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Sorry, They Were on Mute: The SEC's "Token Proposal 2.0" As Blueprint for Regulatory Response to Cryptocurrency

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Abstract

In 2008, as the world dreaded economic meltdown, one or more anonymous individuals titled "Nakomoto" posted a scientific white paper on the Internet. "Bitcoin" was thus born. That name – uttered but once in the white paper – would go on to define a movement, a market, and a mountain.

By late 2010, approximately 100 bitcoin had been mined; two years later, that number approached 10 million, and a second crypto had emerged. By 2018, bitcoin traded at over $18,000 per coin; a year later, that market value had plummeted to less than $5,000. Concurrently, tales of digital asset fortunes lost or stolen have abounded. Thus, the growth of cryptocurrency, while meteoric, has been dampened by theft, volatility, and misuse.

The peer-to-peer transactional system imagined by Nakomoto could hardly be said to have welcomed regulation. And yet, with a market cap measured in the trillions, cryptocurrency is on a path to inevitable regulation. And the Securities and Exchange Commission – the most feared of market regulators - can seemingly use its expansive definition of "security" to reach almost any digital asset arrangement tied to speculation.

Accordingly, Part II of this Article provides background on the definition of "security" as introduced by the federal securities laws. Next, Part III brings a tighter lens to the cases brought by the Commission for the purpose of juxtaposing the two recent "Token" proposals offered by an SEC Commissioner. Finally, Part IV suggests amendments to the bold proposal/quasi-rulemaking. In the main, these amendments concern definitions, the suggested public disclosures, and the harmonization with salutary Commission pronouncements to date.

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In sum, the unconventional Token 2.0 proposal has inspired a Congressional Bill and emboldened the industry. This article lauds the initiative while suggesting the means by which it can crystallize into permanent, efficacious regulation.

I. INTRODUCTION: PLENTY IN A NAME

A. *Crypto's Rough and Tumble Start*

In 2008, as the world dreaded economic meltdown, one or more anonymous individuals posted a scientific "white paper" on the Internet.[1] The formal scholarship suggested that internet merchants and their counterparties could avoid fiat currency (i.e., currency backed by nations) as well as credit card/bank fees through direct barter; that barter would be effectuated by a cyberspace creation termed "bitcoin."[2] That name – uttered but once in the white paper – would go on to define a movement, a market, and a mountain.

Most immediately, those willing to dedicate computer time and smarts could "mine" bitcoin – that is, solve complex algorithmic challenges in search of a reward of a modest amount of the digital assets.[3] Such transactions could be communally "verified" by a "chain of digital signatures" on a sophisticated but public computer network called "blockchain."[4]

Unnamed parties around the globe accepted the challenge. By late 2010, approximately 100 bitcoin had been mined;[5] two years later, that number approached 10 million, and a second crypto had emerged.[6] Contemporaneously, mined coins were sold to others using the internet. Digital, as a blossoming, decentralized ledger, has since set the standard for digital accounting.[7]

In terms of steady value, bitcoin and the oddly futuristic other alt-currencies

[1] Satoshi Nakomoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, BITCOIN (Jan. 3, 2022), https://bitcoin.org/bitcoin.pdf.

[2] *Id.* Interestingly, Nakomoto's 9-page paper (with only 8 footnotes) includes the term "bitcoin" only in its title.

[3] The bitcoin "source code" is said to limit mining to 21 million coins in total. *See* Adam Hayes, *What Happens to Bitcoin After All 21 Million Are Mined?*, INVESTOPEDIA (Feb. 28, 2021), https://www.investopedia.com/tech/what-happens-bitcoin-after-21-million-mined/. As of September 2021, there are 18.82 million coins in circulation. *See infra* note 5.

[4] NAKOMOTO, *supra* note 1, at 2-4.

[5] Raynor de Best, *Number of Bitcoin (BTC) in circulation as of September 13, 2021*, STATISTA (Sept. 14, 2021), https://www.statista.com/statistics/247280/number-of-bitcoins-in-circulation/.

[6] *Id.*

[7] *See* Marco Iansiti and Karim R. Lakhani, *The Truth About Blockchain*, HARV. BUS. REV. (Jan.–Feb. 2017), https://hbr.org/2017/01/the-truth-about-blockchain.

took years to enter the mainstream. By 2013, bitcoin reached a value of approximately $1,100 each.[8] Yet, a wariness of anonymous payment systems was well-founded; an academic study that year concluded that 45 percent of the bitcoin exchanges had gone under, resulting in several taking the money of their customers with them.[9] Indeed, in February 2014, Mt. Gox, the first cryptocurrency exchange, filed for bankruptcy after 850,000 bitcoins went missing.[10] The resulting legal proceedings continue in multiple nations until this day. Separately, within months of bitcoin's launch, the criminal implications were notorious and actively pursued by prosecutors.[11]

The cybersecurity threat has never subsided. It was estimated that crypto assets amounting to almost $1 billion were stolen in 2018 from platforms around the world.[12] In March 2019, $195 million worth of cryptocurrency was lost when the owner of a cryptocurrency trading platform died in sole possession of its digital key. The debacle foisted the trading platform into court protection, prompting calls for national legislation by the Canadian Securities Administrators.[13]

Likewise, the dangerous mix of inexplicable popularity and sheer volatility has warranted inevitable comparisons between the crypto hysteria and the disastrous Dutch tulip bubble craze of the 1600s. In 2013 alone, bitcoin rose over 700%. By late 2015, the pricing gains of 2013 had dissipated, and bitcoin was priced a lowly $245.[14] By 2018, bitcoin traded at over $18,000 per coin; a year later, that market value had plummeted to less than $5,000. Regardless of (or perhaps because of) these demonstrable swings, the investment potential of alt-currency had far

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[8] Georgia Williams, *Bitcoin: A Brief Price History of the First Cryptocurrency*, INVESTING NEWS (Feb. 11, 2021), https://investingnews.com/daily/tech-investing/blockchain-investing/bitcoin-price-history/#:~:text=Bitcoin%20price%20history%3A%20A%20response,price%20performance%2C%202010%20to%202021.

[9] Ian Steadman, *Study: 45 percent of Bitcoin exchanges end up closing*, WIRED U.K. (Apr. 26, 2013, 11:34 AM), https://www.wired.co.uk/article/large-bitcoin-exchanges-attacks.

[10] *See* Tim Allman, *MtGox bitcoin exchange files for bankruptcy*, BBC NEWS (Mar. 1, 2014), https://www.bbc.com/news/av/business-26394986/mtgox-bitcoin-exchange-files-for-bankruptcy.

[11] Kim Zetter, *FBI Fears Bitcoin's Popularity with Criminals*, WIRED (May 9, 2012, 10:51 PM), http://www.wired.com/2012/05/fbi-fears-bitcoin/.

[12] Kristine Owram, *Canada Moves to Regulate Crypto Trading Amid Quadriga Scandal*, BLOOMBERG L. (Mar. 14, 2019, 8:19 AM), https://www.bloomberg.com/news/articles/2019-03-14/canada-moves-to-regulate-crypto-trading-amid-quadriga-scandal.

[13] *Id.* (noting that "crypto assets with a value of almost $1 billion were stolen in 2018 from platforms around the world.").

[14] *Bitcoin Market Price*, COINDESK, https://www.coindesk.com/price/bitcoin (last visited May 14, 2021).

eclipsed any notion of crypto as a means of currency or barter. By mid-2019, a widely held view was that less than 2 percent of all bitcoins were being used for their originally intended purpose of facilitating trade without fiat currency.[15]

Thus, the growth of cryptocurrency has been hindered by theft, volatility, and misuse. In this saga it is the transcendent significance of cryptocurrencies as a means of investment that perhaps warrants the most legal scrutiny. Of course, it is now axiomatic that bitcoin and other alt-currencies have since proven the most appreciating asset in the world.[16] Whether constituting a means or an end, cryptocurrency has grown to be unavoidable. Ironically, this omnipresent market force still suffers from the frustration of both expert and neophyte as to what cryptocurrency actually represents.

B. The Persistently Evasive Definition

Despite its seeming omnipresence in America, cryptocurrency has encountered myriad definitional hesitancies. The Treasury Department has never declared bitcoin or similar creations the equivalent of fiat currencies (i.e., "legal tender"), instead simply insisting that cash exchanges for cryptocurrencies satisfy currency transaction requirements.[17] The Internal Revenue Service (IRS) has issued guidance advising that profits on crypto-related investments should be reported as gains on property[18] – adding that such "property" can be seized to remedy taxpayer debts to the government.[19] The IRS written guidance initially spoke generally of such treatment under the tax laws[20], while an update explained the application of the same provisions to convertible securities and similar instruments.[21]

[15] Olga Kharif, *Bitcoin Rally Masks Uncomfortable Fact: Almost Nobody Uses It*, BLOOMBERG L. (May 31, 2019, 6:46 AM), https://www.bloomberg.com/news/articles/2019-05-31/bitcoin-s-rally-masks-uncomfortable-fact-almost-nobody-uses-it.

[16] As of April 30, 2021, Bitcoin—which underwent a type of "split" in 2017—was valued at over $57,000 per coin, with approximately 18 million coins in worldwide circulation; less than a month later, the price had dropped almost 30%. *See Bitcoin Market Price*, *supra* note 14.

[17] *See* U.S. DEP'T OF THE TREASURY, FIN-2013-G001, APPLICATION OF FINCEN'S REGULATIONS TO PERSONS ADMINISTERING, EXCHANGING, OR USING VIRTUAL CURRENCIES (Mar. 18, 2013).

[18] *See infra* notes 20 and 21.

[19] Allyson Versprille, *IRS Seizing Crypto Assets to Pay Off Tax Debts, Official Says*, BLOOMBERG L. (May 12, 2021, 8:54 AM), https://www.bloomberglaw.com/bloomberglawnews/daily-tax-report/X8AN4204000000?bna_news_filter=daily-tax-report#jcite.

[20] I.R.S. Notice 2014-21, 2014-16 I.R.B. 938; I.R.S. News Release IR-2014-36 (Mar. 25, 2014).

[21] I.R.S. News Release IR-2019-167 (Oct. 9, 2019).

Meanwhile, the Financial Crimes Enforcement Network (FinCEN), an enforcement arm of the Treasury Department, has twice issued guidance reminding that parties "mining" bitcoins for others or exchanging bitcoins for cash must comply with the registration requirements of the money laundering regulations promulgated under the Bank Secrecy Act.[22] To date, FinCEN has stopped short of subjecting cryptocurrency transactions exceeding a monetary threshold in value to reporting requirements.

While the Commodity Futures Trading Commission (CFTC) rushed to fill a void by obtaining judicial equating of cryptocurrency with commodities—via a 2015 disciplinary decision and subsequent court holding interpreting the Commodity Futures Act of 2000—[23] the relevant case decisions simply equate virtual currency "with commodity interests;"[24] moreover, that agency has not consistently litigated those holdings.[25]

All of which raises the problematic query why precise definition has been avoided in the fastest growing market of the 21st century.[26] In sum, in the view of American regulators, cryptocurrency is taxable property, but not an accepted currency, and certainly nor a per se security. Although most often exemplified by bitcoin, there are hundreds of alt-currencies dotting the global map.[27] Indeed, attempt at legal definition of the cyberspace unit is largely an after-thought; bills or disciplinary decisions centering on digital currency arrangements normally get referenced in a footnote.[28] More pointed definition can be linked to esoteric source

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[22] U.S. DEP'T OF THE TREASURY, FIN-2019-G001, APPLICATION OF FINCEN'S REGULATIONS TO CERTAIN BUSINESS MODELS INVOLVING CONVERTIBLE VIRTUAL CURRENCIES (May 9, 2019).

