S. trading platforms like Coinbase as they compete with offshore platforms in jurisdictions where there is no risk of regulatory enforcement surprise.

The absence of notice-and-comment rulemaking by the SEC to address these issues underscores the constitutional need for a robust fair notice defense. The fair notice defense that Ripple has asserted in response to the SEC's charges in this case provides a safeguard against improper government enforcement actions in the digital asset space, as due process requires. Accordingly, Coinbase respectfully urges the Court to deny the SEC's motion asking the Court to summarily dismiss Ripple's fair notice defense before any trial.

PRELIMINARY STATEMENT

One of the fundamental due process protections guaranteed by our Constitution is that government agencies cannot condemn conduct as a violation of law without providing fair notice that the conduct is illegal. By suing sellers of XRP tokens after making public statements signaling that those transactions were lawful, the SEC has lost sight of this bedrock principle.

For years after Bitcoin, Ether, and XRP were launched, the SEC watched as multi-billion-dollar trading markets for these cryptocurrencies developed without stating that it viewed any of these assets as "securities" subject to the onerous restrictions that come with that classification. In 2018, after XRP had become the world's third-largest cryptocurrency behind Bitcoin and Ether, William Hinman, the SEC's then-Director of Corporation Finance, signaled in a speech that fully functional, mature cryptocurrencies including Bitcoin and Ether were not securities. After Director Hinman's speech, and additional SEC guidance reaffirming its core message, multiple sophisticated market actors — including a former CFTC Chair — understood the SEC to be saying that the SEC would not treat many long-traded digital assets (including XRP) as securities.

Coinbase shared this market-wide understanding and listed XRP for nearly two years of trading activity from February 2019 through January 2021.

Without prior public warning, the SEC in December 2020 filed this action alleging for the first time that XRP was a "security" that Ripple had been selling for years in violation of the Securities Act. This allegation alone caused immediate collateral harms to market participants, including to platforms like Coinbase and their retail customers. For example, the SEC's allegation led multiple U.S. platforms to delist and halt trading in XRP shortly after this lawsuit was filed, resulting in a $15 billion decline in XRP's market value and significant losses to Coinbase's customers.

Enforcement actions should not be the primary means by which the SEC makes known what it considers to be illegal. This is particularly true when it comes to regulating emerging U.S. industries, like the cryptocurrency sector, which can be driven overseas by unexpected enforcement litigation, leaving customers without protection. Coinbase and other U.S. cryptocurrency companies that are committed to compliance are particularly vulnerable to these dynamics. That is one of the reasons why earlier this year Coinbase formally petitioned the SEC to engage in rulemaking for the U.S. digital asset industry. It is also why one of the SEC's own Commissioners, Hester Peirce, has criticized the SEC's refusal to engage in rulemaking for cryptocurrency "despite many pleas over many years, to provide regulatory guidance about how our rules apply to crypto-assets," and lamented that the SEC has instead chosen to come onto the scene "with our enforcement guns blazing" in a manner that risks chilling innovation and investment in American cryptocurrency ventures.[5]

[5] *See* Commissioner Hester M. Peirce, *Response to Staff Accounting Bulletin No. 121* (Mar. 31, 2022) *available at* https://www.sec.gov/news/statement/peirce-response-sab-121-033122; Commissioner Hester M. Peirce, *In The Matter of Poloniex, LLC* (Aug. 9, 2021) *available at* https://www.sec.gov/news/public-

The fair notice defense invoked by Ripple provides a constitutionally required check against such overreach of government enforcement powers. As the Supreme Court has stated, the fair notice doctrine is intended to ensure that regulated parties "know what is required of them so they may act accordingly," and furnish precision and guidance "so that those enforcing the law do not act in an arbitrary or discriminatory way." *FCC* v. *Fox Television Stations, Inc.*, 567 U.S. 239, 253-54 (2012).

Given the absence of SEC rulemaking for the cryptocurrency industry, the question of whether the SEC has given fair notice before bringing an enforcement action against sales of one of the thousands of unique digital assets will often be highly fact-intensive, which makes it particularly ill-suited for adjudication on summary judgment. That is especially so here, as the widespread XRP trading in the United States prior to the SEC's enforcement action raises substantial questions of fact about whether the SEC gave fair notice of the position it first took in this litigation. Summarily dismissing those questions before trial would not only be unfair to Ripple, but would undermine the viability of the fair notice defense as a due process protection against government overreach. That protection is particularly important in cases like this one, where the government seeks to penalize conduct based on a statute that purports to impose strict liability without prior notice that the government views the conduct as illegal.

In order to ensure the existing due process precedents on which the fair notice defense rests continue to safeguard against improper regulatory enforcement when needed, the Court should deny the SEC's motion for summary judgment on this issue.

---

statement/pierce-statement-poloniex-080921.

BACKGROUND

A. Digital Assets Are Now A Mainstream Part Of Financial Markets

Bitcoin, Ether, stablecoins, and other cryptocurrencies are now a mainstream part of the financial market ecosystem in the United States and abroad. Hundreds of millions of people globally, including tens of millions in the United States alone, have purchased cryptocurrency assets, which reached a market capitalization of $3 trillion globally last November.[6] Digital assets and the blockchain technologies underlying them have accelerated the democratization of finance that began with mobile payments. For the billions of "unbanked" adults across the globe without access to bank accounts or services, the blockchain-powered evolution of peer-to-peer marketplaces has the potential to resolve deep inequities. Moreover, the demand for digital assets has inspired financial services innovations for Americans, including the development of trading platforms that give traders the ability to execute transactions 24 hours a day, seven days a week with faster transaction settlement times and fewer intermediaries and associated transaction costs.

B. The 1930s Securities Laws Were Not Drafted With Crypto In Mind

Despite the well-recognized growth and rapidly evolving practices in the digital asset ecosystem in the 13 years since Bitcoin first launched in 2009, the SEC has yet to propose new rules governing the cryptocurrency market. In the absence of modern regulations tailored to digital assets, market participants must look to the 1930s-era securities laws that were passed generations before the invention of the computer, the internet, and cryptocurrency. Not surprisingly, many digital assets do not fit within any of the categories of financial instruments recognized as

---

[6] *See* President Joseph R. Biden Jr., *Executive Order on Ensuring Responsible Development of Digital Assets* (Mar. 9, 2022) *available at* https://www.whitehouse.gov/briefing-room/presidential-actions/2022/03/09/executive-order-on-ensuring-responsible-development-of-digital-assets/.

"securities" under the 1933 Securities Act, the 1934 Securities Exchange Act, or the securities regulations that the SEC has promulgated pursuant to those statutes.

In the Securities Act and Exchange Act, Congress explicitly authorized the SEC to regulate an enumerated list of assets that qualify as "securit[ies]" such as "stock[s]," "bond[s]," "debenture[s]," and other familiar investment vehicles. *See* 15 U.S.C. §§ 77b(a)(1), 78c(a)(10). Cryptocurrency, which did not exist when those laws were passed, is absent from the list. To assert enforcement jurisdiction over the cryptocurrency industry, the SEC has shoehorned offers and sales of cryptocurrency into a single ambiguous term on the list — namely, "investment contract" (*see id.*) — which the SEC has treated as though it were a catch-all for virtually any financial transactions that the SEC wishes to regulate.

Congress has passed no law and the SEC has adopted no regulation saying that digital assets are "investment contracts" and thus "securities" subject to SEC oversight. Under U.S. law as it currently stands, one has to look to a test handed down 76 years ago by the Supreme Court in *SEC* v. *W.J. Howey Co.*, 328 U.S. 293 (1946) to determine whether a particular transaction constitutes an "investment contract" under federal securities law. The *Howey* Court interpreted "investment contract" to mean an "investment of money in a common enterprise with a reasonable expectation of profits to be derived from the efforts of others" in holding that an offering of orange-grove interests and related contracts were "investment contracts, as so defined." *See id.* at 298-300.

Instead of proposing rules notifying the cryptocurrency industry as to which digital assets qualify as "securities" subject to SEC oversight, the SEC has obliquely said "that the U.S. federal securities law may apply to various activities, including distributed ledger technology, depending on the particular facts and circumstances,"[7] and that "issuers and other persons and entities engaged in the marketing, offer, sale, resale or distribution of any digital asset will need to analyze the relevant transactions" under the "so-called *Howey* test" to "determine if the federal securities laws apply."[8]

This is not a realistic approach to regulating a technologically new industry and asset class. The fact-specific nature of any *Howey* analysis means that some digital asset transactions may reflect investment contracts, while others do not. In the absence of formal rulemaking from the SEC, determining whether a particular digital asset transaction qualifies as a security under *Howey* currently requires an expensive and labor-intensive analysis that cannot be systematically extrapolated to other digital assets or transactions. The end result is extraordinarily costly to U.S. innovation in this new industry. American innovators must undertake the substantial legal costs needed to proceed in good faith while still risking significant surprise enforcement actions years later.

C. The SEC Has Failed To Provide Adequate Guidance For The Crypto Market

As SEC Commissioner Peirce has stated, "the Commission has refused, despite many pleas over many years, to provide regulatory guidance about how our rules apply to crypto-assets, so some of the responsibility for the lack of legal and regulatory clarity lies at our doorstep."[9]

---

[7] *See* SEC, *Report of Investigation Pursuant to Section 21(a) of the Sec. Exch. Act of 1934: The DAO* (July 25, 2017) ("DAO Report") *available at* https://www.sec.gov/litigation/investreport/34-81207.pdf.

[8] *See* SEC, *Framework for 'Investment Contract' Analysis of Digital Assets* (Apr. 3, 2019) ("SEC Framework") *available at* https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets.

[9] *See* Commissioner Hester M. Peirce, *Response to Staff Accounting Bulletin No. 121*.

Indeed, multiple stakeholders — from lawmakers to market participants — have requested that the SEC establish new rules to bring much-needed regulatory clarity to the digital assets markets. For example, Coinbase recently petitioned the SEC to propose and adopt rules to govern the regulation of securities that are offered and traded via digital means, including potential rules to identify which digital assets are securities.[10] Since then, more than 1,700 individuals signed and sent a form letter asking SEC Chair Gary Gensler to begin a notice-and-comment rulemaking process for digital asset securities.[11] The letter noted that without "smart crypto securities regulation," the United States will fall behind other markets because developers will be deterred from innovating, businesses and platforms will be uncertain about what they can launch without facing SEC litigation, consumers will be unsure whether products they invest in will be shut down, and many will go to offshore venues to transact in digital assets.[12] Moreover, Senator John Hickenlooper sent a letter to Chair Gensler this month "to urge the SEC to issue regulations for digital asset securities through a transparent notice-and-comment regulatory process" because "digital asset markets do not [currently] have a coordinated regulatory framework," which "creates uneven enforcement" and a host of other problems.[13]

---

[10] *See* Coinbase, *Petition for Rulemaking.*

[11] *See* S. Ho, "Industry Ratchets Up Pressure on SEC Asking For Crypto Regulation, But Gensler Says Clear Rules Already Exist," *Thomson Reuters* (Aug. 26, 2022) *available at* https://tax.thomsonreuters.com/news/industry-ratchets-up-pressure-on-sec-asking-for-crypto-regulation-but-gensler-says-clear-rules-already-exist/.

[12] *See* Letter Type A *available at* https://www.sec.gov/comments/4-789/4789-4789a.htm.