[23] *In re* TeraExchange, LLC, CFTC No. 15-33, 2015 WL 5658082 (Sept. 24, 2015); *see also* Commodity Futures Trading Comm'n v. McDonnell, 287 F. Supp. 3d 213, 228 (E.D.N.Y. 2018) (agreeing with the classification of bitcoin as a commodity).

[24] *See* Commodity Futures Trading Comm'n v. McDonnell, No. 18-CV-0361 (E.D.N.Y. Aug. 23, 2018).

[25] The SEC acknowledged the CFTC determination in 2017. *See infra* notes 199-200.

[26] *See, e.g.*, Jason Tashea, *Blockchain-Based Initial Coin Offerings Are All the Rage, but the Legal Terrain is Uncertain*, 104 A.B.A. J. 56 (Mar. 2018).

[27] At least 200 virtual or cryptocurrencies are available for ready sale in both formal and informal markets that operate online at all hours on all days. *See All Cryptocurrencies,* COINMARKETCAP, https://coinmarketcap.com/all/views/all/ (last visited May 10, 2021).

[28] Viewers of the popular television program Saturday Night Live were reminded of the lack of clarity underlying the crypto craze when, in a segment titled "Weekend Update," a pair of mock news anchors continually asked billionaire Elon Musk "But what IS Dogecoin?" *Saturday Night Live: Weekend Update* (NBC television broadcast May 8, 2021). The billionaire, playing an economist in the satirical skit, ultimately offered, "It can be exchanged for cash," as well as "Yes, it's a hustle." *Id.* Without humor, the 24-hour

and complicated result.[29]

Further, the ledger for cryptocurrency, "blockchain," is tautologically defined by the presence of cryptocurrency. For example, The National Conference of State Legislatures has declared simply that all digital currency transactions are recorded in a blockchain.[30] Separately, neither technocrats[31] nor foreign regulators have gone any further in clarifying the nature of the beast, no matter how large it grows.[32]

online market reacted immediately: The price of the dubious crypto currency fell considerably. *See* MacKenzie Sigalos, *Dogecoin Plunges Nearly 30% During Elon Musk's SNL Appearance*, CNBC: CRYPTO DECODED (May 9, 2021, 1:49 AM EDT), https://www.cnbc.com/2021/05/08/dogecoin-price-plummets-as-elon-musk-hosts-saturday-night-live-.html.

[29] On at least one occasion, "virtual currency" has been verbosely defined as:

> [A] digital representation of value that can be digitally traded and functions as: (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status (i.e., when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is not issued or guaranteed by any jurisdiction, and fulfils the above functions only by agreement within the community of users of the virtual currency. Virtual currency is distinguished from fiat currency (a.k.a. "real currency," "real money," or "national currency"), which is the coin and paper money of a country that is designated as its legal tender; circulates; and is customarily used and accepted as a medium of exchange in the issuing country. It is distinct from e-money, which is a digital representation of fiat currency used to electronically transfer value denominated in fiat currency.

Financial Action Task Force [FATF], *Virtual Currencies: Key Definitions and Potential AML/CFT Risks*, at 4 (June 27, 2014), http://www.fatf-gafi.org/media/fatf/documents /reports/Virtual-currency-key-definitions-and-potential-aml-cft-risks.pdf. In contrast, an initial coin offering, or "ICO" (discussed later herein), is defined by the SEC as "a fundraising event in which an entity offers participants a unique coin or 'token' issued on a 'blockchain' or consideration (often in the form of digital assets or fiat currency)". Complaint at 7, Sec. & Exch. Comm'n v. Middleton, No. 19-CV-04625 (E.D.N.Y. Aug. 12, 2019).

[30] Heather Morton, *Cryptocurrency 2018 Legislation*, NAT'L CONF. OF STATE LEGISLATURES (Dec. 31, 2018), https://www.ncsl.org/research/financial-services-and-commerce/cryptocurrency-2018-legislation.aspx.

[31] Ruoke Yang, *When is Bitcoin a Security Under U.S. Security Laws?*, 18 J. TECH. L. & POL'Y 99 (2014).

[32] *See, e.g.*, Monami Yui & Takahiko Hyuga, *Japan Says Bitcoin Not Currency Amid Calls for Regulation*, BLOOMBERG L. (Mar. 6, 2014, 12:13 PM EST), https://www.bloomberg.com/news/articles/2014-03-07/japan-says-bitcoin-is-not-a-currency-amid-calls-for-regulation.

C. The Leviathan Market Presence

As of January 2021, there are over 4,000 identified cryptocurrencies worldwide.[33] In the spring of this year, the cryptocurrency market reached a plateau market capitalization of $2 trillion.[34] While a finite list of American companies accept bitcoin as a payment option, the alt-currency is as ubiquitous as it is complex. Correspondingly, the "victims" of the phenomena have mounted as the public's desire for it swells.[35]

Overall, the peer-to-peer system imagined by Nakomoto could hardly be said to have welcomed regulation.[36] Indeed, the fundamentals of such idyllic economies eschew any form of government intervention.[37] Yet, the popularity of cryptocurrency, its lack of finite definition, its volatile pricing, and its potential for fraud collectively called for (and continue to call for) government oversight. Against such backdrop, the world's foremost business regulator, namely, the SEC, would find remaining dormant impossible. While Commission involvement may have been inevitable, the agency's successful application of an elastic measure continues to warrant admiration. Such laurels are inspired by a body of law more often comprehensible in view of its history than its exact verbiage.

Accordingly, Part II of this Article provides background on the definition of "security" as introduced by the federal securities laws, examining both the counter-intuitive growth of the threshold test and its impressive application by the SEC and private litigants to cryptocurrency arrangements. Next, Part III brings a tighter lens to the cases brought by the Commission for the purpose of juxtaposing the recent "Token" proposals offered by an SEC Commissioner. Part III concludes by offering amendments to the bold proposal in the areas of the suggested exemption, the attending definitions, the putative disclosures, and the reconciliation with both exemption law and Commission pronouncements to date. Part IV ends the Article with reminders on the need for prompt SEC rulemaking.

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[33] Luke Conway, *The 10 Most Important Cryptocurrencies Other Than Bitcoin*, INVESTOPEDIA (Sept. 16, 2021), https://www.investopedia.com/tech/most-important-cryptocurrencies-other-than-bitcoin/.

[34] Gertrude Chavez-Dreyfuss, *Crypto Market Cap Surges to Record $2 Trillion, Bitcoin at $1.1 Trillion*, REUTERS (Apr. 5, 2021, 9:36 AM), https://www.reuters.com/article/us-crypto-currency-marketcap/crypto-market-cap-surges-to-record-2-trillion-bitcoin-at-1-1-trillion-idUSKBN2BS1I7.

[35] Caitlin Ostroff, *New York Attorney General Warns on Cryptocurrency as Bitcoin Rallies*, WALL ST. J. (Mar. 1, 2021, 12:15 PM), https://www.wsj.com/articles/new-york-attorney-general-warns-on-cryptocurrencies-as-bitcoin-rallies-11614618921 ("The state's top law-enforcement official said bitcoin's price rise has lured more bad actors.").

[36] *See generally* Nakomoto, *supra* note 1.

[37] *Id.*

II. BACKGROUND: FROM ORANGE TREES TO DIGITAL TOKENS

A. Statutory Response to The Great Depression

The federal securities laws of 1933 and 1934 were an intense legislative reaction to a decade of Wall Street folly that almost bankrupted a nation. In the main, State-based common law fraud had proven to be a poor match for the pervasive recklessness that had grown among brokerages, investment banks, and stock exchanges; in turn, the companies touted by these intermediaries more often than not chose hyperbole (or outright lies) over fact in luring investors to the purchase.[38] President Roosevelt and Congress were eager to restore investor confidence and reacted to profligate speculation by creating remedial laws with true market impact.[39] The primary purpose of these laws could be said to be ensuring investor protection through mandatory disclosure before the transaction and elastic reach of anti-fraud provisions afterwards. If the Acts themselves were to be "sold" to all interested parties as a rational alternative (i.e., mandatory registration and disclosure), then the question of covered activity would nonetheless be broad.

The first of these laws, the Securities Act of 1933 (the "1933 Act"), is known as the "truth in securities" law.[40] Neither the 1933 Act nor the ensuing Securities

[38] *See generally* MICHAEL A. PERINO, THE HELLHOUND OF WALL STREET: HOW FERDINAND PECORA'S INVESTIGATION OF THE GREAT CRASH FOREVER CHANGED AMERICAN FINANCE (2011) (detailing the congressional "Pecora Hearings" and their success in revealing the depth of issuer fraud in the 1920s).

[39] Promptly after his first inauguration, President Roosevelt began to push for securities reform, primarily based upon the wish of meaningful written issuer disclosures to investors. In his message to Congress on March 29, 1933, President Roosevelt said:

> Of course, the Federal Government cannot and should not take any action which might be construed as approving or guaranteeing that newly issued securities are sound in the sense that their value will be maintained or that the properties which they represent will earn profit. There is, however, an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public.

H.R. REP. No. 73-85, at 2 (1933). Even before FDR worked to repeal Prohibition and reward voters with a drink of alcohol, he worked to revamp the oversight of the stock exchanges. *See* J. SCOTT COLESANTI, FAIRNESS, INC.: THE ORIGINS (AND BILLION-DOLLAR BONUSES) OF RULE 10B-5 AS AMERICA'S INSIDER TRADING PROHIBITION 4 (2018) [hereinafter FAIRNESS, INC.].

[40] The 1933 Securities Act, CORP. FIN. INST., https://corporatefinanceinstitute.com

Exchange Act of 1934 (the "1934 Act"; collectively, "the Acts") were intended to provide a broad federal remedy for all fraud.[41] Instead, these statutes apply only to those investments that are within their broad statutory definition of a "security."[42] Stated more formally, the purpose of the federal securities statutes is "compelling full and fair disclosure relative to the issuance of 'the many types of instruments that in our commercial world fall within the ordinary concept of a security.'"[43]

The protocol built by the New Dealers has grown to be the envy of regulators everywhere. Issuers are compelled to register securities or methodically adhere to demanding "exemptions" from registration authorized by statute. In turn, stock exchanges trading securities must register and submit to the SEC the rules that govern their operations and rulemaking; to this same end, investment advisers (of a certain size) recommending securities must register with the Commission. And, of course, broker-dealers need to register on various levels including the SEC, the states wherein business is sought or conducted, and the largest self-regulatory organization, the Financial Industry Regulatory Authority (FINRA[44]). Penalties for avoiding registration range from fines to criminal incarceration of controlling

/resources/knowledge/trading-investing/1933-securities-act-truth-securities/ (last visited Nov. 6, 2021); *see also* Sec. & Exch. Comm'n v. Ralston Purina Co., 346 U.S. 119, 124 n.10 (1953).

[41] *See* Marine Bank v. Weaver, 455 U.S. 551, 556 (1982); *see also* Northland Cap. Corp. v. Silver, 735 F.2d 1421, 1431 (D.C. Cir. 1984); Baurer v. Plan. Grp., Inc., 669 F.2d 770, 774 (D.C. Cir. 1981).

[42] 15 U.S.C. §§ 77b(a)(1), 78c(10) (providing a detailed list of categories and examples of "securities," including catchall language such as "any interest or instrument commonly known as a 'security'").