[13] *See* Senator J. Hickenlooper, Letter to Chair Gary Gensler (Oct. 13, 2022) *available at* https://www.hickenlooper.senate.gov/wp-content/uploads/2022/10/Sen.-Hickenlooper-Letter-to-Chair-Gensler-on-Digital-Asset-Regulation2.pdf.

To date, the SEC has not answered these calls. Although Bitcoin was launched in 2009, it was not until eight years later in 2017 that the SEC first offered any indication of how it thought the securities laws might apply to crypto assets. The SEC's sporadic, sometimes conflicting actions and statements since then have been described by SEC Commissioner Peirce as a "Jackson Pollock approach to splashing lots of factors on the canvas without a clear message" to the cryptocurrency market.[14]

Since 2017, virtually all of the SEC's enforcement actions and public reports concerning digital assets — including the SEC's July 2017 DAO Report, its August 2019 Digital Assets Framework, and various public statements by the SEC's then-Chair Jay Clayton in 2017 and 2018 — have focused on the legal theory that sales of digital tokens via initial coin offerings ("ICOs") to finance the development of *new* cryptocurrencies constitute securities offerings.[15]

Critically, at the same time that the SEC was warning about ICOs, it was also telling the public that well-established cryptocurrencies, including Bitcoin and Ether, were "no longer" securities (if they ever were) because they had become detached from any centralized enterprise, in contrast to ICOs used by entrepreneurs to raise capital for startup businesses.[16]

As Director Hinman explained in his 2018 speech, "[i]f the network on which the token or coin is to function is sufficiently decentralized — where purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts — the assets

---

[14] *See* Commissioner Hester M. Peirce, *How We Howey*, Securities Enforcement Forum (May 9, 2019) *available at* https://www.sec.gov/news/speech/peirce-how-we-howey-050919.

[15] *See* DAO Report.

[16] *See* Director William Hinman, *Digital Asset Transactions: When Howey Met Gary (Plastic)* (June 14, 2018) *available at* https://www.sec.gov/news/speech/speech-hinman-061418.

may not represent an investment contract."[17] Using Bitcoin and Ether as examples, Director Hinman stated that even if these popular cryptocurrencies initially could have been viewed as securities, they are no longer securities because the blockchain networks on which they function had become sufficiently decoupled from the efforts of any central enterprise, such that they no longer satisfied *Howey*'s requirement of a "central third party whose efforts are a defining factor in the enterprise."[18] This concept that a cryptocurrency's *Howey* classification may shift over time has been colloquially referred to as Director Hinman's "morphing" theory.[19]

Of course, Director Hinman's speech is not official SEC guidance nor rulemaking, but it remains on the SEC's website today, and his "morphing" theory has been reaffirmed by the SEC. For example, the SEC's 2019 Digital Asset Framework identified "some of the factors to be considered in determining whether and when a digital asset may *no longer* be a security."[20] Until Director Hinman's remarks are superseded by rulemaking, his guidance will rightly continue to loom large for the cryptocurrency industry and public.

D. This Enforcement Action Surprised And Harmed Crypto Market Participants

Because XRP was very similar to Bitcoin and Ether, and because XRP was the third-largest cryptocurrency behind Bitcoin and Ether by market capitalization, numerous stakeholders reasonably understood Director Hinman's speech to mean that the SEC viewed XRP to be outside of the SEC's regulatory purview. In 2020, for example, former CFTC Chair Christopher Giancarlo

---

[17] *Id.*

[18] *Id.*

[19] *See* R. Crea et al., "Metamorphosis: Digital Assets and the U.S. Securities Laws," *Harvard Law School Forum On Corporate Governance* (July 7, 2018) *available at* https://corpgov.law.harvard.edu/2018/07/07/metamorphosis-digital-assets-and-the-u-s-securities-laws/.

[20] *See* SEC Framework (emphasis added).

published an article relying on Director Hinman's analysis to conclude that XRP was not a security.[21] He explained that "XRP and the underlying XRP Ledger were designed in 2011 and 2012 specifically as a payment mechanism," and further stated:

> Consistent with statements from other SEC officials, director Hinman named bitcoin and ether as examples of cryptocurrencies that were, or had become, sufficiently decentralised networks such that regulating the tokens or coins that function on them as securities may not be required. If bitcoin and ether are sufficiently decentralised, the case for decentralisation of XRP is even stronger.[22]

In addition, the widespread market adoption of XRP speaks volumes about how the market understood the SEC's guidance. As this Court has noted, before the SEC filed this lawsuit in December 2020, "XRP was listed on over 200 exchanges, billions of dollars in XRP was bought and sold each month, numerous market-makers engaged in daily XRP transactions, Ripple's [On-Demand Liquidity] product was used by many customers, and XRP was used in third-party products, many of which were developed independently of Ripple." (Dkt. 440 at 4-5). It is implausible to think that all of these disparate actors would have done so if they believed, as the SEC now claims, that XRP sales were illegal.

When the SEC alleged for the first time that XRP was a security in its December 2020 complaint against Ripple, innumerable market participants worldwide were surprised and harmed. In the end, the constituents who suffered the most were retail customers, as evidenced by the fact that the SEC's announcement of this lawsuit triggered a $15 billion decline in XRP's market value.

This result could have been avoided if the SEC had engaged in the time-tested notice-and-comment rulemaking process under the Administrative Procedure Act to establish standards that

---

[21] *See* C. Giancarlo and C. Bahlke, "Cryptocurrencies and US Securities Laws: Beyond Bitcoin and Ether," *Int'l Fin. L. Rev.* (June 17, 2020).

[22] *Id.* (British spelling in original).

would have alerted the public that the SEC views XRP as a security. Indeed, the magnitude of the direct market impact of this action far exceeds the $1 billion threshold set by the Office of Management and Budget ("OMB") in its guidance to federal agencies on what constitutes a major rulemaking deserving of formal quantitative analysis of its benefits and costs.[23] The indirect market impact of creating this legal uncertainty is not fully quantifiable, but is likely far in excess of the $15 billion loss to retail customers. Yet, at the time this action was filed, the SEC failed to address the need for a regulatory framework for digital assets, nor has it done so since that time, instead choosing to regulate the industry through individual enforcement actions alone.

ARGUMENT

The fair notice doctrine is one of the few constitutionally recognized protections against the harms caused by unpredictable government enforcement actions. That safeguard is particularly important for the cryptocurrency industry, which the SEC has so far chosen to regulate through *ex post* enforcement actions rather than *ex ante* rulemaking. Summarily dismissing the fair notice defense before trial in this case, where there is substantial evidence that the SEC led the market to believe that the very conduct it now seeks to punish was allowed, would endanger the viability of the defense as a constitutional guardrail in future cases. Notice-and-comment rulemaking on topics such as which digital assets are securities is critical to provide regulatory certainty and foster American leadership in the global cryptoeconomy.

In the absence of such rulemaking, the fair notice defense takes on added significance as a constitutional barricade against unforeseeable enforcement actions by regulators, especially in cases like this one where regulators seek to impose strict liability on conduct without providing

---

[23] *See* OMB, The White House of President Barack Obama, *Circular A-4*: *Regulatory Analysis* (2003) *available at* https://obamawhitehouse.archives.gov/omb/circulars_a004_a-4/.

prior guidance that they view the conduct as illegal. As a prudential matter, the Court should allow the fair notice defense in this case to proceed to the trial phase to ensure that the existing due process precedents underpinning this vital constitutional protection remain valid.

I. Existing Due Process Precedents Prohibit Unforeseeable Enforcement Actions

Existing precedents furnish substantial support for Ripple's invocation of the fair notice defense. The Fifth Amendment to the Constitution prohibits federal government agencies such as the SEC from depriving anyone of "life, liberty, or property, without due process of law." U.S. Const. Amend. V. One of the fundamental principles of due process "in our legal system is that laws which regulate persons or entities must give fair notice of conduct that is forbidden or required." *Fox*, 567 U.S. at 253. "This requirement of clarity in regulation is essential to the protections provided by the Due Process Clause of the Fifth Amendment," and "requires the invalidation of laws that are impermissibly vague." *Id.* A statute or regulation violates due process if it "fails to provide a person of ordinary intelligence fair notice of what is prohibited, or is so standardless that it authorizes or encourages seriously discriminatory enforcement." *Id.*

As the Supreme Court has stated, when "an agency's announcement of its interpretation is preceded by a very lengthy period of conspicuous inaction, the potential for unfair surprise is acute." *Christopher* v. *SmithKline Beecham Corp.*, 567 U.S. 142, 158 (2012). Accordingly, the Supreme Court and Second Circuit have upheld fair notice defenses like Ripple's in circumstances, such as those presented here, where a regulator's change in enforcement policy created unfair surprise as to whether charged conduct violated the law.

For example, the Supreme Court in *FCC* v. *Fox Television Stations, Inc.* dismissed enforcement actions by the Federal Communications Commission ("FCC") alleging that Fox and ABC television stations violated a statute prohibiting the broadcasting of indecent material because the FCC failed to give Fox or ABC fair notice that fleeting obscenity could be found actionably indecent. 567 U.S. at 254. Prior to bringing those lawsuits, the FCC had a long-standing policy that distinguished between the repetitive occurrence of obscenity, which warranted indecency enforcement actions, versus isolated or occasional obscenity, which did not. *Id.* at 245-47. After the Fox and ABC broadcasts at issue, which involved fleeting obscenity, the FCC changed its enforcement policy and sued Fox and ABC for violating the indecency statute. *Id.* at 254. The Supreme Court held that the FCC's "lack of notice to Fox and ABC that its interpretation had changed" such that their conduct violated the statute "as interpreted and enforced by the agency failed to provide a person of ordinary intelligence fair notice of what is prohibited." *Id.*

The Second Circuit reached a similar result in *Upton* v. *SEC*, 75 F.3d 92 (2d Cir. 1996). There, the SEC sanctioned the CFO of a broker-dealer for failing to prevent his firm from engaging in an industry-standard practice that the SEC determined, without adequate prior notice, violated the SEC's customer protection rule. Before the charged conduct, the SEC had ordered public administrative proceedings against another brokerage firm and two of its managers for engaging in the same practice, and the CFO's firm was informally warned by a New York Stock Exchange examiner that the SEC might consider this practice to be illegal. *Id.* at 94-95. However, the SEC had otherwise given little indication to the public that it viewed the practice as problematic. *Id.* at 94-98. The Second Circuit vacated the SEC's decision to sanction the CFO because he "was not on reasonable notice that [his company's] conduct might violate" the relevant SEC rule, and because the SEC "may not sanction [the CFO] pursuant to a substantial change in its enforcement policy that was not reasonably communicated to the public." *Id.* at 98.

These cases, and others like them, stand for the proposition that government agencies cannot enforce legal prohibitions against conduct that their prior enforcement policies allowed absent fair notice. *See, e.g.*, *KPMG, LLC* v. *SEC*, 289 F.3d 109, 115-16 (D.C. Cir. 2002) (KPMG lacked fair notice of the SEC's novel interpretation of an accounting rule); *Trinity Broadcasting of Florida, Inc.* v. *FCC*, 211 F.3d 618, 629-30 (D.C. Cir. 2000) (Trinity lacked fair notice of the FCC's interpretation of a regulation in light of prior conflicting statements by the FCC, applications Trinity made that demonstrated its interpretation of the regulation, and the FCC's prior precedent of declining to enforce its regulation in this way); *accord NLRB* v. *Majestic Weaving Co.*, 355 F.2d 854, 860 (2d Cir. 1966) (criticizing "when a financial penalty is assessed for action that might well have been avoided if the agency's changed disposition had been earlier made known, or might even have been taken in express reliance on the standard previously established").

Bearing these precedents in mind, the SEC is not entitled to a summary judgment ruling that finds, as a matter of law, that there is no set of facts under which Ripple's fair notice defense could prevail at trial. As Ripple has argued, the mere fact that so many market participants believed that XRP sales were allowed raises substantial, disputed questions of fact about whether a person of ordinary intelligence would have understood the SEC's guidance to allow the very XRP sales that it is now seeking to punish. Based on that fact alone, a reasonable jury could answer that question — which is central to the disposition of Ripple's fair notice defense — in Ripple's favor. As a result, that question cannot be resolved on summary judgment papers. It must be tried.

More broadly, because there is substantial legal and factual support for Ripple's invocation of the fair notice defense in this case, summarily dismissing the defense on this record would jeopardize the validity of the defense in future cases.

II. SEC Rulemaking Is Essential To Account For New Technology In The Crypto Space

While the fair notice defense provides a vital constitutional backstop against unexpected SEC enforcement actions, it is not an adequate substitute for SEC rulemaking. Absent legislative reform, notice-and-comment rulemaking from the SEC that addresses the new technology presented by digital assets is the only way to provide the regulatory clarity needed for the United States to play a leadership role in this industry.

The United States has the opportunity to spearhead the responsible development of digital assets and related innovations across the globe. In order for this to occur, as President Biden recently acknowledged, "an evolution and alignment of the United States Government approach to digital assets" is needed,[24] particularly as to the regulation of digital asset securities. The United States does not currently have a functioning market in digital asset securities due to the lack of a clear and workable regulatory regime. Coinbase and many other U.S. trading platforms have tried in good faith to steer clear of listing digital assets that the SEC may deem to be securities to ensure that they operate in full compliance with existing laws. But new rules facilitating the use of digital asset securities would allow for a more efficient and effective allocation of capital in American financial markets and create new opportunities for American entrepreneurs and investors.

Foreign governments are already drafting and adopting regulations that meet the specific needs of cryptocurrency markets. For example, the European Union ("EU") recently agreed on the Markets in Crypto Assets ("MiCA") regulation first proposed in 2020, and countries and markets such as the United Kingdom, Switzerland, Hong Kong, Australia, Brazil, and Dubai have all taken important steps towards establishing or have already established cryptocurrency regulations.[25]

---

[24] *See* President Biden, *Executive Order on Ensuring Responsible Development of Digital Assets*.

[25] *See* EU Council, *Digital Finance: Agreement Reached on European Crypto-assets Regulation (MiCA)* (June 31, 2022); HM Treasury, *Government Sets Out Plan to Make UK a Global Cryptoasset Technology Hub* (Apr. 4, 2022); Swiss Federation, *Federal Act on the Adaptation of Federal Law to Developments in Distributed Electronic Ledger Technology* (Sept. 15, 2014); Hong Kong Legislative Council, *Anti Money Laundering and Counter-Terrorist Financing (Amendment) Bill* (June 24, 2022); Australian Treasury, *Crypto Asset Secondary Service Providers: Licensing and Custody Requirements (Consultation Paper)* (Mar. 21, 2022); Chamber of Deputies, Projeto de Lei Nº 4401, De 2021 (Aug. 21, 2021); Dubai Financial Services Authority, *Consultation Paper No. 143, Regulation of Crypto Tokens* (Mar. 8, 2022).

The SEC, however, has not taken any meaningful steps in this direction at all. Although there is now a multi-trillion dollar global market for trading in digital assets, the SEC has not yet opened a public dialogue, even informally, with digital asset market participants about the design of a practical regulatory framework, let alone proposed any new rules. Rather than initiate rulemaking, the SEC's current Chair, Gary Gensler, has made a variety of assertions through speeches and testimony that have introduced fear and uncertainty in cryptocurrency markets. But the ongoing informal suggestions that certain digital assets may be securities under some as-yet-undisclosed standard, coupled with erratic shifts in the SEC's enforcement priorities, has now created untenable uncertainty for the U.S. cryptocurrency industry and market participants.

Indeed, the SEC recently announced that its Enforcement Division's Crypto Assets and Cyber Unit would soon double in size.[26] Leading with enforcement actions before proposing rules results in arbitrary outcomes with limited value as guiding precedent. Ripple and others have been the subject of extensive enforcement scrutiny while others — with nearly identical products or services — have apparently been subject to none. This approach has led to both confusion and the uneven treatment of market participants. Regulators should not be picking winners and losers in the cryptocurrency industry. They should be setting the rules openly so all companies have a chance to follow them.

It is no answer to say that all digital assets should simply be registered with the SEC. Registration under current SEC rules is incompatible with the way that most digital assets function. For example, assets trading on securities exchanges must meet registration, disclosure, and listing requirements that are currently tailored to issuers of traditional debt and equity securities of public

[26] SEC, *SEC Nearly Doubles Size of Enforcement's Crypto Assets and Cyber Unit* (May 3, 2022) *available at* https://www.sec.gov/news/press-release/2022-78.

companies. But most digital assets trading on platforms like Coinbase do not represent ownership stakes in complicated public companies or pay returns to investors through dividends or interest. Traditional disclosures also do not cover features unique to digital assets that would be considered important to market participants, such as the supply and demand of cryptocurrency tokens, the risk of blockchain network attacks, what kind of governance rights are embedded in which tokens, who has the ability to change the code underlying the assets or network, and other features that do not exist with respect to stocks and other traditional securities. The disclosures that digital asset holders may need are materially different from those that public companies typically make. If current disclosure rules were applied, cryptocurrency market participants would be left with both incomplete and irrelevant information.

In addition, existing SEC registration requirements for national securities exchanges are currently unsuitable to the way digital asset platforms operate. A major innovation in digital asset markets has been to internalize the custodying, trade matching, execution, and settlement of digital assets within a single entity, thereby reducing the number of intermediaries and associated transaction costs imposed on customers — a meaningful and groundbreaking benefit. Existing SEC requirements, however, only allow broker-dealers to be members of registered securities exchanges, meaning that retail customers can only trade assets on exchanges indirectly by using the services of broker-dealers that charge transaction fees and add intermediation risks that could be avoided on digital asset trading platforms, again to the benefit of customers.

These hurdles risk driving investment and innovation in digital assets offshore, potentially to jurisdictions with fewer regulatory burdens and consumer safeguards. If this occurs, U.S.-based retail and institutional customers will continue to buy and sell digital assets, but will do so on unreliable overseas platforms, and no U.S. regulators will be able to protect them. Failure to resolve these shortcomings leaves American investors vulnerable due to a lack of regulatory clarity, prevents U.S. market participants from leveraging the efficiencies new technologies can offer, and materially impairs the use of U.S. markets to raise capital for the development of such innovations. Such results are wholly inconsistent with the SEC's mission.

As SEC Commissioner Peirce has stated, "Neither complex [SEC] staff guidance nor enforcement actions are a satisfactory way to guide people who are eager to comply with the law, but unsure how to do so."[27] Rather, "the right way to build a regulatory framework" for cryptocurrency is to use the authority that Congress has conferred on the SEC to engage in "notice-and-comment rulemaking."[28] Coinbase and many other market participants have petitioned the SEC to do so.

III. A Robust Fair Notice Defense Is Critical In The Absence Of Crypto Rulemaking

Until the SEC engages in rulemaking for cryptocurrency, the fair notice defense is a constitutionally required brace against arbitrary, surprise cryptocurrency enforcement actions. As the Supreme Court has made clear, the fair notice defense is intended to address "at least two connected but discrete due process concerns: first, that regulated parties should know what is required of them so they may act accordingly; second, precision and guidance are necessary so that those enforcing the law do not act in an arbitrary or discriminatory way." *Fox*, 567 U.S. at 253-54. Both concerns are implicated by the SEC's pattern of prioritizing enforcement over rulemaking when it comes to regulating cryptocurrency. Absent notice-and-comment rulemaking

---

[27] Commissioner Hester M. Peirce, *Paper, Plastic, Peer-to-Peer* (Mar. 15, 2021) *available at* https://www.sec.gov/news/speech/peirce-paper-plastic-peer-to-peer-031521.

[28] Commissioner Hester M. Peirce, *On the Spot: Remarks at "Regulatory Transparency Project Conference on Regulating the New Crypto Ecosystem: Necessary Regulation or Crippling Future Innovation?"* (June 14, 2022) *available at* https://www.sec.gov/news/speech/peirce-remarks-regulatory-transparency-project-conference.

to address the collateral harms caused by unexpected enforcement actions, the fair notice defense is a critical deterrent against the SEC's current enforcement-centric approach to digital assets. Therefore, the lack of notice-and-comment rulemaking should be weighed heavily by courts considering a fair notice defense, especially in cases like this one where the SEC seeks to impose strict liability on conduct that it previously signaled was lawful.

Coinbase remains hopeful that the SEC will seize the opportunity to engage with public stakeholders to fashion pragmatic cryptocurrency regulations. But in the absence of such regulations, requiring the SEC to give fair notice of what conduct in the cryptocurrency industry it views as illegal before suing remains a fundamental due process check. Preventing Ripple's fair notice defense from even being heard at trial will not only undermine Ripple's ability to avail itself of a defense afforded by the basic tenets of due process, but will also give the SEC no incentive to engage in the rulemaking work the cryptocurrency industry and its customers need.

CONCLUSION

For the foregoing reasons, the Court should deny the SEC's motion for summary judgment dismissing Ripple's fair notice defense.

Dated: October 31, 2022
New York, New York

CAHILL GORDON & REINDEL LLP

By: /s/ Nola B. Heller

Nola B. Heller
Samson A. Enzer

32 Old Slip
New York, New York 10005
(212) 701-3000
nheller@cahill.com
senzer@cahill.com

Attorneys for *Amicus Curiae* Coinbase, Inc.

EXHIBIT 15

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

-against-

RIPPLE LABS, INC., BRADLEY GARLINGHOUSE, and CHRISTIAN A. LARSEN,

Defendants.

Case No. 20-cv-10832 (AT) (SN)

BRIEF OF *AMICUS CURIAE* THE BLOCKCHAIN ASSOCIATION

Jason Gottlieb
Michael Mix
Daniel C. Isaacs
MORRISON COHEN LLP
909 Third Avenue
New York, New York 10022
Telephone: (212) 735-8600
Facsimile: (212) 735-8708

Attorneys for Amicus Curiae
The Blockchain Association

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

OTHER AUTHORITIES

INTERESTS OF *AMICUS CURIAE*

The Blockchain Association (the "Association") is a membership organization of industry leaders advocating for the innovation and collaboration necessary to support American leadership of the blockchain industry. The Association advocates for a public policy environment to help blockchain networks thrive in the United States. The Association accomplishes this goal by educating key constituencies about how blockchain technology can bring about a more secure, private, and competitive digital marketplace in the United States. It also advocates for regulatory clarity so that the United States can be the leader in blockchain innovation. It further coordinates with industry, government, and aligned groups to amplify the Association's message and effect meaningful change. The Association's nearly one hundred members range from blockchain projects to early stage investors, exchange platforms, and other infrastructure providers.[1]

The Association is keenly interested in major litigation regarding blockchain issues, because in this nascent area, overly broad court rulings could negatively affect the entire blockchain industry in entirely unanticipated and unintended ways. The Association, as a leader in the blockchain industry, has a significant interest in this litigation: a ruling that does not account for the many different types of blockchain technologies and industry uses, in ways that make material differences in legal outcomes, could deleteriously affect the Association and its members.