[43] Sec. & Exch. Comm'n v. W.J. Howey Co., 328 U.S. 293, 299 (1946) (quoting H.R. REP. NO. 73-85, at 11 (1933)); *see also* Sec. & Exch. Comm'n v. Cap. Gains Rsch. Bureau, Inc., 375 U.S. 180, 186 (1963) (holding that the primary purpose of the federal securities laws is to "substitute a philosophy of full disclosure for the philosophy of *caveat emptor*"). Moreover, "[o]ne of [the 1934 Act's] central purposes is to protect investors through the requirement of full disclosure by issuers of securities . . . ." Tcherepnin v. Knight, 389 U.S. 332, 336 (1967). Thus, the design of the statute was to "protect investors by promoting full disclosure of information thought necessary to informed investment decisions." Sec. & Exch. Comm'n v. Ralston Purina Co., 346 U.S. 119, 124 (1953) (citing A.C. Frost & Co. v. Coeur D'Alene Mines Corp., 312 U.S. 38, 40 (1941)). "[T]he Court repeatedly has described the 'fundamental purpose' of the Act as implementing a 'philosophy of full disclosure . . . .'" Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 477–78 (1977) (quoting Cap. Gains Rsch. Bureau, Inc., 375 U.S. at 186).

[44] Created in 2007, FINRA combined the Divisions of Enforcement of its predecessor, NASD, and the New York Stock Exchange. *See The Institution of Experience: Self-Regulatory Organizations in the Securities Industry, 1792-2010*, SEC HIST. SOC'Y, http://www.SEChistorical.org/museum/galleries/sro/sro06g.php (last visited May 12, 2021).

individuals.[45]

In turn, as primary enforcer of the most expansive system of securities statutes, the SEC has nearly 100 years of experience in enforcing the Acts. Both statutes bestow jurisdiction among federal courts to hear cases imposing disciplinary action far exceeding traditional European and state notions of business regulation. Both Acts also operate around the jurisdictional lynchpin of the presence of a *security*. As is demonstrated below, the federal courts have been unflagging allies in expanding that pivotal notion in the cause of punishing investor abuse. This consistent judicial animation of the New Deal spirit is best exemplified by the willingness to identify promoters and investors in arrangements varying wildly from the traditional notion of a corporate share certificate.

B. The Threshold Question of Locating a "Security"

From its inception, Section 2(a)(1) of the Securities Act of 1933 has contained a veritable laundry list of arrangements defining "securities." In its current form, the statutory definition of a "security" reads as follows:

> 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.[46]

A similarly broad and inclusive list exists in Section 3 of the 1934 Act. The

[45] *See, e.g.*, United States v. Wolfson, 405 F.2d 779, 783 (2d Cir. 1968) (upholding conviction of an issuer found to have avoided registration).

[46] 15 U.S.C. § 77b(a)(1).

courts have equated the two Acts in this regard.[47] Consequentially, the existence of a security far surpasses shares traded on a stock exchange or even deals carefully crafted to exclude either the coverage of the securities laws or the moniker of "stock." Further, once satisfying the jurisdictional nexus of locating a security (i.e., identifying a security in the transaction, as required by statutes and/or regulations requiring registration), the SEC can charge entities as acting as unregistered broker-dealers, investment advisers, or stock exchanges.[48]

Remarkably, the dual laundry lists within the Act have served primarily as academic starting points for further application. While it is accepted that Congress had tried to craft a broad definition that would "meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits,"[49] the federal legislature failed to define the catch-all phrase "investment contract." [50] The resulting common law standard results in case-by-case determinations of the threshold question to any dispute. And the Supreme Court availed itself of that flexibility, aggrandizing jurisdiction in crafting a case law test that has come to be known as the "*Howey* Test." That test spurs a case-by-case determination utilizing a 4-part, conjunctive analysis created by the Supreme Court in the eponymous case. In sum, the test seeks to identify passive investors, while – owing to the later *Tcherepnin* case – discerning the "economic realities of the transaction." [51]

While there had been prior occasion for the High Court case to interpret the definition of "investment contract" in the 1933 Act,[52] the *Howey* decision of 1946

[47] In *Tcherepnin*, the Supreme Court held that the statutory term "security" has the same flexible meaning under both the Acts. 389 U.S. at 338 ("As used in both the 1933 and 1934 Acts, security 'embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.'"). However, SEC charges often reference both Acts.

[48] *See, e.g.*, Sec. & Exch. Comm'n v. McFarland, No. 18-CV-6634 (S.D.N.Y. July 24, 2018); Coburn, Exchange Act Release No. 84553 (Nov. 8, 2018).

[49] "Congress' purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called." Reves v. Ernst & Young, 494 U.S. 56, 61 (1990).

[50] "Throughout the history of struggling for an appropriate definition, courts have been mindful of the fact that the bottom-line question is whether the particular investment or instrument involved is one that needs or demands the investor protection of the federal (or state) securities laws." THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 30-31 (3d ed. 1996).

[51] Tcherepnin v. Knight, 389 U.S. 332, 352-53 (1967).

[52] *E.g.*, Sec. & Exch. Comm'n v. C.M. Joiner Leasing Corp., 320 U.S. 344, 350 n.6 (1943) (finding the offer and sale of assignments in oil leases, coupled with the promoter's

offered clearer guidance for review of novel arrangements. In a decision weighing the sale of orange tree lots when coupled with efforts of the promoter to monetize, the Supreme Court found the creative arrangement to satisfy Section 2(1) of the 1933 Act. As the Court stated, the test "permits the fulfillment of the statutory purpose of compelling full and fair disclosure relative to the issuance of 'the many types of instruments that in our commercial world fall within the ordinary concept of a security.'"[53]

The 4-part conjunctive test created by the Supreme Court in the landmark *Howey* case is strikingly friendly to parties asserting the presence of a security. The standard seeks to identify passive investors (i.e., those who rely solely on others for profits). In turn, promoters satisfy the test regardless of intent, for *Howey* instructed that a security could result even from a "bona fide" belief that the securities laws did not apply.[54]

Consequentially, the list of investment contract arrangements has grown almost without pause. Indeed, in the past 40 years, case law has expanded the application of securities laws to business models such as franchises[55] and unsecured promissory notes.[56] Moreover, the intent of the parties to expressly include or exclude exempted transactions within the securities laws is irrelevant, as demonstrated by *Great Rivers Coop. v. Farmlands Indus.*[57] and *United States v. Leonard.*[58]

Thus, the SEC has chilled quixotic offers of profitable investment by labeling "promoter" and "investor" to expand its reach in widely disparate areas. Some notable examples include condominium subletting agreements,[59] animal breeding

promise to drill test wells, constitute investment contracts, reasoning that section 2(1) expressly references "fractional undivided interest in oil, gas, or other mineral rights").

[53] H.R. REP. No. 73-85, at 11 (1933).

[54] Sec. & Exch. Comm'n v. W.J. Howey Co., 328 U.S. 293, 301 (1946).

[55] Sec. & Exch. Comm'n v. Aqua-Sonic Prods. Corp., 524 F. Supp. 866, 878 (S.D.N.Y. 1981).

[56] Sec. & Exch. Comm'n v. Thompson, 732 F.3d 1151, 1151 (10th Cir. 2013).

[57] Great Rivers Co-op of Se. Iowa v. Farmland Indus. Inc., 198 F.3d 685, 699 (8th Cir. 1999). The *Great Rivers* court stated that the promoter's state registration of the arrangement was a nullity in its determination.

[58] United States v. Leonard, 529 F.3d 83 (2d Cir. 2008). The *Leonard* court expressly discounted the defendant's classification of the arrangement as being subject solely to New York's Limited Liability Company statute.

[59] Bamert v. Pulte Home Corp., 445 F. App'x 256 (11th Cir. 2011).

farms,[60] "death bonds,"[61] and internet-gaming coins.[62]

In view of the successful expansion of SEC application of Section 5 and the concomitant universal application of Rule 10b-5 as an anti-fraud remedy,[63] the fact that the SEC would take on the challenge of protecting American "investors" in alt-currencies is unsurprising. Better fitting still is the application of the Acts to a popular spinoff of the bitcoin craze, the initial coin offering (ICO).[64] An "initial coin offering" or "ICO" is a recently developed form of fundraising event in which an entity offers participants a unique digital "coin" or "token" in exchange for consideration (most commonly Bitcoin, Ether, or fiat currency). In such lucrative ventures, fledgling companies with grandiose plans exchange future "tokens" in a unique digital enterprise. The company raising capital (i.e., the "Promoter") asserts that sales of such tokens are necessary to gather network participants, while the regulator fears that the tokens – going beyond any "utility" – are commensurate with issuing stock that may appreciate in value. Because many investor-purchasers actually part with money, ICOs consistently state plausible cases for securities law coverage, particularly in light of the great many federal courts rewarding

[60] Sheets v. Dziabis, 738 F. Supp. 307 (N.D. Ind. 1990).

[61] Sec. & Exch. Comm'n v. Life Partners, Inc., 87 F.3d 536 (D.C. Cir. 1996). In the infamous SEC loss, the D.C. Circuit ruled that the fractionalized interests in transferred life insurance policies (called "viatical settlements"), being reliant upon the life expectancy of the terminally ill, failed to satisfy the "efforts of others" element of *Howey*. That holding was later contravened by other courts, most notably the high court of Texas in *Life Partners, Inc. v. Arnold*, 464 S.W.3d 660 (Tex. 2015). The Texas decision evidences the state court reliance on *Howey*:

> We hold that the agreements at issue are investment contracts because they constitute transactions through which a person pays money to participate in a common enterprise with the expectation of receiving profits, under circumstances in which the failure or success of the enterprise and the person's realization of the expected profits is at least predominately due to the entrepreneurial or managerial efforts of others.

Id. at 662.

[62] Sec. & Exch. Comm'n v. SG Ltd., 265 F.3d 42, 42 (1st Cir. 2001).

[63] Since its inception, Section 10(b) of the 1934 Act has outlawed securities fraud. 15 U.S.C. § 78j(b) (1934). Since 1942, enabling SEC Rule 10b-5 has outlawed three alternative genres thereof: scheme liability [subsection "a"], misstatement liability [subsection "b"], practice/course of business liability [subsection "c"]. 17 C.F.R. § 240.10b-5. The rule can be invoked by government and private litigants alike and has been successfully applied countless times to individuals, corporations, government subdivisions, and foreign entities. *See generally* FAIRNESS, INC., *supra* note 39, at 3–60.

[64] For purposes of this article, cryptocurrency and ICOs are equated as digital assets.

expansion in favor of investor protection.[65] Such scrutiny by the courts is rarely a stretch; often, tokens are listed by third parties and tradeable immediately after they are issued.[66]

To be sure, the SEC's application of the *Howey* test to crypto arrangements goes beyond ICOs. However, ICO offerings appear to have garnered the most attention from the Commission. And that attention is rewarded when the orange grove case from 1946 is successfully applied.

C. The Howey Test

For the vast majority of jurisdictional inquiries, the *Howey* test fleshes out what constitutes an 'investment contract" for purposes of the federal securities laws.[67] The term had no standard meaning in any commercial context, although it appeared in a number of states' "Blue Sky laws" before the 1933 Act.[68] In layman's terms, the test seeks to identify transactions in which investors are relying on others to manage the enterprise that will produce financial returns on their investments.[69] These investors often lack the expertise of the promoters behind the arrangement. The test, thus, identifies those deals warranting registration under the Acts, which required formal disclosures about the deal and the issuer.