INTRODUCTION AND SUMMARY OF ARGUMENT

Statements made by the Securities and Exchange Commission (the "SEC") in this case and others illustrate that it views the United States securities laws, and in particular the registration provisions, as applying beyond the initial "investment contract" between the issuer of a blockchain product and its primary purchasers. In other words, even if an initial token issuance qualified as an investment contract, and thus had to be registered (or qualify for an exemption) under Section

[1] This *amicus* brief reflects the views of the Association, but does not reflect the views of any individual member of the Association. While Ripple Labs, Inc. ("Ripple") is a member of the Association, it did not contribute to or participate in the preparation of this brief.

5 of the Securities Act of 1933, the SEC seems to believe that that token remains a “security” through further, downstream transactions, no matter what rights the initial purchaser kept for themselves (vis- -vis the seller) before selling the token downstream, why the downstream user purchases that token, or how that token is used. Indeed, the SEC Chair Gary Gensler recently opined, without significant explanation, that the “vast majority” of tokens are securities.[2]

Put simply, that view should not be – cannot be – the law. A token is a piece of software. There is no doubt that anything, even software, can be issued as part of an investment contract. There is also no doubt that the software itself, transferred without any legal rights at all, is not that investment contract.

The SEC’s extremely broad interpretation of the securities laws would have devastating effects on the industry (and even outside the industry). Market participants acquire tokens in many different ways, and use them for many different purposes. Many of those methods or uses have nothing to do with primary sales or distributions of tokens, such as payment for goods and services, conveyance of intellectual property rights, inventory tracking and other “back office” functions, or for a specific purpose in a given blockchain project.

In fact, numerous other examples from the industry demonstrate how tokens are used in practice, outside the ambit of anything that could possibly be considered an investment contract.

---

[2] *See* Gary Gensler, Chairman, *Securities and Exchange Comm’n, Statement on Financial Stability Oversight Council’s Report on Digital Asset Financial Stability Risks and Regulation Before the Financial Stability Oversight Council Open Meeting* (Oct. 3, 2022), *available at* https://www.sec.gov/news/speech/gensler-statement-fsoc-meeting-100322 (“Of the nearly 10,000 tokens in the crypto market, I believe the vast majority are securities”); *see also* Gary Gensler, Chairman, *Securities and Exchange Comm’n, Prepared Remarks of Gary Gensler on Crypto Markets, Penn Law Capital Markets Association Annual Conference* (April 4, 2022), *available at* https://www.sec.gov/news/speech/gensler-remarks-crypto-markets-040422 (“many of the tokens trading on these platforms may well meet the definition of securities’”); Gary Gensler, Chairman, *Securities and Exchange Comm’n, Remarks Before The Aspen Security Forum* (Aug. 3, 2021), *available at* https://www.sec.gov/news/speech/gensler-aspen-security-forum-2021-08-03 (“I believe we have a crypto market now where many tokens may be unregistered securities”).

Indeed, much of the industry focuses on building digital networks that utilize tokens that are not designed or intended to qualify as securities. Applying the securities laws to those tokens – whether or not through the prism of the *Howey* test – would significantly restrict those networks from functioning. In this case, a ruling not narrowly tailored to the particular facts at issue could create havoc across a wide array of individuals and entities in the blockchain space.

Additionally, the SEC's draconian view that a token initially sold in an investment contract continues to be inextricably linked with that investment contract when it is subsequently transferred – even when any legal rights between the issuer and the initial purchaser are not transferred with the token – would destroy nearly an entire industry. Numerous tokens would not be able to function for their intended purpose, or at all.

Market participants across the industry already struggle to see through the fog as to how securities laws apply to digital assets due to the SEC's pattern of "regulation by enforcement," and its history of inconsistent, incomplete, and confusing public statements. Here, for instance, the SEC asserts that any market participant of ordinary intelligence should not only understand that XRP was originally issued as part of an investment contract, but that XRP itself, in its current incarnation in a secondary market, is a security. The SEC's position that market participants can simply follow the securities laws falls flat, because the securities laws do not contemplate how an asset that may have been issued as a security can exist when it is no longer attached to any form of investment contract, a crucial consideration when attempting to apply *Howey*.

The SEC's apparent response to these concerns – relegated to a footnote in its 75-page opposition brief, and (to our knowledge) not previously stated in any formal rule or guidance – is that the industry need not worry about secondary market transactions in tokens, because an initial token seller like Ripple should register its token as a security, and transactions between two public investors not involving affiliates, dealers, or underwriters are exempt from registration requirements, "despite such transactions involving securities." This answer cannot suffice. Registration is not "just" registration. It necessitates following the securities laws and regulations for buying, selling, brokering, dealing, custodying, trading, and exchanging. And those regulations were not designed to, and do not, address a significant portion of how industry participants use tokens.

Finally, the SEC disregards clear Supreme Court and Second Circuit precedent instructing that securities transactions that take place abroad are beyond the jurisdictional reach of the SEC. Though the blockchain industry is global in nature, the federal securities laws are not. The Second Circuit has repeatedly re-emphasized the Supreme Court's lesson on this subject. Accordingly, both for liability and (if necessary) damages purposes, this Court should be mindful of the limits of the securities laws. Even if XRP (or any particular token) were found to be a security, this Court should properly cabin any findings to "territorial" transactions, and exempt transactions where the SEC has not sustained its burden to prove territoriality.

ARGUMENT

I. THE COURT SHOULD CONSIDER A TOKEN'S PARTICULAR USE OR PURPOSE

Tokens can be designed or used in virtually any way that a piece of software can be programmed to be used. The possibilities are limitless.

The Association's members, counterparties, business partners, or customers acquire tokens in many different ways. Some participants may acquire tokens directly from a blockchain project, whether or not initially sold as part of an "investment contract." But those participants are just one part of the market. Other market participants acquire tokens in other ways. Some purchase tokens through a digital asset exchange like Coinbase, Kraken, Binance, FTX, or many others, or buy tokens directly from another party in a peer-to-peer transaction. Some acquire (or borrow) tokens from "liquidity pools," with no particular counterparty at all, such as in a decentralized finance protocol. Some acquire tokens by performing some service for a blockchain project, such as writing software, coding back-end processes or user interfaces, creating design work, or discovering bugs. Some acquire tokens through a giveaway to jump-start a network, where there is no investment of money, time, effort, or anything else. Some receive tokens as a gift, either welcome, or even uninvited, such as where an individual sends tokens to another's wallet out of the blue. Some acquire tokens through "play-to-earn" models, where they receive tokens for achieving certain success in online games. This list is not nearly exhaustive.

Once a person has acquired a token, that token can be used in just as many different ways. Certainly, some use it as they would any asset, attempting to profit from the appreciation in value of a given token, through sales, lending, or borrowing – and, depending on the project, those profits might or might not depend on the efforts of the initial issuers. Some people use tokens as a currency or a payment method. In the SEC's memorandum of law in support of its motion for summary judgment, ECF No. 640 (the "SEC Moving Brief" or the "SEC Moving Br."), the SEC quotes Mr. Garlinghouse saying, "I can't buy coffee with XRP." SEC Moving Br. at 43. But that quote is from 2018, and cryptocurrency has changed dramatically since then. Many companies – including Google,[3] AMC,[4] Subway,[5] and yes, even coffee purveyor Starbucks[6] – accept cryptocurrency as payment for goods and services. Likewise, PayPal permits users to transfer

---

[3] Oliver Knight, *Google Partners With Coinbase to Accept Crypto Payments for Cloud Services*, Yahoo Finance (Oct. 11, 2022), https://ca.finance.yahoo.com/news/google-partners-coinbase-accept-crypto-121803385.html.

[4] Chris Katje, *AMC To Accept Bitcoin and Crypto For Payment, Are NFT Commemorative Tickets Next?*, Yahoo Finance (Sept. 19, 2021), https://finance.yahoo.com/news/amc-accept-bitcoin-crypto-payment-205509000.html.

[5] Andrew Torba, *I Bought Subway With Bitcoin and It Was Awesome*, Coindesk (Nov. 22, 2013), https://www.coindesk.com/business/2013/11/22/i-bought-subway-with-bitcoin-and-it-was-awesome/.

[6] Samyuktha Sriram, *Customers Can Reload Starbucks Card With Bitcoin and Ethereum As Coffeehouse Explores 'Tokenizing Stars,'* Yahoo Finance (Nov. 11, 2021), https://finance.yahoo.com/news/customers-reload-starbucks-card-bitcoin-154130368.html.

cryptocurrency to other users, including to pay for goods and services.[7] Others use cryptocurrency ATMs to transfer their tokens into cash for immediate use to pay for goods and services. Recently, the venerable financial institution BNY Mellon announced that it would accept cryptocurrency deposits from retail users, just like it accepts fiat currency.[8]

Some tokens are used in a particular implementation in a blockchain-based infrastructure. Such tokens can be used, *inter alia*, to pay (or receive discounts on) transaction fees;[9] to serve as a "receipt" for liquidity provided to a liquidity pool;[10] as a payment for transferring data across a blockchain-based network for internet-connected devices that uses nodes as hotspots to connect wireless devices to the network;[11] to allow users access to decentralized online cloud storage;[12] to attain access to specific features in games;[13] to purchase in-game items;[14] and many more. These tokens may or may not have been originally issued as part of an investment contract, but they can have many kinds of consumptive uses outside that initial issuance (and lack any or all of the rights that were transferred as part of the initial investment contract).

---

[7] *PayPal Users Can Now Transfer, Send, and Receive Bitcoin, Ethereum, Bitcoin Cash, and Litecoin*, Paypal (Aug. 12, 2022), https://newsroom.paypal-corp.com/2022-06-07-PayPal-Users-Can-Now-Transfer-Send-and-Receive-Bitcoin-Ethereum-Bitcoin-Cash-and-Litecoin.

[8] Mehnaz Yasmin and Saeed Azhar, *BNY Mellon to offer crypto services in digital asset push*, Yahoo Finance (Oct. 11, 2022), https://finance.yahoo.com/news/bny-mellon-offer-crypto-services-143413827.html.

[9] *What Are Transaction Fees?*, Bitcoin.com, https://www.bitcoin.com/get-started/what-are-transactions-fees/ (last visited Oct. 25, 2022).

[10] *What Are Liquidity Pools?*, Gemini (Nov. 30, 2021), https://www.gemini.com/cryptopedia/what-is-a-liquidity-pool-crypto-market-liquidity.

[11] Andrew Hayward, *Andreessen-Backed Helium Raises $111 Million to Grow Crypto Wireless Network*, Decrypt (Aug. 10, 2021), https://decrypt.co/78222/andreessen-backed-helium-raises-111-million-to-grow-crypto-wireless-network.

[12] *Why Decentralized Data Storage Could be the Next Big Thing in Web 3.0*, Cryptonews (Sept. 19, 2022), https://cryptonews.com/news/why-decentralized-data-storage-could-next-big-thing-web-30.htm.

[13] Roy Gaurav, *How The Gaming Industry Uses Crypto?*, CoinMarketCap (Jan. 2022), https://coinmarketcap.com/alexandria/article/how-the-gaming-industry-uses-crypto.

[14] *Nexon America Accepts Cryptocurrencies for Purchase of In-Game Items*, Yahoo Finance (Dec. 14, 2021), https://finance.yahoo.com/news/nexon-america-accepts-cryptocurrencies-purchase-150000404.html.