[65] *See, e.g.*, Sec. & Exch. Comm'n v. Edwards, 540 U.S. 389, 393 (2004) ("'Congress' purpose in enacting the securities laws was to regulate *investments*, in whatever form they are made and by whatever name they are called.' Reves v. Ernst & Young, 494 U.S. 56, 61 (1990). To that end, it enacted a broad definition of 'security,' sufficient 'to encompass virtually any instruments that might be sold as an investment.' *Ibid*.").

[66] Munchee Inc., Securities Act Release No. 10445, 2017 WL 10605969 (Dec. 11, 2017) [hereinafter *Munchee* Order].

[67] It is commonly accepted that the *Howey* decision began a period of the SEC brashly applying the Acts to nonconventional securities—an ever-growing list of investments the First Circuit has described as "a kaleidoscopic assortment of pecuniary arrangements that defy categorization." *SG Ltd.*, 265 F.3d at 47 (denying defendants' motion to dismiss). This expansive reading of the statute is buttressed by court decisions noting the lack of other regulatory remedies—the Supreme Court has even expressly tilted the scales in favor of finding a security when the instruments in question "would escape federal regulation entirely if the [Securities] Acts were held not to apply." *Ernst & Young*, 494 U.S. at 67-69 (finding farm cooperative demand notes to be securities after analysis under the Second Circuit's "family resemblance" test, used to identify commercial paper). *See also* FAIRNESS, INC., *supra* note 39, at 27-28.

[68] *See* Leslie J. Crocker, *Investment Contracts under Federal and State Law*, 17 W. RSRV. L. REV. 1108, 1111 (1966).

[69] Sec. & Exch. Comm'n v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946).

(i) <u>*The Test in Parts*</u>

The *Howey* test is typically described as having four elements. The first element requires an investment of money.[70] Courts have held that cash is not the only form of contribution or investment that will satisfy this prong.[71] This prong has been interpreted to include cash, promissory notes,[72] and bartered-for goods and services.[73] The investment of money element is met when an investor parts with consideration "with the hope of some future return."[74] And as one commentator has aptly noted, "[i]t appears that any nuanced reading of the first element is subsumed in subsequent [t]est factors."[75]

The second element requires that the investment of money be in a "common enterprise."[76] The Supreme Court in *Howey* made a showing of fact to support a finding of commonality but failed to define the contours of this required commonality, leaving it to the lower courts to flesh out.[77] Two sub-tests have developed to satisfy the requirement of commonality. First, this element can be satisfied through "horizontal commonality," which focuses on the connection between and among the investors (i.e., looking for investors sharing the risk of the enterprise by sharing profits and losses proportionately).

The alternate approach to the second element taken by some circuits is known

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[70] *Id.* at 301.

[71] Uselton v. Com. Lovelace Motor Freight, Inc., 940 F.2d 564, 574 (10th Cir. 1991).

[72] Hector v. Wiens, 533 F.2d 429, 432-33 (9th Cir. 1976).

[73] Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551, 552 n.12 (1979). *But see* United States v. Jones, 450 F.2d 523, 525 (5th Cir. 1971) (finding airline ticket vouchers not to be securities for purposes the prohibition against carriage of forged instruments set out in 18 U.S.C. § 2311, even where such provision—which largely echoed the 1933 Act and 1934 definitional sections—specifically included "evidence of indebtedness").

[74] *See* LARRY D. SODERQUIST, UNDERSTANDING THE SECURITIES LAWS (4th ed. 2003), *reprinted in* LARRY D. SODERQUIST, *Reach of Securities Act Regulation in* CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES: NUTS & BOLTS OF SECURITIES LAWS 113, 119 (Practising Law Institute 2005); *Howey*, 328 U.S. at 300.

[75] J. Scott Colesanti, *Trotting Out the White Horse: How the S.E.C. Can Handle Bitcoin's Threat to American Investors*, 65 SYRACUSE L. REV. 1, 32 (2015).

[76] Sec. & Exch. Comm'n v. W.J. Howey Co., 328 U.S. 293, 301 (1946).

[77] Christopher L. Borsani, *A "Common" Problem: Examining the Need for Common Ground in the "Common Enterprise" Element of the* Howey *Test*, 10 DUQ. BUS. L.J. 1, 4 (2008); *see also* Jonathan E. Shook, Note, *The Common Enterprise Test: Getting Horizontal or Going Vertical in Wals v. Fox Hills Dev. Corp.*, 30 TULSA L.J. 727, 732-33 (1995) ("Unfortunately, because neither the Court in *Howey* nor any subsequent Supreme Court decision has defined the 'common enterprise' prong of the *Howey* test, the federal courts have been left to disagree.") (citing Shawn Hill Crook, Comment, *What is a Common Enterprise? Horizontal and Vertical Commonality in an Investment Contract Analysis*, 19 CUMB. L. REV. 323, 325 (1989).

as "vertical commonality," which focuses on the connection between the promoter and investors, looking for "the fortunes of the investor interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties."[78]

The third element requires that investment be undertaken with the expectation of profits.[79] This expectation cannot be of additional contributions, and the return on investment must be the principal motivation for the investment.[80] This element is often synonymous with the marketing of the financial arrangements particular to the given investment and is often demonstrated by a "[p]romoter's wistful statements or advertising of successful commercial activities."[81]

Finally, the fourth element requires that the profits result from the efforts of others.[82] This element has seen significant movement since *Howey* was decided. The original language in *Howey* required that the investment of money in this common enterprise be undertaken with the expectation of profits *solely* from the efforts of others.[83] Excluding where an investor provided any efforts would exclude from the protection of the securities laws any investment that involved even the most minimal effort from the investors.[84] In a pair of victories against a notorious Ponzi schemer in the 1970s, the SEC succeeded in amending the test so

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[78] Sec. & Exch. Comm'n v. Glenn W. Turner Enters., Inc., 474 F.2d 476, 482 n.7 (9th Cir. 1973). The subsequent variation of element two can be summarized as follows:

> [V]ertical commonality was juridically divided into strict and broad varieties, enthusiastically embraced by litigants and opportunistically utilized by the SEC. "Strict" vertical commonality requires that the economic fates of the Promoter and Investor be tied and that their fortunes rise and fall together, the focus rests upon a closely-aligned "one-to-one relationship between the investor and investment manager." Conversely, "broad" vertical commonality requires only that the "efforts" of Promoter and Investor be "linked." The Supreme Court has not determined which, if any, of the versions is universally required.

Colesanti, *supra* note 75, at 33-34 (footnotes omitted).

[79] *Howey*, 328 U.S. at 301.

[80] Some courts combine the third and fourth components, and thus refer to the test as a three-part test. *See, e.g.*, Sec. & Exch. Comm'n v. Life Partners, Inc., 87 F.3d 536, 540 (D.C. Cir. 1996); Warfield v. Alaniz, 569 F.3d 1015, 1020 (9th Cir. 2009) (citing Sec. & Exch. Comm'n v. Rubera, 350 F.3d 1084, 1090 (9th Cir. 2003)) ("We distilled *Howey*'s definition into a three-part test . . . ."). This combination is supportable, as the full idea is that the investor has an expectation of profit and that expectation must come, to a large measure, from the efforts of someone other than the investor.

[81] Colesanti, *supra* note 75, at 34-35.

[82] Sec. & Exch. Comm'n v. W.J. Howey Co., 328 U.S. 293, 301 (1946).

[83] *Id.*

[84] Robinson v. Glynn, 349 F.3d 166, 170 (4th Cir. 2003).

that only "essential" or "managerial" promoter efforts be located.[85]

Overall, the *Howey* test, for better or for worse, is what courts and investors are left with to determine whether a given opportunity is an investment contract and, thus, within the reach of the Acts, specifically the registration and prospectus delivery requirements of Section 5. As was noted:

> Despite some hiccups, *Howey* transformed the 1933 Act and 1934 Act into dynamic statutes that would forever value the dual promises of Section 5 (i.e., registration and prospectus delivery[86]). Moreover, the federal bench has continued to uphold *Howey*'s promise of protection for investors in securities traditional or otherwise; such continued protection is laudable for, among other reasons, the vulnerability and political nature of agency-made law in general.[87]

(ii) *Application to Cryptocurrency Arrangements*

The SEC has not been shy about using the *Howey* test to attempt to rein in "the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits."[88] While cryptocurrency itself has never been declared a security by a court or the Commission, the world of cryptocurrency arrangements is fertile ground for SEC intervention. Commentators have debated whether and how cryptocurrencies should be regulated, with the debate clearly illustrating that any path to regulation was not self-evident from the language of the 1933 and 1934 Acts.[89] Under certain circumstances, the SEC has declared that both vehicles purchasing cryptocurrency and ICOs themselves constitute sales of securities warranting formal registration with the agency (and the filing of related public disclosures).[90]

In the seminal SEC action, *SEC v. Shavers*, the SEC asserted that a fund

[85] Sec. & Exch. Comm'n v. Glenn Turner Enters., Inc., 474 F.2d 476, 482 (9th Cir. 1973); Sec. & Exch. Comm'n v. Koscot Interplanetary, Inc., 497 F.2d 473, 485 (5th Cir. 1974).

[86] 15 U.S.C. § 77f (a), (c).

[87] FAIRNESS, INC., *supra* note 39; THOMAS LEE HAZEN, PRINCIPLES OF SECURITIES REGULATION 328-29 (2d. ed. 2006); WILLIAM F. FOX, UNDERSTANDING ADMINISTRATIVE LAW 54-57 (6th ed. 2012) (noting that the federal agencies' "administrator[s are] totally subject to Presidential control").

[88] Sec. & Exch. Comm'n v. W.J. Howey Co., 328 U.S. 293, 299 (1946).

[89] *See* FAIRNESS, INC., *supra* note 39 (calling for more active SEC regulation of Bitcoin). For a broader, generalized call for regulatory action, see Yang, *supra* note 31, at 114-15 (concluding that any sale of bitcoin itself satisfies all prongs of the *Howey* test).

[90] *See, e.g.*, *Munchee* Order, *supra* note 66, at *8.

designed to trade bitcoin constituted an investment contract under *Howey*.[91] Shavers, the founder and operator of "Bitcoin Savings & Trust" (BTCST), solicited lenders to invest in bitcoin-related opportunities.[92] Shavers challenged the court's subject matter jurisdiction, arguing that the BTCST investments were not securities because bitcoin is not "money."[93]

The court agreed with the Commission, finding that the BTCST investments were ripe for application because bitcoin could be used as money to purchase goods and services and could be exchanged for "conventional" currencies. Accordingly, the court found that "Bitcoin is a currency or form of money, and investors wishing to invest in BTCST provided an investment of money."[94]

Subsequent SEC cases would be more instructive. The Commission enjoyed a string of uninterrupted victories clawing back monies for investors or swelling government coffers with fines. Indeed, the *Howey* test elements of "money" and "profits" (i.e., elements 1 and 3) posed nearly no obstacle to application. Investors in startups willingly trade consideration and consistently show a desire for profit. Thus, the challenge for the SEC lies in the "common enterprise" and "efforts of others" requirements (i.e., elements 2 and 4, respectively).