Token usage extends literally to the limits of imagination. Some tokens allow users to participate in community governance, such that a participant can vote on a proposal for a given project, or even create one.[15] Other tokens allow users to collectively own some asset like a domain name.[16] Some tokens are "stablecoins," pegged to the value of some other assets like fiat currency.[17] Some tokens represent digital embodiments of art, music, videos, or other media, and can convey intellectual property rights in a host of ways, with various encoded limits. A "non-fungible token" or "NFT" is a common example of such a token.[18] Such tokens sometimes come with attendant benefits, such as membership in a club, or rights to receive a signed album.[19] Separately, some blockchains (typically private blockchains) use tokens for back-office transactions like inventory tracking.[20]

With all of these uses (and many more), a token is functionally quite unlike, say, a stock certificate. In the old days, before digitalization, a stock certificate was printed on a piece of paper. The physical piece of paper itself was no more than a representation of ownership, voting rights, or dividends. It didn't matter if that physical piece of paper was treated as "the security" in the secondary market, because it was inseparable from the rights attendant to its investment contract.

---

[15] Alex Lielacher, *What Is A Governance Token? A Beginner's Guide*, Crypto.News (July 24, 2022), https://crypto.news/learn/what-is-a-governance-token/.

[16] Leeor Shimron, *Amazon.eth, Starbucks.bitcoin, Coke.dao? Crypto Domain Names Are The Next Big NFT Craze*, Forbes (Sept. 10, 2022), https://www.forbes.com/sites/leeorshimron/2022/09/10/amazoneth-starbucksbitcoin-cokedao-crypto-domain-names-are-the-next-big-nft-craze/ sh 4cc5e866b1dd.

[17] Tomio Geron, *Why Stablecoins Stand Out in the Cryptocurrency World*, The Wall Street Journal (June 10, 2019), https://www.wsj.com/articles/why-stablecoins-stand-out-in-the-cryptocurrency-world-11560218460.

[18] Jazmin Goodwin, *What is an NFT? Non-fungible tokens explained*, CNN Business (Nov. 10, 2021), https://www.cnn.com/2021/03/17/business/what-is-nft-meaning-fe-series/index.html.

[19] Shivani Vora, *The Global Restaurant Brand With The Million Dollar NFT Membership Club*, Forbes (Mar. 19, 2022), https://www.forbes.com/sites/shivanivora/2022/03/19/the-global-restaurant-brand-with-the-million-dollar-nft-membership-club/ sh 4ff4dab31a5f.

[20] *Blockchain for Supply Chain: Track and Trace*, Amazon Web Services, https://aws.amazon.com/blockchain/blockchain-for-supply-chain-track-and-trace/ (last visited Oct. 25, 2022).

The SEC could easily treat the stock certificate as the stock itself – it made little difference.

Because tokens are infinitely designable software, they fundamentally change this paradigm. Both a stock certificate and a token can be provided to others in a secondary market. But the token, unlike the stock certificate, can be acquired and used in untold ways that have nothing to do with an investment contract. Treating the token itself as if it were a security makes no sense under the securities laws, and creates a host of "square peg, round hole" problems that the SEC has not addressed. The lack of clear direction from the SEC as to all of the secondary effects of treating token themselves as securities makes it all the more important that any ruling in this case is narrowly tailored to the facts and circumstances presented here.

II. THE SEC UNLAWFULLY INCLUDES SECONDARY SALES AS EVIDENCE OF AN INVESTMENT CONTRACT

The SEC, in this case and others, has taken the position that a token itself is a security, such that subsequent, secondary transactions in that token constitute an unregistered securities offering in violation of the securities laws. For example, the SEC cites, to support the argument that XRP purchasers reasonably expected to profit, the fact that XRP is tradeable on secondary cryptocurrency trading platforms. SEC Moving Br. at 55-56. In arguing that such profits would result from the efforts of Ripple, the SEC argues that Ripple intended to maintain a secondary market for users to sell XRP. SEC Moving Br. at 62. The SEC further argues that purchasers of XRP who resold XRP to others acted as "statutory underwriter[s]" of Ripple's offering. SEC Moving Br. at 64. And the SEC has previously stated in this case (in opposition to a motion to intervene by XRP holders) that, as an embodiment of the facts and circumstances under which it was offered and sold, "[t]he XRP traded, even in the secondary market today represents that investment contract." ECF No. 153 at 24.

These statements are not accidents. The SEC has taken a similar position in other matters. In a recently-filed complaint, *SEC v. The Hydrogen Tech. Corp., et al.*, Case 1:22-cv-08284-LAK

(S.D.N.Y.), ECF No. 3 (the "Hydrogen Complaint"), the SEC alleged that the defendants violated the securities laws by selling tokens "in the secondary trading market." In *SEC v. Kik Interactive Inc.*, 19 Civ. 5244 (AKH) (S.D.N.Y.), ECF No. 58, the SEC argued that "[a]ll purchasers of Kin – those who bought Kin directly from Kik and those who bought in the secondary market – were deprived of the important disclosures that a registration statement and SEC reporting would have provided regarding their investments" (emphasis added). Several SEC settlement orders reflect similar statements.[21] And SEC Chair Gary Gensler has recently stated that the "vast majority" of tokens are – not were, but are – securities.[22]

The Association respectfully submits that even if this Court holds that the original issuance of XRP was a security, the Court should refrain from deciding that secondary sales are investment contracts, or that XRP itself is, today, a security. To the extent that the SEC is taking the position that secondary market transactions of XRP – or any other token – can be considered securities, that position is not legally supportable and would have disastrous effects in the industry at large. The *amicus* brief filed by the Chamber of Digital Commerce (ECF No. 649, the "Chamber *Amicus*") persuasively makes the legal argument that under existing law, tokens themselves – even

---

21 *See, e.g.*, *In the Matter of Block.one*, SEC Admin. Proc. 3-19568, at 4 (Sept. 30, 2019), *available at* https://www.sec.gov/litigation/admin/2019/33-10714.pdf ("Block.one did not take any steps to prevent the ERC-20 Tokens from being immediately resellable to U.S.-based purchasers in secondary market trades."); *In the Matter of Zachary Coburn*, SEC Admin. Proc. 3-18888, at 1-2 (Nov. 8, 2018), *available at* https://www.sec.gov/litigation/admin/2018/34-84553.pdf (finding that "an online platform that allow[ed] buyers and sellers to trade certain digital assets in secondary market trading" was a securities exchange); *In the Matter of Tokenlot, LLC, Lenny Kugel, and Eli L. Lewitt*, SEC Admin. Proc. 3-18739, at 4 (Sept. 11, 2018), *available at* https://www.sec.gov/litigation/admin/2018/33-10543.pdf (finding that respondents acted as brokers or dealers when they sold "digital tokens in secondary trading that occurred after those tokens' initial offering periods had ended"); *In the Matter of Munchee Inc.*, SEC Admin. Proc. 3-18304, at 5 (Dec. 11, 2017), *available at* https://www.sec.gov/litigation/admin/2017/33-10445.pdf (finding that MUN tokens were securities because, in part, "Munchee intended for MUN tokens to trade on a secondary market").

22 David Hollerith, *SEC Chair Gensler says "vast majority' of cryptocurrencies are securities*, Yahoo Finance (Sept. 8, 2022), https://finance.yahoo.com/news/sec-chair-gensler-majority-cryptocurrencies-securities-124610154.html.

if the subject of an investment contract – are not themselves securities. *See* Chamber *Amicus* at 5-7. As a factual and policy matter, if a token initially sold in an investment contract is always inextricably linked with that investment contract every time it is subsequently transferred (even if it is transferred without any of that investment contract's attendant rights), then none of the above myriad applications of tokens – nearly an entire industry – could possibly function. To the contrary, even if a token were originally sold in an investment contract, that token is separate and separable from the original investment contract.

III. UNDER THE *E* TEST, MANY SECONDARY MARKET TRANSACTIONS IN TOKENS ARE NOT SECURITIES TRANSACTIONS

A. <u>The Test</u>

The Securities Act defines the term "security" as including "any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, transferable share, investment contract," or other listed instruments. 15 U.S.C. § 77b(1). The question of whether an instrument is a security often turns on whether the instrument is an "investment contract" under that definition. In *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), the Supreme Court articulated that test: "an investment contract, for purposes of the Securities Act, means a <u>contract, transaction or scheme</u> whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." 328 U.S. at 298-299 (emphasis added).

An analysis of the *Howey* factors reveals that many secondary market transactions – and most uses of tokens as listed above – do not meet the test of an "investment contract." A token, by itself, is not a "contract, transaction or scheme," but rather an instrument, or asset, or just software. The asset itself, once severed from any "contract, transaction or scheme" that may have existed, is not a security. While, as the SEC points out numerous times, the *Howey* test is "flexible," *see* SEC's Memorandum of Law in Opposition to Defendants' Motion for Summary

Judgment, ECF No. 674 (the "SEC Opp.") at 1, 12, 13 15, it is not infinitely so. The SEC should not be able to expand the definition of a "scheme" to cover any digital asset that was once relevant in any way to an investment contract, particularly when the token is no longer tied to that investment contract (if there ever was one).

1. <u>Many Blockchain Transactions Do Not Satisfy the "Investment of Money" Clause</u>

The SEC Moving Brief asserts that the "investment of money" prong of *Howey* is undisputed. SEC Moving Brief at 649 ("Defendants do not dispute that they offered and sold XRP in exchange for money,' which suffices to establish the investment of money' aspect of the *Howey* test"); SEC Opp. at 25. However, some evidence in the public summary judgment record[23] belies that assertion. According to Defendants Ripple, Bradley Garlinghouse, and Christian A. Larsen (collectively, the "Ripple Defendants"), Ripple gave XRP away for free, to charities and grant recipients. ECF No. 643 (the "Defendants Moving Br.") at 10. Ripple also used XRP to pay for services from vendors and employees. *Id.* at 11. Mr. Larsen also donated amounts of XRP to charity. *Id.* at 12.

Such transactions are common in the industry. Market recipients that receive tokens for free, or in exchange for services, did not make an "investment of money" under *Howey*. *Cf. Int'l Bhd. of Teamsters, Chauffeurs, Warehousemen & Helpers of America v. Daniel,* 439 U.S. 551, 559-60 (1979) (rejecting argument that that exchange of labor in return for participation in employee pension plan was an investment of money; to meet "investment of money" prong, the purchaser must give up "some tangible and definable consideration in return for an interest that had substantially the characteristics of a security"); *Fraser v. Fiduciary Tr. Co. Int'l,* No. 04 Civ. 6958 (RMB) (GWG), 2005 U.S. Dist. LEXIS 48059, at 14 (S.D.N.Y. June 23, 2005) ("no

23 As a non-party to the instant matter, the Association only has access to the public filings. Accordingly, when discussing the case record, the Association is largely limited to the parties' redacted memoranda of law. The Association does not have access to the parties' declarations and exhibits, or their Rule 56.1 statements.

purchase or sale where instead of giving up some tangible and definable consideration, participants in the employee stock ownership plan earn stock through labor for the employer. The notion that the exchange of labor will suffice to constitute the type of investment which the Securities Acts were intended to regulate was rejected in *Daniel*.") (quotation marks and brackets omitted).