In the *Telegram Group* case,[95] the SEC set forth its position that, beyond essential managerial efforts by promoters (i.e., element 4), the absence of any required investor efforts to create profits sufficed. Thus, in alleging that "the principal means by which investors would reasonably expect to profit is through their resale of [tokens],"[96] the SEC obviated the need to allege or prove that the promoter issuer actively encourages a third-party market. The case resulted in the successful halting of an offering by a foreign-based mobile messengering application determined to be tied to the "world's most adopted cryptocurrency wallet."[97]

A year later, in the *Ackerman* case, the SEC halted an offering by a physician who had secured $33 million in an advertised effort to "pool money to invest in cryptocurrencies."[98] The SEC alleged that the physician diverted millions of

[91] Sec. & Exch. Comm'n v. Shavers, No. 4:13-CV-416, 2013 WL 4028182, at *1 (E.D. Tex. Aug. 6, 2013) *aff'd on reh'g on other grounds*, No. 4:13-CV-416, 2014 WL 4652121 (E.D. Tex. Sept. 18, 2014).

[92] *Id.* at *1.

[93] *Id.*

[94] *Id.* at *2.

[95] Complaint, Sec. & Exch. Comm'n v. Telegram Grp. Inc., No. 19 CIV. 9439 (PKC), 2020 WL 61528 (S.D.N.Y. Oct. 11, 2019).

[96] *Id.* at ¶ 98.

[97] *Id.* at ¶ 103.

[98] Complaint at ¶ 3, Sec. & Exch. Comm'n v. Ackerman, No. 1:20-CV-1181 (S.D.N.Y. Feb. 11, 2020).

dollars of such contributions for personal use. In alleging the presence of a security, the SEC complaint alleged that the defendant falsely claimed that his controlled entities "successfully traded various crypto currencies through various crypto exchanges using proprietary algorithmically driven software for other pooled investment groups."[99]

A scrutiny of a broader selection of crypto cases likewise reveals that to raise the question of a security's presence is largely to answer it in the affirmative.[100] Many other cases would successfully apply *Howey* to coin offerings. Those disciplinary proceedings would benefit from loud declarations of support from the SEC Chair and others.

D. SEC Public Pronouncements of Note

Curiously, while avoiding formal rulemaking, between 2017 and 2020, the Commission often publicized a confident view that crypto arrangements fell within the securities laws. In the oft-discussed 2017 DAO report, the SEC, while deciding against enforcement action, declared that Slock.it, a German cyberspace corporation holding "a corpus of assets through the sale of DAO Tokens to investors" had sold securities under American laws.[101] "Slock.it" had sold over 1 billion DAO Tokens in less than a month in the spring of 2016.[102] The SEC did not bring an enforcement action against the startup because a hacker stole approximately one-third of the digital asset organization's assets after the DAO Tokens were sold but before it was able to begin financing the project.[103]

In applying the *Howey* test to DAO Tokens, the SEC first concluded that the investors in DAO Tokens did invest money, although no traditional currency changed hands.[104] Specifically, the SEC found that investors in DAO Tokens used Ether (ETH), a virtual currency used on a decentralized platform that runs smart contracts known as the Ethereum Blockchain to make their investments. Each investor tendered ETH in exchange for DAO Tokens. Despite the lack of traditional currency to satisfy the "investment of money" prong of *Howey*, the SEC

[99] *Id.* at ¶ 33.

[100] *See infra* notes 144-58 and accompanying text.

[101] *See generally,* Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Release No. 81207 (July 25, 2017) [hereinafter DAO Report], https://www.SEC.gov/litigation/investreport/34-81207.pdf.

[102] *Id.* at 2-3. The DAO's intended purpose was to "blaze a new path in business for the betterment of its members, existing simultaneously nowhere and everywhere and operating solely with the steadfast iron will of unstoppable code." *Id.* at 5.

[103] *Id.* at 1.

[104] *Id.* at 11 (citing Uselton v. Comm. Lovelace Motor Freight, Inc., 940 F.2d 564, 574 (10th Cir. 1991)).

concluded that the investment in DAO Tokens "is the type of contribution of value that can create an investment contract under *Howey*."[105]

Next, the SEC combined discussion of the commonality prong of the *Howey* test with the DAO Tokens in its discussion of the "reasonable expectation of profits" prong of the *Howey* test. The only reference to the commonality requirement is the SEC's unsupported conclusion that DAO Token investors were invested in a common enterprise.[106]

The SEC devoted more analysis to the expectation of profits prong and noted that for purposes of the *Howey* test, profits can include "dividends, other periodic payments, or the increased value of the investment."[107] A profit-seeking enterprise, the DAO's objectives included funding projects in exchange for a return on investment.[108] Since DAO Token holders had the possibility of sharing in potential profits from the various contracts funded, the SEC concluded that "a reasonable investor would have been motivated, at least in part, by the prospects of profits on their investment of ETH in The DAO."[109]

The final prong of the *Howey* test (i.e., that the profits be derived from the managerial efforts of others) was met with the DAO Tokens. Namely, since the investors "relied on the managerial and entrepreneurial efforts of Slock.it and its co-founders" (e.g., generating project proposals), there existed the requisite reliance upon the promoters.[110]

Finally, the SEC made it clear that the federal securities laws apply to any and all investments that fall within the statutory definition:

> The registration requirements are designed to provide investors with procedural protections and material information necessary to make informed investment decisions. These requirements apply to those who offer and sell securities in the United States, regardless whether the issuing entity is a traditional company or a decentralized autonomous organization, regardless whether those

[105] *Id.* (first citing Sec. & Exch. Comm'n v. Shavers, No. 4:13-CV-416, 2014 WL 4652121, at *1 (E.D. Tex. Sept. 18, 2014); and then citing *Uselton*, 940 F.2d at 574 ("[T]he 'investment' may take the form of 'goods and services,' or some other 'exchange of value.'")).

[106] *Id.*

[107] Sec. & Exch. Comm'n v. Edwards, 540 U.S. 389, 394 (2004).

[108] DAO Report, *supra* note 101, at 11-12.

[109] *Id.*

[110] *Id.* at 12. The SEC was not troubled by the DAO Token holders' voting rights, finding that these rights "did not provide them with meaningful control over the enterprise, because (1) DAO Token holders' ability to vote for contracts was a largely perfunctory one; and (2) DAO Token holders were widely dispersed and limited in their ability to communicate with one another." *Id.* at 14.

> securities are purchased using U.S. dollars or virtual currencies, and regardless whether they are distributed in certificated form or through distributed ledger technology.[111]

The clear precedent became an injunction action not much later. In late 2017, the SEC halted an entrepreneurial offering commenced by Munchee, Inc.[112] Munchee, a California corporation with a deal with Apple, issued digital coins to budding restaurant critics for submitting a review of a local eatery.[113] The Commission halted the offering on day two of its operation, which had been slated to earn $15 million from American purchasers.[114] The accompanying SEC settlement order quoted a case from an earlier generation weighing cooperative apartment shares as securities, *United Housing Found., Inc. v. Forman*.[115] The order stated:

> The "touchstone" of an investment contract "is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." This definition embodies a "flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits."[116]

Also, in late 2017, the SEC Chair issued a warning to all potential ICO issuers that the securities laws would presumably apply to their deals:

> A key question for all ICO market participants: "Is the coin or token a security?" As securities law practitioners know well, the answer depends on the facts. For example, a token that represents a participation interest in a book-of-the-month club may not implicate our securities laws, and may well be an efficient way for the club's operators to fund the future acquisition of books and facilitate the distribution of those books to token holders. In contrast, many token offerings appear to have gone beyond this construct and are more analogous to interests in a yet-to-be-built publishing house with the authors, books and distribution networks all to come. It is especially troubling when the

[111] *Id.* at 18.
[112] *Munchee* Order, *supra* note 66.
[113] *Id.*
[114] *Id.*
[115] United Hous. Found., Inc. v. Forman, 421 U.S. 837 (1975).
[116] *Munchee* Order, *supra* note 66, at 8 (first quoting United Hous. Found., Inc., 421 U.S. at 852-53, then quoting Sec. & Exch. Comm'n v. W.J. Howey Co., 328 U.S. 293, 299 (1946)).

> promoters of these offerings emphasize the secondary market trading potential of these tokens. Prospective purchasers are being sold on the potential for tokens to increase in value – with the ability to lock in those increases by reselling the tokens on a secondary market – or to otherwise profit from the tokens based on the efforts of others. These are key hallmarks of a security and a securities offering.[117]

The Chair's warning to investment professionals concurrently acknowledged a presumption that related parties would, where appropriate, be subject to the securities laws:

> I also caution market participants against promoting or touting the offer and sale of coins without first determining whether the securities laws apply to those actions. Selling securities generally requires a license, and experience shows that excessive touting in thinly traded and volatile markets can be an indicator of "scalping," "pump and dump" and other manipulations and frauds**.** Similarly, I also caution those who operate systems and platforms that effect or facilitate transactions in these products that they may be operating unregistered exchanges or broker-dealers that are in violation of the Securities Exchange Act of 1934 (emphasis in original).[118]

This fire and brimstone approach resonates when a schemer is the target, much less so when a business seeks to sell digital coins for use on its network (i.e., "utility tokens"). To the extent the weight of the Commission's vaunted Division of Enforcement was not readily comprehended, the Chair continued:

> On cryptocurrencies, I want to emphasize two points. First, while there are cryptocurrencies that do not appear to be securities, simply calling something a "currency" or a currency-based product does not mean that it is not a security. Before launching a cryptocurrency or a product with its value tied to one or more cryptocurrencies, its promoters must either (1) be able to demonstrate that the currency or product is not a security or (2) comply with applicable registration and other requirements under our securities laws.[119]

[117] Jay Clayton, Chairman, *Statement on Cryptocurrencies and Initial Coin Offerings*, U.S. SEC. & EXCH. COMM'N (Dec. 11, 2017), https://www.SEC.gov/news/public-statement/statement-clayton-2017-12-11.

[118] *Id.* (emphasis in original).

[119] *Id.*

Further, the SEC's admonitions were effectively spread to third parties. Approximately a year after the Munchee Order and the Chair's warnings, the Commission made good on its advertised presumption that coins issued via ICOs are securities. Significantly, in accepting $900,000 to promote three ICOs on his Instagram, Twitter, and Facebook accounts, champion boxer Floyd Mayweather was found to have violated Section 17b of the Securities Act.[120] In a much publicized settlement with the boxer, the SEC imposed discipline upon Mayweather – an ordinary citizen, not a securities professional – for his paid endorsement of digital tokens. That SEC Order tersely held, "Mayweather violated Section 17(b) of the Securities Act by touting three ICOs that involved the offer and sale of securities on his social media accounts without disclosing that he received compensation from an issuer for doing so, or the amount of the consideration."[121]

The SEC Order naming Mayweather did not explain the application of Section 5 or the *Howey* test to the ICOs in issue.[122] The conclusion seems to be presumed, as it was in a companion settlement Order concluded with celebrity DJ Khaled.[123] Mayweather consented to pay $600,000 in satisfaction of a fine and disgorgement, as well as the undertaking to refrain from further violations[124] and Khaled agreed, for a two-year period, to:

> Forgo receiving or agreeing to receive any form of compensation or consideration, directly or indirectly, from any issuer, underwriter, or dealer, for directly or indirectly publishing, giving publicity to, or circulating any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a Security, digital or otherwise, for sale, describes such Security.[125]

The rush to apply the Acts without definitive classification of the underlying

[120] *See generally* Floyd Mayweather Jr., Securities Act Release No. 10578, 2018 WL 6266203 at 2 (Nov. 29, 2018) [hereinafter *Mayweather* Order].

[121] *Id.*

[122] *Id.* at 6.

[123] Khaled Khaled, Securities Act Release No. 10579, 2018 WL 6266204 (Nov. 29, 2018) [hereinafter *Khaled* Order].

[124] *Mayweather* Order, *supra* note 120, at 4.