This litigation is not the only place the SEC has asserted that an "investment of money" is not limited to investments of money. For example, in the Hydrogen Complaint, the SEC alleged that the defendants therein violated the securities laws by offering tokens to others "via bounty programs [and] employment compensation." Hydrogen Complaint 143. In a settlement with Tomahawk Exploration LLC ("Tomahawk") and David Thomas Laurance,[24] the SEC pointed to "online marketing" including "promotion," and asserted, "[t]he lack of monetary consideration for free' shares does not mean there was not a sale or offer for sale for purposes of Section 5 of the Securities Act. Rather, a gift' of a security is a sale' within the meaning of the Securities Act when the donor receives some real benefit." *Id.*, citing *SEC v. Sierra Brokerage Servs., Inc.*, 608 F. Supp. 2d 923, 940-43 (S.D. Ohio), *aff'd*, 712 F.3d 321 (6th Cir. 2013). The SEC further asserted that Tomahawk "received value in the creation of a public trading market for its securities." In other words, in the SEC's view, nobody needed to have made any investment of any money, or anything whatsoever, to satisfy the "investment of money" prong of the *Howey* test – the fact that the items given away could then be traded publicly is enough of a benefit. That interpretation renders the Supreme Court's "investment of money" jurisprudence a nullity.

Such a holding would have devastating real-world effects on the industry. As noted above, many projects try to attract participants to use their network through giveaways of tokens for use in their system. Requiring such projects to follow the registration rules for such giveaways is not

[24] *In The Matter of Tomahawk Exploration LLC and David Thomas Laurance*, SEC Admin Proc. 3-18641 (August 14, 2018), https://www.sec.gov/litigation/admin/2018/33-10530.pdf.

consistent with the securities laws or with *Howey*. Any ruling addressing the "investment of money" prong should limit the SEC to the plain language of *Howey*.

The Supreme Court's language in *Howey* should be taken literally: an investment contract requires an actual investment of tangible consideration. Intangibles cannot suffice, because such concepts could include literally anything. For example, "the creation of a public market" cannot suffice, because <u>anything</u> given away broadly might create a market. *Howey* makes clear that courts should only find an investment contract when confronted with an issuer "who seek[s] the use of the money of others[.]" *Howey*, 328 U.S. at 299. The SEC has not carried, nor even tried to carry, that burden with respect to secondary market transactions in XRP.

2. *<u>Many Blockchain Transactions Do Not Satisfy the "Common Enterprise" Prong</u>*

The second element of the *Howey* test examines whether or not the investment of money is in a "common enterprise." A "common enterprise within the meaning of *Howey* can be established by a showing of horizontal commonality': the tying of each individual investor's fortunes to the fortunes of the other investors by the pooling of assets, usually combined with the pro-rata distribution of profits." *Revak v. SEC Realty Corp.*, 18 F.3d 81, 87 (2d Cir. 1994). "In a common enterprise marked by horizontal commonality, the fortunes of each investor depend on the profitability of the enterprise as a whole." *Id.* (citation omitted).

This Court's decision should recognize that tokens present a complicated and nuanced set of issues, and any findings of commonalities – horizontal or vertical – must be cabined not just to the specific facts of this case, but the specific purchases and purchasers at issue.

A common enterprise can exist if there is "vertical commonality," where the "investors' fortunes need not rise and fall together; a pro-rata sharing of profits and losses is not required." *Id.* The Second Circuit has determined that "broad vertical commonality" – where "the fortunes of the investors need be linked only to the efforts of the promoter" – does not satisfy *Howey*. *Id.*

The Second Circuit has not expressly determined whether "strict vertical commonality" – which "requires that the fortunes of investors be tied to the fortunes of the promoter" – satisfies *Howey*. *Id.*; *see also SEC v. Kik Interactive Inc.*, 492 F. Supp. 3d 169, 178 n.5 (S.D.N.Y. 2020).

The SEC asserts that both horizontal and vertical commonality exist with respect to XRP. The SEC asserts that a "purchase of XRP is an investment in a common enterprise with other XRP holders and with Ripple" because "[a]ll units of XRP are fungible with each other, and the price of all units of XRP rise or fall equally." SEC Moving Br. at 2; *see also* SEC Opp. at 27. Elsewhere in the SEC's Moving Brief, the SEC states that XRP holders are in "horizontal commonality" with one another because XRP holders are "all identical to one another" and the "market price increases or decreases for all units of XRP together and equally." SEC Moving Br. at 50-51; *see also* SEC Opp. at 27. Ripple "pooled proceeds from its sale of XRP in an effort to boost the value of the investment, such that the stronger the ecosystem that Ripple built, the greater the demand for XRP and thus the greater the value of each purchaser's investment." *Id.* at 51. The SEC alternatively alleges "strict vertical commonality" because the "success of XRP affects the fortunes of Ripple, its executives, and XRP investors" and a "price decline would be detrimental for all." SEC Moving Br. at 52; *see also* SEC Opp. at 28. The SEC further analogizes to *Howey*, where investors' profits "came when the promoter sold the oranges and then, rather than pooling the cash from those sales, allocated those proceeds *pro rata*." SEC Opp. at 31 (emphasis omitted).

The SEC's argument for a "common enterprise" ignores the realities of how many market participants use tokens. As explained above, participants can acquire tokens like XRP for many reasons: for payment for goods and services, for membership in a community, for community governance of a project, or for infinite other purposes. Those market participants who use tokens for these markedly different reasons cannot to be said to be in any sort of horizontal "common enterprise," as their "fortunes" are not necessarily tied to the profitability of the enterprise as a whole, as they might be for a participant acquiring XRP to speculate on its value for a profit.

Even if tokens are originally sold with an aim that purchasers could profit, those tokens might continue to exist and be continually traded and used, regardless of whether those aims still apply. The lack of any privity or contractual rights between the original seller and downstream purchasers extinguishes the possibility of any common enterprise between token holders. *See Hart v. Pulte Homes of Michigan Corp.*, 735 F.2d 1001, 1003 (6th Cir. 1984) (*Howey* test not met where "defendants were under no contractual duty to develop the subdivisions" and "plaintiffs had no right to share in the profits of successful development"); *Woodward v. Terracor*, 574 F.2d 1023, 1025 (10th Cir. 1978) (contract for real property was not an "investment contract" because "the mere fact that the plaintiffs bought lots from [the seller] does not mean that by such acquisition they were thereafter engaged in a common venture or enterprise."); *S&S N.Y. Holdings, Inc. v. Able Energy, Inc.*, No. 11 Civ. 2388 KBF, 2012 WL 3084112, at 5 (S.D.N.Y. July 27, 2012) (finding no investment contract where the governing agreement was no longer valid); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1050 (S.D.N.Y. 1975) (finding no investment contract where promoter was not contractually obligated to manage or "run the development and distribute profits to the plaintiff, as did the operators of the orange groves in *Howey*"); *De Luz Ranchos Inv., Ltd. v. Coldwell Banker & Co.*, 608 F.2d 1297, 1300–01 (9th Cir. 1979) (finding no investment contract despite marketing materials emphasizing promoter's efforts to develop surrounding land).

The SEC's theory that all holders of a fungible asset are in a common enterprise merely because that asset has a single market price is equally flawed. That characteristic is true of virtually <u>every</u> commodity. The SEC's theory would transform the holders of any particular commodity in existence into a common enterprise with each other. The "common enterprise" prong would be rendered meaningless.

The lack of commonality rings even more strongly if this Court considered "vertical commonality." The fortunes of those who use XRP for the myriad other reasons besides appreciation in value are not necessarily tied to the fortunes of Ripple as a corporate entity. Similarly, in many other projects among the Association's membership, their counterparties, and the greater blockchain ecosystem, the fortunes of the project that originally issued the token may be completely unrelated to the value of the token. If a token carries no rights to equity in the issuer, or dividends, or any share of profits, then the fortunes of the issuer may well be completely irrelevant to the value of the token. In those cases, the token value derives not from any promise of equity or dividends, but rather its use in other projects or networks. Or, as can be seen in the example of ETH (or other similar tokens in other blockchains), a token's value can arise from its flexibility as a base on which to build other software functionalities, completely independent of whatever entity first issued it. And of course, for projects that have completely decentralized, and could pass the "Bahamas Test" referenced in *SEC v. Telegram Grp. Inc.*, 448 F. Supp. 3d 352, 375 (S.D.N.Y. 2020), where the entire founding team could retire to the Bahamas and never again work on the project, there may be no fortunes of any issuer at all to which any token value could be tied.

Thus, even if this Court finds that some participants purchased XRP as part of some common enterprise at some point, we respectfully submit that the Court should cabin that finding, and not find that by necessity, all purchasers in the market at all times were part of a common enterprise. In light of the innate complexity of tokens, a decision finding that "commonality" exists should be limited to the facts of this case, and a particular, articulated commonality.

3. *Many Blockchain Transactions Do Not Satisfy the "Expectation of Profits" Prong*

The third element of the *Howey* test asks whether the investor has an expectation of profits. "By profits, the court has meant either capital appreciation resulting from the development of the initial investment or a participation in earnings resulting from the use of investors' funds."

United Housing Found., Inc. v. Forman, 421 U.S. 837, 852 (1975). "In such cases the investor is attracted solely by the prospects of a return on his investment[,]" *id.*, and "not the profits of the scheme in which they invest." *SEC v. Edwards*, 540 U.S. 389, 394 (2004). The Supreme Court has "used profits' in the sense of income or return, to include, for example, dividends, other periodic payments, or the increased value of the investment." *Id.* "By contrast, when a purchaser is motivated by a desire to use or consume the item purchased the securities laws do not apply." *Forman*, 421 U.S. at 852-53 (citation omitted). *See also Libaire v. Kaplan*, No. CV 06-1500 (DRH) (ETB), 2008 U.S. Dist. LEXIS 145311, at 16 (E.D.N.Y. Jan. 17, 2008) (no expectation of profits where plaintiff expected to "maintain his access to the hunting preserve and club facilities"); *Banco Espanol de Credito v. Sec. Pac. Nat'l Bank*, 763 F. Supp. 36, 44 (S.D.N.Y. 1991) (no expectation of profit where plaintiffs would receive repayment of their principal "plus a fixed rate of interest").

Although the "inquiry is an objective one focusing on the promises and offers made to investors" and "is not a search for the precise motivation of each individual participant," courts have considered "the stated intent of prospective and actual purchasers" in evaluating the "motivations of the hypothetical reasonable purchaser." *Telegram*, 448 F. Supp. at 371, 374.

Here, the SEC's argument for why it has met the "expectation of profits" prong focuses on what the Ripple Defendants did to market XRP to direct purchasers and help them profit. For example, the SEC argues that the Ripple Defendants promoted XRP as an investment; took steps to have XRP listed on secondary markets in order to enable investors to realize a profit; emphasized the existence of active and liquid trading markets; targeted its offers and sales of XRP to those speculating for profit; offered and sold XRP in unlimited quantities; and made statements that Ripple had a significant supply of XRP and therefore had an interest in increasing XRP's value. SEC Moving Br. at 53-58; SEC Opp. at 47.

However, the SEC ignores the expectations of downstream purchasers in the secondary market and participants who acquired XRP for reasons other than profit. The Ripple marketing materials to which the SEC refers would have little to no impact on those market participants who use tokens as currency, or who use tokens for a specific use in a blockchain-based infrastructure, or who use tokens as a receipt for a transaction. Such market participants would have different motivations rather than profit. *See Forman*, 421 U.S. at 858 ("What distinguishes a security transaction – and what is absent here – is an investment where one parts with his money in the hope of receiving profits from the efforts of others, and not where he purchases a commodity for personal consumption"). *Amici* by I-Remit, Inc. and TapJets, Inc. (ECF Nos. 656, 660) are two actual examples of such entities who use XRP for reasons other than profit. The SEC contends that the "existence of, or even the desire for, some consumptive use does not defeat *Howey*'s expectation of profit' prong," SEC Opp. at 45, but here, as explained, the "consumptive use" can be completely separated from the original investment contract.