[125] *Khaled* Order, *supra* note 123, at 3. Of note is the SEC No Action Letter of early April 2019, which permitted an ICO to move forward without registration of tokens representing air charter discounts where the issuer, among other things, did not emphasize the "potential for increase in the market value of the Token" and the Token was limited to an immovable price of $1. *See* TurnKey Jet, Inc., SEC Staff No-Action Letter, 2019 WL 1471132 (Apr. 3, 2019); *see also* Turnkey Jet, Inc., *infra* notes 218-19.

product may have reached an illogical extreme in 2018. In *Zaslavskiy*, a federal court upheld a DOJ indictment while simply deferring the application of the *Howey* test for the finder of fact.[126]

Thus, for several years, the SEC, in word and deed, expanded the scope of the securities laws to include ICOs. The Commission now benefits from precedents in the form of SEC administrative Orders and federal court decisions, as well as a wealth of related case law expanding the application of the *Howey* test for over 70 years.

Moreover, a further advantage to SEC involvement in regulating a novel field is the attendant and inevitable civil class actions that ensue. Such actions by supplemental enforcers of the securities laws are described below.

E. Class Action Litigation and State Authorities

Private class actions seeking a return of investments in blockchain and alt-currency abound, even though the grounds for such broad SEC interpretation of relevant definitions and anti-fraud prohibitions are vulnerable. A review of private cases from New York and California demonstrates the application of the *Howey* test to ICOs to facilitate class action lawsuits brought by investors in failed companies that had promoted using blockchain in conjunction with a new cryptocurrency.

In the 2018 case of *Coffey v. Ripple Labs*, the plaintiff alleged a "neverending ICO" that would result in the issuer inevitably controlling 80 percent of the available digital coins. The complaint alleged that the defendant's admission to seeking investments in coins to fund "its operation and its network" suffices as satisfying the common enterprise element of the *Howey* test, while the admitted reliance on the defendant's expertise satisfies element 4 (i.e., "efforts of others"). The private suit has survived motions to dismiss and is pending in California federal court, while a high-profile related SEC action against Ripple Labs continues.[127]

More pointedly, in the 2019 case of *Balestra v. ATBCOIN LLC,*[128] a class action was brought forth against an issuer and two of its founders for a violation

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[126] Jean-Jacques Cabou & Todd Kerr, Perkins Coie LLP, *Federal District Court Upholds Securities Indictment for ICOs but Defers Final Howey Determination in United States v. Zaslavskiy*, JDSUPRA (Sept. 14, 2018), https://www.jdsupra.com/legalnews/federal-district-court-upholds-43110/ (discussing United States v. Zaslavskiy, No. 17-CR-4346339 (E.D.N.Y. Sept. 11, 2018)).

[127] *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges Ripple and Two Executives with Conducting $1.3 Billion Unregistered Securities Offering (Dec. 22, 2020), https://www.sec.gov/news/press-release/2020-338.

[128] Balestra v. ATBCOIN LLC, 380 F. Supp. 3d 340, 346 (S.D.N.Y. 2019).

of the '33 Act by selling unregistered securities through an ICO. ATBCOIN was a technology-based start-up, the purpose of which was to facilitate rapid and low-cost digital financial transactions leveraging blockchain technology. In denying the defendants' motion to dismiss, the court found all four of the elements of the *Howey* test satisfied.

Specifically, between June 12, 2017, and September 15, 2017, ATBCOIN conducted an ICO and promised to launch a resulting ATB blockchain. By the end of the ICO, ATBCOIN raised over $20 million from thousands of investors, but the promised blockchain had not materialized. Within a year, Balestra's coins had dropped in value by more than 85 percent from the purchase price.

ATBCOIN did not file a registration statement at any point either before, during, or after the ICO. Thus, the plaintiff sued for rescission under the private cause of action relating to unregistered securities sales found at Section 12(a)(1) of the '33 Act.[129] When discussing the *Howey* test, the court emphasized that the analysis should be based on the economic realities of the underlying transaction. Noting that all potential profits were "entirely reliant" on the success of the blockchain platform, the decision, likewise, emphasized that the issuer had advertised "serious people from many prosperous countries" were investing in the coins.[130]

Separately, the states have weighed in on the relevant definition in a conflicting and cursory fashion. When state approaches are too varied, model "codes" can often harmonize the legal field. For example, all 50 states have adopted the Uniform Commercial Code in largely common variations. Closer to the topic at hand, the Uniform Securities Act of 1954 succeeded in inspiring and/or conforming state "Blue Sky statutes" throughout the country. Likewise, a budding movement exists to consistently adopt a proposed "Virtual Currency Businesses Act" among state legislatures.[131] That movement has garnered only a modicum of interest.

Individualized legislation among the states ranges from measures inviting

[129] 15 U.S.C. § 77l(1). Separately, Section 12(2) of the 1933 Act creates a private cause of action against the seller for investors who purchase a security sold by means of an oral communication or prospectus including a material misstatement or omission. The provision was held to apply to only formal, registered offerings in Gustafson v. Alloyd Co., Inc., 513 U.S. 561 (1995).

[130] *Balestra*, 380 F. Supp. 3d at 356–57.

[131] *See* UNIF. REG. OF VIRTUAL-CURRENCY BUSINESSES ACT (UNIF. L. COMM'N 2017).

virtual businesses through tax advantages (e.g., New Jersey [132]), to those memorializing salutary federal "transmitter" developments (e.g., Wisconsin[133]), to those demanding registration (e.g., New York).[134] Perhaps more telling are the standards evolving from state disciplinary actions against promoters seeking to maximize investor interest in technologies through misstatements and/or fraud. In a 2014 disciplinary Complaint, the Missouri Securities Commission expressly faulted the defendants (Virtual Miners) for "not disclosing, among others, that virtual currencies are not backed by a central bank/are not insured and no way is available to reverse a virtual currency transaction.[135]

Concurrently, the umbrella organization for the states has simply warned investors of the likelihood of fraud in digital asset offerings. To wit, the North American Securities Administrators Association (NASAA), an entity that predates the federalization of securities laws and serves as the voice of state securities regulators, routinely lists crypto-fraud among its top 10 investor concerns.[136] Although the organization has no rulemaking or enforcement apparatus, its warnings can be both pointed and colorful:

> Virtual reality may exist only in science fiction, but consumers now are able to purchase goods and services with virtual money such as Bitcoin, PP Coin and other digital currencies. Unlike traditional coinage, these alternatives typically are not backed by tangible assets, are not issued by a governmental authority and are subject to little or no regulation. The value of Bitcoins and other digital currencies is highly volatile and the concept behind the currency is difficult to understand even for sophisticated financial experts given the complicated mathematical algorithms that

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[132] The Garden State is considering a fully state-based protocol and, in 2020, took up the "Digital Asset and Blockchain Technology Act." *See* Turner Wright, *New Jersey Introduces Bill to Regulate Cryptocurrencies at State Level*, COINTELEGRAPH (Feb. 24, 2020), https://cointelegraph.com/news/assemblywoman-introduces-digital-asset-and-blockchain-technology-act.

[133] Wisconsin's money transmitter license applies to those entities converting and selling cryptocurrency. *See Wisconsin Money Transmitter Laws*, SHIPKEVICH, PLLC, https://moneytransmitterlaw.com/state-laws/wisconsin/ (last visited May 14, 2021).

[134] Since 2015 New York's "bitlicense" demands registration with the state and other routine supervisory activities. *See Virtual Currency Businesses*, N.Y. DEP'T OF FIN. SERVS. https://www.dfs.ny.gov/apps_and_licensing/virtual_currency_businesses (last visited May 13, 2021).

[135] Virtual Mining, Corp., Case No. AP-14-09 (Mo. Sec. of State June 2, 2014), https://www.sos.mo.gov/cmsimages/SECurities/orders/AP-14-09.pdf (prelim. cease and desist order).

[136] *Top Investor Threats,* N. AM. SEC. ADM'RS ASS'N, http://www.nasaa.org/3752/top-investor-threats/ (last visited Aug. 3, 2014).

> determine when new blocks of coins will be released. This environment has provided fertile ground for scam artists to capitalize on the increasing popularity and acceptance of digital currencies. Investors should be aware that investments that incorporate abstract money systems present very real risks, including the possibility of virtual reality leaving an investor virtually broke NASAA.[137]

Such characterization, while undoubtedly part of the debate over the appropriate degree attending ideal regulation, does not answer the question. Accordingly, the harsh solution of application of the federal securities laws appears poised to continue, with noteworthy fines and resultant headlines. In the long term, the greatest chance for peaceful coexistence between the regulators and the entrepreneurs advancing blockchain is perhaps concrete SEC rulemaking. The SEC's ability to fashion formal guidance exceeds even its storied litigation talents. Formal and final rulemaking could serve to satisfy the competing needs of enforcement and education. For the time being, such rulemaking has taken the form of two, informal digital "token" proposals floated for public review, the subject of the next section.

III. ANALYSIS: COMMISSIONER PEIRCE'S "TOKEN 2.0" PROPOSAL[138]

A. *A More Granular Study of SEC Cyber Actions to Date*

Since 2013, the Commission has initiated over 70 disciplinary actions against those originating, selling, or advertising crypto arrangements that were not registered with the SEC.[139] The overwhelming majority of these cases (c. 65%) involve alleged violations of Section 5 of the 1933 Act for the sale of unregistered "securities," and often, Section 10(b)/Rule 10b-5 of the 1934 Act for concurrently engaging in fraud. These actions routinely result in settlement; one glaring example is the pending litigation with Ripple Labs.[140] A demarcation by nature of

[137] *Id.*

[138] The first proposal (i.e., "Token 1.0") was shared by Commissioner Peirce in February 2020. *See* Hester M. Peirce, Comm'r, U.S. Sec. & Exch. Comm'n, *Running on Empty: A Proposal to Fill Gap Between Regulation and Decentralization* (Feb. 6, 2020).

[139] A separate tally of approximately 20 actions during the same time frame focuses upon online "account intrusions" or the "dark web." *See Cyber Enforcement Actions,* U.S. SEC. & EXCH. COMM'N, https://www.SEC.gov/spotlight/cyberSECurity-enforcement-actions (last visited Nov. 6, 2021).

[140] A rare defendant committed to contesting allegation of unregistered sales of securities is Ripple, the digital coins of which comprised an offering exceeding $1 billion. *See* Complaint, Sec. & Exch. Comm'n v. Ripple Labs, Inc., No. 20-CV-10832, 2021 WL 1814771 (S.D.N.Y. Dec. 22, 2020).

defendant is pictured by the chart below.

Crypto Actions by the Commission[141]

Type/Defendant	**Frequency/Years**	**Examples**
Issuers	c. 45 occasions; 2014-present	*In re Erik T. Voorhees*,[142] *SEC v. Krstic*[143]
Broker-Dealers/Sellers	c. 10 occasions; 2016-present	*SEC v. Bitcoin Investment Trust* (registered broker-dealer)[144]
Touters	c. 5 occasions; 2018-present	*SEC v. Khaled*, *Mayweather* (celebrities touting digital coin offerings without disclosing compensation received)[145]
Other	c. 10 occasions; 2013-present	*SEC v. Garza* (bitcoin mining company)[146]; *SEC v. Coburn* (trading platform operating as an "exchange")[147]

[141] The referenced actions are available in chronological format at https://www.SEC.gov/spotlight/cyberSECurity-enforcement-actions (last visited May 18, 2021). Those entries link to the corresponding SEC Complaint; per the Acts, the Commission can commence actions both internally at administrative hearing, *see* section 19 of the 1933 Act, 15 U.S.C. § 77(t), (u), or in federal district court, *see* section 20(b) of the 1933 Act, 15 U.S.C. § 77(t), (v). Court is normally reserved for the non-professional.

[142] Press Release, U.S. Sec. & Exch. Comm'n., SEC Charges Bitcoin Entrepreneur with Offering Unregistered Securities (June 3, 2014), https://www.SEC.gov/news/press-release/2014-111.

[143] Press Release, U.S. Sec. & Exch. Comm'n., SEC Charges Three Individuals in Digital Asset Frauds (Feb. 1, 2021), https://www.SEC.gov/news/press-release/2021-22.

[144] Bitcoin Inv. Trust, Exchange Act Release No. 78282, 2016 WL 4363462 (July 11, 2016).

[145] *Khaled* Order, *supra* note 123; *Mayweather* Order, *supra* note 120. *See also* Steven Seagal, Securities Act Release No. 10760, 2020 WL 950728 (ALJ Feb. 27, 2020) (punishing a Hollywood screen actor who touted a digital offering); Gregory Mott, *Actor Steven Seagal Fined by SEC for Touting Bitcoin Offering*, BLOOMBERG (Feb. 27, 2020), https://www.bloombergquint.com/onweb/actor-steve-seagal-fined-by-sec-for-touting-bitcoin-offering.

[146] Complaint, Sec. & Exch. Comm'n v. Garza, No. 3:15-CV-1760 (D. Conn. Dec. 1, 2015).

[147] Zachary Coburn, Exchange Act Release No. 84553 (ALJ Nov. 8, 2018); *see also* Press Release, U.S. Sec. & Exch. Comm'n., SEC Charges EtherDelta Founder with

In sum, SEC Enforcement action in this area has been consistent, frequent, and successful. It has reached both entities and their officers, foreign concerns,[148] those seeking to alter/improve upon existing alt-currencies,[149] and those simply creating their own digital coins.[150] Defendants have included a former state senator,[151] a Hollywood actor,[152] an online adult entertainment marketplace,[153] the pioneer in computer antivirus software,[154] and a famed political lobbyist.[155] Defendants have represented over 15 U.S. states, and actions have even proceeded where entities/activities are arguably subject to other regulatory protocol.[156]

Operating an Unregistered Exchange (Nov. 8, 2018), https://www. SEC.gov /news/press-release/2018-258. It bears noting that, while reading the tea leaves on a new agency administration is always complicated, the new Commission Chairman seems poised to support government action against unregistered crypto "exchanges" that attract investor dollars. *See* Nikhilesh De, *SEC Chair Gary Gensler Recommends Congress Regulate Crypto Exchanges*, COINDESK (May 6, 2021), https://www.coindesk.com/policy/2021/05/06/sec-chair-gary-gensler-recommends-congress-regulate-crypto-exchanges/.

[148] *See, e.g.*, Press Release, U.S. Sec. & Exch. Comm'n, SEC Obtains Emergency Asset Freeze, Charges Crypto Fund Manager with Fraud (Dec. 28, 2020), https://www.SEC.gov/news/press-release/2020-341; Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges ICO Research and Rating Provider with Failing to Disclose It Was Paid to Tout Digital Assets (Aug. 20, 2019), https://www.SEC.gov/news/press-release/2019-157.

[149] Press Release, U.S. Sec. & Exch. Comm'n., SEC Charges Issuer, CEO, and Lobbyist with Defrauding Investors in AML BitCoin (June 25, 2020), https://www.SEC.gov/news/press-release/2020-145.

[150] Solutech, Inc., Securities Act Release No. 10853, Exchange Act Release No. 899999, 2020 WL 9171106 (ALJ Sept. 25, 2020).

[151] Press Release, U.S. Sec. & Exch. Comm'n., SEC Emergency Action Stops Digital Asset Scam (Mar. 20, 2020), https://www.SEC.gov/news/press-release/2020-66.

[152] Press Release, U.S. Sec. & Exch. Comm'n., Actor Steven Seagal Charged with Unlawfully Touting Digital Asset Offering (Feb. 27, 2020), https://www.SEC.gov/news/press-release/2020-42.

[153] Jonathan C. Lucas, Litigation Release No. 24607, 2019 WL 4596722 (S.D.N.Y. Sept. 23, 2019).

[154] Press Release, U.S. Sec. & Exch. Comm'n., SEC Charges John McAfee with Fraudulently Touting ICOs (Oct. 5, 2020), https://www.SEC.gov/news/press-release/2020-246.

[155] Press Release, U.S. Sec. & Exch. Comm'n., SEC Charges Issuer, CEO, and Lobbyist with Defrauding Investors in AML BitCoin (June 25, 2020), https://www.SEC.gov/news/press-release/2020-145.

[156] *See, e.g.*, Press Release, U.S. Sec. & Exch. Comm'n., Unregistered ICO Issuer Agrees to Disable Tokens and Pay Penalty for Distribution to Harmed Investors (Sept. 15, 2020), https://www.SEC.gov/news/press-release/2020-211 (disciplining a sports gambling enterprise).

Owing to Division of Enforcement expertise and explicit statutory authority,[157] the SEC has both acted quickly to prevent coin offerings[158] and acted in hindsight to punish alleged wrongdoers after the offerings. To be sure, actions are sometimes aided by disturbing attendant misstatements or theft.[159] While some defendants allegedly orchestrated schemes merely involving cryptocurrency, the majority of cases involve the issuance of digital coins/tokens, the revenues from which are nearly unfathomable.[160]

The Commission's litigation strategy has continued with a consistent legal approach (i.e., alleged violation of 1933 Act Section 5), yet its penalties have ratcheted up from modest fines to the total amount of the coin offering.[161] Intent is relevant only for determining sanctions; the SEC cyber actions evidence findings

[157] Both section 8A of the 1933 Act, 15 U.S.C. § 77h-1, and section 21C of the 1934 Act, 15 U.S.C. § 78u-3, authorize the SEC to seek an internal cease-and-desist order whenever "any person is violating, has violated, *or is about to violate* any provision . . . ." (emphasis added). *See, e.g.*, Loci Inc., Securities Act Release No. 10950, Exchange Act Release No. 92215, 2021 WL 2554441 (June 22, 2021) ("Respondents Loci and Wise shall cease and desist from committing or causing any violations and any future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.").

[158] *See, e.g.,* Press Release, U.S. Sec. & Exch. Comm'n., ICO Issuer Settles SEC Registration Charges, Agrees to Return Funds and Register Tokens as Securities (Feb. 19, 2020), https://www.SEC.gov/news/press-release/2020-37.

[159] *See, e.g.*, Complaint, Sec. & Exch. Comm'n v. Nat. Diamonds Inv. Co., No. 19-CV-80633, 2019 WL 2202144, at ¶ 8 (S.D. Fla., May 13, 2019) ("In addition to operating a multi-layer Ponzi scheme, Aman, Natural Diamonds, and Eagle used investors' funds to purchase horses and riding lessons for Aman's adult son, pay Aman's church and pastors more than $1.5 million, pay H .Seigel and his company more than $3 million, and pay more than $3 million to Aman directly or for his other personal expenditures, including shopping at Gucci and paying the rent on his home . . . .").

[160] *See, e.g.*, Press Release, U.S. Sec. & Exch. Comm'n., Unregistered $25.5 Million ICO Issuer to Return Money for Distribution to Investors (May 28, 2020), https://www.SEC.gov/news/press-release/2020-124 ($25.5 million offering); Press Release, U.S. Sec. & Exch. Comm'n, SEC Halts Alleged $1.7 Billion Unregistered Digital Token Offering (Oct. 11, 2019), https://www.sec.gov/news/press-release/2019-212 ($1.7 billion offering). The pending litigation against Ripple Labs seeks restitution of an offering of $1.3 billion. Press Release, U.S. Sec. & Exch. Comm'n., SEC Charges Ripple and Two Executives with Conducting $1.3 Billion Unregistered Securities Offering (Dec. 22, 2020), https://www.SEC.gov/news/press-release/2020-338.

[161] *See, e.g.*, Kik Interactive Inc., Litigation Release No. 24493, 2019 WL 2387042 (S.D.N.Y. June 4, 2018) (seeking rescission of the entire $100 million unregistered offering). The complaint against Kik was later settled in October 2020. *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Obtains Final Judgment Against Kik Interactive for Unregistered Offering (Oct. 21, 2020), https://www.SEC.gov/news/press-release/2020-262.

against those acting perhaps naively[162] as well as those acting in blatant bad faith.[163] All cases are publicized by Commission "Press Releases," disclosed, on average, once a month.[164] Activity is patently increasing, as a total of 6 cyber actions in the years 2016/2017[165] grew to nearly 40 actions in 2019/2020.[166]

Thus, analysis reveals an enforcement strategy capturing both investment professionals and newcomers, entities domestic and foreign, issuers and third-party endorsers ("touters"), and parties acting both negligently and of ill-design. If a primary emphasis can be discerned, it could be said to be twofold: 1) the danger of issuer ease of entry into the market, and 2) the danger of investor passivity. Most significantly, all cases are tied to the pivotal finding of a security in a truly unconventional arrangement, defined neither by statute nor SEC rule.

Therefore, such disciplinary actions commence with and thrive upon an unchallenged application of the *Howey* test. The winning streak is bound to end as the defense Bar gains game footage to view – fans of securities regulation note that the SEC settled its allegations against Kik Interactive for 5 cents on the dollar.[167] More importantly, at least one Commissioner has loudly supported the dual notions of 1) providing a safe harbor for issuers of digital coins, and 2) ensuring investors that their purchases are legal. The clearest attempts at progressing that provocative approach are detailed and analyzed below.

B. Token Proposal 1.0 (2020)

To be sure, there is not unanimous support at the top level of the Commission for either the aggressive application of the generic *Howey* test or the hodgepodge of threatening pronouncements. Since 2017, as Commission Enforcement actions have increased dramatically in frequency,[168] Commissioner Hester Peirce (the self-proclaimed "Crypto Mom"[169] advancing market interests) has decried the lack of

[162] *See, e.g.*, Erik T. Voorhees, Securities Act Release No. 9592, 2014 WL 2465620 (June 3, 2014).

[163] *See, e.g.*, *supra* note 148.

[164] *Press Releases*, U.S. Sec. & Exch. Comm'n (Jan. 3, 2022), https://www.SEC.gov/news /pressreleases.

[165] *Cyber Enforcement Actions*, U.S. Sec. & Exch. Comm'n (Jan. 3, 2022), https://www.SEC.gov /spotlight/cyberSECurity-enforcement-actions.

[166] *Id.*

[167] *See* Press Release, U.S. Sec. & Exch. Comm'n, *supra* note 161.

[168] *See Cyber Enforcement Actions*, *supra* note 165.