Accordingly, even if the Court finds that <u>some</u> participants purchased XRP with an expectation of profit, the Association respectfully requests that the Court is careful to not conclude that by necessity, all purchasers in the market for XRP had some expectation of profit. Any ruling that treats the "expectation of profits" test in a way that imputes some market participants' expectations to all other participants, for all time, would risk transforming a few statements at the outset of a project to a permanent fixture, when those statements may have been targeted at an original investment contract, but not the token itself. Such an overbroad approach would inject further confusion into the market, and negatively affect the American blockchain industry.

4. <u>Many Blockchain Transactions Do Not Satisfy the "Efforts of Others" Prong</u>

For similar reasons, any ruling that the XRP purchasers expected profits based on the "efforts of others" should be restricted to include only primary purchasers of XRP. The SEC asserts that "no genuine dispute exists" that XRP investors expected that their profits would result from the efforts of the Ripple Defendants. SEC Moving Br. at 59. But, just as with the "expectation of profits" prong, the SEC's argument that XRP purchasers expected their profits to result from the efforts of the Ripple Defendants focuses on actions taken by the Ripple Defendants that would be relevant to primary purchasers of XRP. For example, Ripple touted the expertise of its team and its considerable resources; Ripple told investors that it had a large financial stake in XRP; and Ripple funds itself from selling XRP. SEC Moving Br. at 59-63; SEC Opp. at 47. Any contractual obligations that Ripple may have undertaken with the initial sale of XRP were not passed to secondary purchasers. Those secondary purchasers received a piece of software, but no legal rights vis- -vis Ripple, reinforcing that their purchase of XRP had nothing to do with the efforts of Ripple – who owed those secondary purchasers no legal obligations.

Again, tokens can have many uses. Users, especially in the secondary market, own tokens for all sorts of reasons, including those that have nothing to do with the efforts of the original promoter. Token users may instead care about the functionality of those tokens for whatever their specific use may be, and not care in the least about the efforts of any promoter to make the value of those tokens appreciate. Similarly, those who acquire tokens for use in community governance may be equally unconcerned about the original promoter. Even if a project specifically promises at the outset to make efforts to increase its token's value, those statements may come with an "expiration date," a point at which the project is no longer engaged in such activities, and market participants acquire the token for other uses or purposes. Unlike a traditional security certificate – where if the company goes out of business, the certificate is worthless – a token may still have significant value to a holder or purchaser, entirely separate from an original promoter.

Accordingly, even if this Court finds that some participants purchased XRP with an expectation of profit from the efforts of others, we respectfully request that the Court should be careful not to conclude that by all necessity, all purchasers in the secondary market for XRP had an expectation of profit from the efforts of Ripple (or anyone in particular).

IV. THE RIPPLE DEFENDANTS' FAIR NOTICE DEFENSE RAISES CONCERNS THAT ARE COMMON IN THE INDUSTRY

The Association strongly disagrees with some of the SEC's assertions regarding the Ripple Defendants' "fair notice defense" concerning the lack of guidance provided by the SEC to market participants. The SEC's argument, if successful, could have detrimental consequences for the market as a whole. The notion that a token theoretically could be offered as part of an investment contract is certainly well-known, but a host of unanswered questions remain, both as to the basic question of what is a security, and the more complicated but equally important questions of what rule-abiding market participants may do with their tokens even if they were classified as securities.

The SEC claims that the Ripple Defendants – and indeed any participant of "ordinary intelligence" – had fair notice that the SEC would consider XRP to be a security because its "message has been clear: those who sell digital assets to publicly raise capital must ensure their actions comply with federal securities laws." SEC Moving Br. at 6. The SEC argues that *Howey* itself, along with its progeny, provide defendants with fair notice "as to what conduct and characteristics sufficed to meet the *Howey* test." *Id.* at 71. And the SEC claims that the Ripple Defendants had fair notice as a result of various SEC enforcement actions and public statements, including the 2017 Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO (the "DAO Report").[25] *Id.* at 74.

But regulation of digital assets through enforcement actions and SEC public statements is not sufficient to put market participants on notice as to what is or isn't a security. The Association, as an industry group, can certainly attest that its members – who all are possessed of at least

[25] *See* Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Securities and Exchange Comm'n (July 25, 2017), https://www.sec.gov/litigation/investreport/34-81207.pdf.

"ordinary intelligence" in this particular area – do not have a clear sense of what is or is not considered a security, much less how tokens could or should be treated and traded on secondary markets in a manner consistent with securities laws.[26]

The DAO Report itself is ineffective in putting participants at notice as to whether any particular token is a security. For example, the DAO Report, which concerns initial rather than secondary market sales, repeatedly uses vague and conditional language, such as the "U.S. federal securities laws may apply to various activities, including distributed ledger technology, depending on the particular facts and circumstances ." DAO Report at 10. It also states that "[w]hether or not a particular transaction involves the offer and sale of a security—regardless of the terminology used—will depend on the facts and circumstances, including the economic realities of the transaction." DAO Report at 17-18. Aside from merely citing *Howey*, the DAO Report does not provide further clarity for which issuances are securities, and which are not.

As explained above, all blockchain projects are different, and there are numerous issuances of and uses for tokens that are not for investment purposes. The blockchain industry is much broader than the DAO tokens at issue in the now five-year-old DAO Report. Moreover, it is unclear if or how the principles articulated in the DAO Report apply to secondary markets.

Other than through enforcement actions, the SEC last issued guidance on the question of whether a token was a security in April 2019,[27] a near-lifetime ago in a sector where technology is evolving at lightning speed. That guidance provided a list of over sixty factors for analyzing whether a token is a security – without weighting any particular factors, or explaining whether any

---

[26] As evidence that the determination of whether or not XRP or any other token is a security is not an easy task, more than 200 exchanges – many of which are sophisticated, and represented by counsel, apparently came to the conclusion that XRP was not a security. ECF No. 673 (the "Ripple Defendants Opp.") at 49-51.

[27] *Framework for "Investment Contract" Analysis of Digital Assets*, Securities and Exchange Commission (Apr. 3, 2019), *available at* https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets.

of them were dispositive. It actually created more confusion in the industry.[28] And it recognized that tokens qualifying as securities at the time of an initial sale sometimes "should be reevaluated at the time of later offers or sales," an explicit acknowledgment of the distinction between primary and secondary market transactions that the SEC seems to ignore here. It is disingenuous to claim that the industry could possibly be on "fair notice" of whether any token that does not precisely fit the facts of a previous token against which the SEC has sought enforcement is a security.

"Regulation by enforcement" does not provide the "fair notice" that the SEC argues. It is impossible to parse the existing enforcement decisions for some kind of unified theory as to what is or isn't a security, because each SEC enforcement decision is based on the unique facts and circumstances of that case. Certainly, some common themes arise. But most market participants have moved far past the typical "initial coin offerings" that were commonplace in 2017, and the lack of certainty forces many projects either into structures that are unnecessarily disadvantageous, or outside the borders of the United States altogether.[29]

The SEC's argument about the apparent ease with which market participants should be able to ascertain whether a token is a security is belied by the statements of its own commissioners. In 2021, for example, Commissioner Hester M. Peirce and then-Commissioner Elad L. Roisman

---

[28] *See, e.g.*, Hester M. Peirce, Commissioner, *Securities and Exchange Comm'n*, *How We Howey* (May 9, 2019), *available at* https://www.sec.gov/news/speech/peirce-how-we-howey-050919 ("Whether the framework gives anything new to the seasoned securities lawyer used to operating in the facts and circumstances world of *Howey* is an open question. I worry that non-lawyers and lawyers not steeped in securities law and its attendant lore will not know what to make of the guidance. Pages worth of factors, many of which seemingly apply to all decentralized networks, might contribute to the feeling that navigating the securities laws in this area is perilous business. Rather than sorting through the factors or hiring an expensive lawyer to do so, a wary company may reasonably decide to forgo certain opportunities or to pursue them in a more crypto-friendly jurisdiction overseas."); *see also* DINNGO, *The Known and the Unsaid from the SEC's Framework* (Aug. 20, 2019), https://medium.com/dinngo-exchange/the-known-and-the-unsaid-from-the-secs-framework-ad8b2a7c6d2c ("from a crypto exchange's perspective, [the SEC's 2019 Framework] has muddied the waters rather than clearing them").

[29] Users are also not well-served by regulation by enforcement. The decline of XRP's market price as a result of this litigation evidently led to losses of $15 billion. Ripple Defendants Opp. at 52.

issued a public statement criticizing a settlement with a digital assets exchange that publicized upcoming digital token offerings.[30] The Commissioners expressed that they were "disappointed that the Commission's settlement did not explain *which* digital assets were securities, an omission which is symptomatic of our reluctance to provide additional guidance about how to determine whether a token is being sold as part of a securities offering or which tokens are securities." ECF No. 264-1 at 1 (emphasis in original). They added that "[t]here is a decided lack of clarity for market participants around the application of the securities laws to digital assets and their trading." *Id.* The *Howey* test "is helpful, but, often, including with respect to many digital assets, the application of the test is not crystal clear." *Id.*

Thus, there is considerable uncertainty, even at a very basic level, as to whether a token, at issuance, is a security. But even past that "Securities Law 101" question, numerous other questions confound the issue of whether a token in the secondary market could be treated as a security. The now-infamous June 2018 "Hinman Speech,"[31] of course, asked the basic question: even if a token was a security when it was originally offered to purchasers as part of an investment contract, at what point does it become a non-security The following year, the SEC's aforementioned April 2019 guidance made a brief and unsatisfactory attempt at an answer. Since then, silence.

Even assuming that a token were to be treated as a security, the SEC has issued no guidance on questions that were settled for traditional securities, but pose new and vital problems for tokens. If a token is a security, on what secondary markets can it trade How does Rule 15c3-3 (the so-called "custody rule") apply to custody of tokens that are in users' own wallets How can tokens

---

[30] *See* Public Statement, Commissioner Hester Peirce and Commissioner Elad Roisman, SEC, *In the Matter of Coinschedule* (July 14, 2021), https://www.sec.gov/news/public-statement/peirce-roisman-coinschedule.

[31] William Hinman, SEC, *Digital Asset Transactions: When Howey Met Gary (Plastic)*, Remarks at the Yahoo Finance All Markets Summit: Crypto (June 14, 2018), *available at* https://www.sec.gov/news/speech/speech-hinman-061418.

be "legended" or "unlegended" under Regulation D   If removing a restrictive legend is an issue of state law,[32] what if the issuer is not in any particular state   Or is decentralized   What if there are no "transfer agents" capable to effectuate such removal for a token, even if it could be legended   How can Rule 144(c)(2) (for non-reporting issuers, which most token issuers would be) apply if a company can't meet the requirements of 17 CFR § 240.15c2-11 (which most could not)   How does an issuer of tokens relying on an exemption under Section 12(g) (17 CFR § 240.12g-1) know when the tokens have come to be held by more than 2,000 persons, if tokens can be traded peer-to-peer (or peer-to-pool) on decentralized exchanges

The SEC's assertions that market participants are on "fair notice" of how tokens are treated under the securities laws ring hollow when the market lacks clarity on even the most basic of points, like whether a token is a security, let alone all of these details as to how a token that was treated as a security could possibly conform to the securities regulations. If a particular token were considered a security, the numerous "square peg, round hole" problems – some of which are listed above, with many others remaining – would preclude full compliance with the securities laws. The technological essence of a token often makes it impossible for it to fully comply. In that situation, what is a well-meaning, law-abiding project to do   When so many questions remain regarding how a token could possibly function as a security, how can the SEC say that anyone is on "fair notice" that a token itself could be a security

The SEC's rejoinder to these deep, persistent industry concerns is buried in a footnote of its opposition brief: "XRP transactions between two public investors not involving Ripple's affiliates, dealers, or underwriters would be exempt from Section 5's registration requirements, despite such transactions involving securities," because such "public" transactions would not

---

[32] *See, e.g.*, *Rule 144: Selling Restricted and Control Securities*, Securities and Exchange Comm'n (Jan. 16, 2013), https://www.sec.gov/reportspubs/investor-publications/investorpubsrule144htm.html.

involve an issuer, underwriter, or dealer. SEC Opp. at 45 n.25, *citing* 15 U.S.C. § 77d(a)(1). For that reason, the SEC asserts that the requirement that an initial issuer register tokens would not impact the business of subsequent users of that token, and brushes off the concerns of the industry *amici* that submitted briefs in this matter. SEC Opp. at 46 n.26.

The SEC's theory – for which it tellingly does not cite any prior SEC statements or guidance – does not answer the myriad problems articulated in this brief or in the other *amici*. Even if a downstream user of tokens is exempted from the registration requirements of 15 U.S.C. § 77(e),[33] the fact that the token was originally considered to be a security means that the token would have to trade as a security, on securities exchanges (or OTC). And compliance with all of the ongoing rules for registered securities would lead to a host of new "square peg, round hole" problems. What is the mechanism for users to take such tokens off-exchange How would users be able to build software on top of the tokens What would happen if the original issuer went bankrupt and the tokens were de-listed by the exchanges Would the tokens then trade OTC Since "only broker-dealers qualified with FINRA as market makers can apply to quote securities on the OTCBB,"[34] what if no brokers were approved to broker such transactions Since "companies that want to have their securities quoted on the OTCBB must seek the sponsorship of a market maker as well as file current financial reports with the SEC or with their banking or insurance regulator," *id.*, what happens if there are no such qualified market makers Or no "company" to file current financial reports The SEC has not begun to scratch the surface of all the unanswered questions about how tokens could possibly trade in the secondary markets if they were all securities. In that context, it is impossible to conclude that the industry is on "fair notice"

---

33 If the SEC were to initiate such an action against such a downstream user, that user has the burden to show that the tokens were exempt from the registration requirement. *Telegram*, 448 F. Supp. 3d at 365. Such exemptions are "construed strictly." *Id.* at 366.

34 *See Over-the-Counter Market*, Securities and Exchange Commission (May 9, 2013), https://www.sec.gov/divisions/marketreg/mrotc.shtml.

– not just of the elementary question of whether a token can even be a security, but if so, the myriad of questions about how that could possibly work consistent with securities regulations.

The lack of clarity on these key issues has plagued the blockchain industry and stifled innovation. The Association respectfully requests that the Court seriously countenance the Ripple Defendants "due process" defense, in light of this rampant uncertainty in the industry. This Court should lay down a marker: before the SEC brings enforcement actions against blockchain industry participants for failing to abide by securities laws and regulations, those laws and regulations must be clear, understandable, and sensible in the context of a software token that has a fundamentally different technological nature than a traditional security.

V. UNDER *M RRIS* , THE SECURITIES LAWS ARE INAPPLICABLE TO EXTRATERRITORIAL TOKEN TRANSACTIONS

Finally, the Ripple Defendants argue that certain transactions on foreign securities exchanges cannot be redressed by the United States securities laws under the doctrine set forth in the landmark Supreme Court decision *Morrison v. Nat'l Austl. Bank Ltd.*, 561 U.S. 247 (2010). Ripple Defendants Moving Br. at 58-74. Given the international nature of the blockchain industry, an appropriate application of *Morrison* is vital.

In *Morrison*, the Supreme Court held that the federal securities laws apply only to (i) transactions on U.S. securities exchanges and (ii) "domestic transactions in other securities." *Morrison*, 561 U.S. at 267. To determine which transactions are domestic for purposes of *Morrison*, courts look to various facts relating to both the purchase and the sale of the security. Given these complexities, courts have focused on the "location of the transaction," as required under 561 U.S. at 268, as the location where "irrevocable liability" was incurred. *See Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 67 (2d Cir. 2012) ("transactions involving securities that are not traded on a domestic exchange are domestic if irrevocable liability is incurred or title passes within the United States"); *Parkcentral Global HUB Ltd. v. Porsche Auto. Holdings*

SE, 763 F.3d 198 (2d Cir. 2014) (no U.S. jurisdiction of share swaps of a foreign issuer). *Cf. Cavello Bay Reinsurance Ltd. v. Stein*, 986 F.3d 161 (2d Cir. 2021) (no U.S. jurisdiction in a private offering between a Bermudan investor and Bermudan issuer).

The SEC argues that *Morrison* and *Absolute Activist* are inapplicable to Section 5 of the Securities Act, and that instead the determination of domesticity for claims under Section 5 is governed by Rule 901 of Regulation S, as clarified by certain "safe harbors" in Rule 903. SEC Opp. at 57 n.29, 69-72. That test was set forth in the pre-*Morrison* case *Europe & Overseas Commodity Traders, S.A. v. Banque Paribas London*, 147 F.3d 118 (2d Cir. 1998), and already rejected earlier in the litigation. *See* ECF No. 441 at 224 ("Regulation S does not govern the Court's analysis of whether the Individual Defendants' offers and sales occurred domestically for the purposes of Section 5"). This Court should continue to reject the SEC's attempts to circumvent the Supreme Court's and Second Circuit's clear precedent to create some new test.[35]

The Association emphasizes the importance of the territorial limits of the securities laws set forth in *Morrison*. The blockchain industry is global in scope. Many actors in the space are operating outside of the United States, and even many U.S.-based actors have an international presence. Accordingly, many token transactions do not incur "irrevocable liability" in the United States, and under *Morrison* such a transaction is not covered by U.S. securities laws.[36]

In this case and others, the SEC has sought to undercut *Morrison* and expand the definition of "domestic" transactions. In support of its argument that certain defendants incurred irrevocable liability to sell while in the United States, the SEC argues that, *inter alia*, certain transactions were

---

[35] *SEC v. Gruss*, 859 F. Supp. 2d 653 (S.D.N.Y. 2012), cited by the SEC, SEC Opp. at 57, was decided under the Investment Advisers Act of 1940, and is thus inapplicable to whether or not *Morrison* applies to Section 5.

[36] Section 929P of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 limited the holding of *Morrison* where fraud is concerned, but the territorial limits of *Morrison* are in full effect for the registration provisions of the securities laws – all that is at issue in this case. 15 U.S.C. § 77v.

"reflected on the XRP Ledger, which means each transaction had to be independently and simultaneously validated by each of the U.S. nodes of the ledger, because of how the ledger is programmed." SEC Opp. at 64. The SEC further argues that because, "in the XRP blockchain, all the nodes must validate a transaction for their own purposes by listening to the other nodes, including the many existing in the United States all of the Individual Defendants' sales were validated in nodes that were in the U.S. that are therefore domestic transactions." SEC Opp. at 68. The SEC takes this same view in a recent lawsuit filed in the United States District Court for the Western District of Texas, *SEC v. Balina*, 22-cv-00950 (W.D. Tex.), ECF No. 1 69, where the SEC alleged that certain transactions involving the cryptocurrency ETH "took place in the United States" because those contributions "were validated by a network of nodes on the Ethereum blockchain, which are clustered more densely in the United States than in any other country."

The SEC's theory is inconsistent with *Morrison*. Courts have rejected the approach of finding domestic jurisdiction based on the location of servers. *See Anderson v. Binance*, No. 1:20-cv-2803 (ALC), 2022 U.S. Dist. LEXIS 60703, at 11-12 (S.D.N.Y. Mar. 31, 2022) (to allege a "domestic" transaction, "Plaintiff must allege more than stating that title passed in whole or in part over servers located in California that host [Defendant's] website").

Incidental contact with the United States is insufficient to render a foreign transaction predominantly domestic. *See, e.g.*, *Loginovskaya v. Batratchenko*, 764 F.3d 266, 275 (2d Cir. 2014) ("The direction to wire transfer money to the United States is insufficient to demonstrate a domestic transaction."); *Banco Safra S.A. Cayman Islands Branch v. Samarco Mineracao S.A.*, No. 16 Civ. 8800 (RMB), 2019 WL 2514056, at 5 (S.D.N.Y. June 18, 2019) (allegations that purchases and sales "were conducted through' bank accounts in New York are insufficient to demonstrate a domestic transaction"); *Schentag v. Nebgen*, No. 17 Cv. 8734 (GHW), 2018 WL

3104092, at 12 (S.D.N.Y. June 21, 2018) ("[A]llegations that investors transferred money to or between U.S. bank accounts, without more, are insufficient to satisfy *Morrison*.").

The same rules should apply to nodes. If a French seller sells a token to a French buyer, but the nodes validating the transaction happen to be based in the United States, those two parties are not incurring irrevocable liability within the United States – whether the nodes validating a transaction "listen[] to the other nodes, including the many existing in the United States" or whether the validating node is determined via a "first to the flag" mechanism to find the "first node to solve a complex computational problem," *see* SEC Opp. at 68. Parties to a transaction occurring on the blockchain likely have no knowledge of, or control over, where the validating nodes are located. The fact that a node validating a transaction happened to be located in the United States is a coincidence to the transaction. It does not mean that the parties became "bound to effectuate the transaction" within the United States, or that "irrevocable liability was incurred or title was transferred within the United States." *Absolute Activist*, 677 F.3d at 67-68.[37]

Moreover, if the SEC's theory became law, the industry might deliberately avoid nodes in the United States, or restructure validation processes to avoid U.S. nodes, which in turn would be an extremely harmful deadweight loss to the U.S. blockchain industry.

The Association respectfully requests that the Court consider the international nature of the blockchain industry when deciding the parties' summary judgment motions. To the extent that any transaction of XRP was predominantly extraterritorial, with "irrevocable liability" incurred outside the United States, such a transaction is outside the U.S. securities laws, and should not

[37] To the extent that *Williams v. Block One*, No. 20-cv-2809 (LAK), 2022 U.S. Dist. LEXIS 171550 (S.D.N.Y. Aug. 15, 2022) found that the location of nodes was a relevant consideration to an extraterritoriality analysis under *Morrison*, SEC Opp. at 68, the Association respectfully submits *Block One* was incorrectly decided under *Morrison* and *Absolute Activist* for the reasons set forth herein.

either be a trigger for any liability, and (if this Court decided that liability was appropriate) such transactions should not be counted for purposes of disgorgement or civil monetary penalties.

CONCLUSION

The Association respectfully requests that the Court consider the issues presented herein when determining the parties' summary judgment motions.

Dated: New York, New York
October 28, 2022

MORRISON COHEN LLP

By: /s/ Jason Gottlieb
Jason Gottlieb
Michael Mix
Daniel C. Isaacs
909 Third Avenue
New York, New York 10022
(212) 735-8600

Attorneys for Amicus Curiae
The Blockchain Association