[169] *See* Hester M. Peirce, Comm'r, U.S. Sec. & Exch. Comm'n, Remarks Before the 51st Annual Institute on Securities Regulation: Broken Windows (Nov. 4, 2019). In this speech, Commissioner Peirce both owned the moniker "crypto mom" and decried the speedy application of securities laws to coin offerings, an SEC practice she said "hindered" economic growth. *Id.*

clear guidance for those issuing digital assets or shares.[170]

In early 2020, Commissioner Peirce offered a provocative change to the SEC routine of suing issuers that had gone about issuing digital "tokens" improperly. Specifically, in a speech in Chicago, the Commissioner colorfully noted the need for practicality in fashioning an overdue regulatory response:

> It is important to write rules that well-intentioned people can follow. When we see people struggling to find a way both to comply with the law and accomplish their laudable objectives, we need to ask ourselves whether the law should change to enable them to pursue their efforts in confidence that they are doing so legally.[171]

While confessing that her own ideas had yet to be finalized, the Commissioner noted that the ultimate SEC response affected at least five areas:

1. Issuers releasing tokens to be used in a network,
2. Entities "providing custody for crypto assets,"
3. Issuers "launching an exchange-traded product based on bitcoin,"
4. Broker-dealers handling cryptocurrency related transactions, and
5. Entities establishing alternative trading centers on which to exchange "crypto assets."[172]

Contemporaneously, the Commissioner stated that "our securities laws stand in the way of innovation." Nonetheless, she limited her suggestions to the first of these affected areas, token issuers. To that end, Peirce highlighted that the fear of SEC enforcement activity for such issuers is both "real" and "not unfounded."[173]

[170] *See, e.g.*, Hester M. Peirce, Comm'r, U.S. Sec. & Exch. Comm'n, Remarks at Securities Enforcement Forum: How We Howey (May 9, 2019).

[171] Hester M. Peirce, Comm'r, U.S. Sec. & Exch. Comm'n, Running on Empty: A Proposal to Fill the Gap Between Regulation and Decentralization (Feb. 6, 2020) (including the text of the first Token Proposal).

[172] *Id.*

[173] *Id.* It is worth noting that an explanation of policy published by the SEC Division of Corporation Finance in April 2019 has become part of the pleadings in private litigation against digital coin issuers. *See, e.g.*, Complaint, Friel v. Dapper Labs, Inc., No. 1:21-CV-05837, at ¶ 49-50 (S.D.N.Y. July 7, 2021) (state class action). The complaint directly quotes the SEC pronouncement that:

> The U.S. Supreme Court's *Howey* case and subsequent case law have found that an "investment contract" exists when there is the investment

Explaining that such enforcement relied heavily on the application of the *Howey* test to novel arrangements, Peirce continued by both politely mocking the eponymous case and noting the commentary of experts that it relies heavily on the subjective (i.e., investment) intent of the asset purchaser.[174]

Accordingly, the baleful effect of instinctively applying the "infamous" *Howey* test to all crypto deals was directly assailed as thwarting economic growth:

> We have created a regulatory Catch 22. Would-be networks cannot get their tokens out into people's hands because their tokens are potentially subject to the securities laws. However, would-be networks cannot mature into a functional or decentralized network that is not dependent upon a single person or group to carry out the essential managerial or entrepreneurial efforts unless the tokens are distributed to and freely transferable among potential users, developers, and participants of the network. The securities laws cannot be ignored, but neither can we as securities regulators ignore the conundrum our laws create.[175]

The Commissioner's initial attempt at jumpstarting SEC rulemaking in this area chose the most frequent target of SEC discipline. It also highlighted the assistance required by (unnamed) budding token networks (i.e., issuers conveying digital coins/tokens to purchasers for use in an environment controlled by the

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> of money in a common enterprise with a reasonable expectation of profits to be derived from the efforts of others. The so-called "*Howey* test" applies to any contract, scheme, or transaction, regardless of whether it has any of the characteristics of typical securities. The focus of the *Howey* analysis is not only on the form and terms of the instrument itself (in this case, the digital asset) but also on the circumstances surrounding the digital asset and the manner in which it is offered, sold, or resold (which includes secondary market sales). Therefore, 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 to determine if the federal securities laws apply.

Complaint, Friel v. Dapper Labs, Inc., No. 1:21-CV-05837, at ¶ 50 (S.D.N.Y. July 7, 2021) (quoting STRATEGIC HUB FOR INNOVATION & FIN. TECH., SEC. & EXCH. COMM'N, FRAMEWORK FOR "INVESTMENT CONTRACT" ANALYSIS OF DIGITAL ASSETS (Apr. 3, 2019), https://www.SEC.gov/corpfin/framework-investment-contract-analysis-digital-assets).

[174] Hester M. Peirce, Comm'r, U.S. Sec. & Exch. Comm'n, Running on Empty: A Proposal to Fill the Gap Between Regulation and Decentralization (Feb. 6, 2020).

[175] *Id.*

issuer[176]). While noting that there was always the availability of registration (or exemption therefrom),[177] and that there had been some SEC No Action Letters[178] issued to networks,[179] the Token 1.0 proposal emphasized the urgency of the moment. To that end, Token 1.0 clearly delineated three objectives: "requiring disclosures tailored to [issuer] needs, preserving the application of the antifraud provisions of the securities laws, and giving [investors] . . . an ability to participate in networks of interest to them."[180]

Coincidentally, the suggested "safe harbor" was described as seeking to exempt three entities, activities, or products:

> (1) the offer and sale of tokens from the provisions of the Securities Act of 1933, other than the antifraud provisions, (2) the tokens from registration under the Securities Exchange Act of 1934, and (3) persons engaged in certain token transactions from the definitions of "exchange," "broker," and "dealer" under the 1934 Act.

Such clarity of purpose was perhaps surpassed by the contribution of new vocabulary: "issuers" (i.e., *Howey* "Promoters") was scaled back and labeled "initial development team" in a nod to the goal of networks proving both legitimate

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[176] Ideally, a token network would function in the same manner as the use of cartoon themed coins at a Chuck E. Cheese restaurant, wherein a unique currency only has value in the children's arcade. Indeed, the metaphor has been used by officials on occasion to explain how digital tokens can avoid application of the securities laws. *See, e.g.*, Lydia Beyoud, *'Chuck E. Cheese' Test May Tell SEC If Crypto Token a Security*, BLOOMBERG L. (Dec. 12, 2018, 3:08 PM), https://news.bloomberglaw.com/banking-law/chuck-e-cheese-test-may-tell-SEC-if-crypto-token-a-SECurity.

[177] Specifically, Regulation A, 17 C.F.R. § 230.251-262 (2021), or Regulation D, 17 C.F.R. § 230.500-508 (2021). In securities law, an SEC "Regulation" is a set of rules aimed at the same purpose. Separately, it was noted that, at the time of the Token 1.0 Proposal, issuers had used the exemptive process, but no issuer had utilized the formal registration process. *See* SEC Speech, "Running on Empty: A Proposal to Fill the Gap Between Regulation and Decentralization" (Feb. 6, 2020), *available at* https://www.sec.gov/news/speech/peirce-remarks-blockress-2020-02-06 (fn. 7).

[178] The SEC No-Action Letter is a storied compromise among the agency's arsenal that communicates to the issuer or other person that intended activities as proposed by the requester will not prompt enforcement action. Like the IRS Private Letter Ruling, the No-Action Letter is rescindable and at no time has any bearing on the activities of parties other than the direct addressee. *See No Action* Letters, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/glossary/no-action-letters (Jan. 3, 2022).

[179] *See* Turnkey Jet, Inc., *supra* note 125; Pocketful of Quarters, Inc., SEC Staff No-Action Letter, 2019 WL 8128104 (July 25, 2019).

[180] Running on Empty, *supra* note 171.

and transitory.[181] In sum, the safe harbor's requirements would impose obligations for a period of three years. After that time, it was hoped that "network maturity" would be reached, and that issued tokens would achieve a functionality rendering applicability of the securities laws superfluous.[182]

Overall, balancing the aims of network growth, disclosure, and liquidity, Token Proposal 1.0 laid out for discussion the hypothetical "SEC Rule 195."[183] The safe harbor suggestion was supported by reference to SEC cases or secondary authorities. The proposal was directly aimed at exclusion of four Exchange Act provisions through the creation of a corresponding tally of SEC Rules.[184] In short, Token Proposal 1.0 would have served to shield issuers from the Acts under a sunset safe harbor while avoiding discussion of the role of third parties (e.g., trading platforms, custodial broker dealers, promoters) and remaining silent on other investor protections previously established through litigation.

C. Token Proposal 2.0 (2021)

Commissioner Pierce urged feedback on Token Proposal 1.0 via links to SEC e-mail addresses, including her own.[185] In early 2021, she released on the SEC website and elsewhere "Token Proposal 2.0," her second attempt at impromptu rulemaking[186] (TP 2.0).[187] While the outline for the safe harbor was largely kept intact, further details and substance were provided. In the main, TP 2.0 requires semi-annual updates by the developers of the cryptocurrencies, as well as an "exit report" upon reaching the 3-year anniversary of a currency's launch; moreover, TP

[181] *Id.*

[182] *Id.*

[183] SEC Rules, when appearing in 3-digit format, indicate an elaboration on the 1933 Act (e.g., "Rule 151", 17 C.F.R. § 230.151 (1986), which provides a safe harbor from Section 5 application for certain variable annuity contracts).

[184] Specifically, sections of the 1933 Act defining "exchange," "broker," and "dealer," as well as avoidance of the registration requirement found at Section 12 of the 1934 Act. 15 U.S.C. § 781 (2015).

[185] Interestingly, Commissioner Peirce solicited comments on the 1.0 Proposal, to be submitted to "Github," a collaborative forum which aims to assist software developers. *See* GITHUB, https://github.com/. The Commission launched its own digital entrepreneurial site, "FinHub," in December 2020. *See* Press Release, U.S. Sec. & Exch. Comm'n., SEC Announces Office Focused on Innovation and Financial Technology: FinHub Specialized Unit to Become Stand-Alone Office (Dec. 3, 2020), https://www.SEC.gov/news/press-release/2020-303.

[186] Public Statement, Hester M. Peirce, Comm'r, U.S. Sec. & Exch. Comm'n, Token Safe Harbor Proposal 2.0 (Apr. 13, 2021), https://www.SEC.gov/news /public-statement/peirce-statement-token-safe-harbor-proposal-2.0 [hereinafter TP 2.0].

[187] TP 2.0 was said to have been informed by comments from "the crypto community, securities lawyers, and members of the public." *Id.*

2.0 includes guidance for the outside counsel likely to prepare such filings with the Commission.[188]

The newer proposal remains technical in verbiage and draws its aim from several areas of SEC rulemaking on the topic of issuer exemptions from registration. Indeed, an early note to TP 2.0 repeats a disclaimer found in several SEC exemptions:

> Rule 195 is not an exclusive safe harbor. A person who does not meet all of the applicable conditions of Rule 195 still may claim any other available exemption under the Securities Act of 1933 for the offer and sale of Tokens.

Such "non-exclusivity" is a staple of exemption law and inures to the benefit of the issuer: If technicalities are not complied with, the issuer may invoke other provisions declaring the 1933 Act inapplicable.[189]

Of course, TP 2.0 reflects the views of the office of a sole SEC Commissioner and does not comport with APA rulemaking. Nonetheless, the proposal marks a turnaround in the Commission's approach to the thorny problem of ever-changing cryptocurrency deals. At the present time, the notion centers on four operative parts, the most salient of which is described and analyzed below.[190]

(i) *The Definitions*

TP 2.0 includes but a modest set of definitions – four in total, placed at the end of the proposal.[191] To bring the exemptive safe harbor more in line with existing law and trends, credibility could be established by placing them earlier in

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[188] *Id.*

[189] *See, e.g.*, SEC Rule 500 within the Regulation D exemption provides:

> Attempted compliance with any rule in Regulation D does not act as an exclusive election; the issuer can also claim the availability of any other applicable exemption. For instance, an issuer's failure to satisfy all the terms and conditions of rule 506(b) shall not raise any presumption that the exemption provided by Section 4(a)(2) of the Act is not available.

17 C.F.R. § 230.500(c) (internal citations omitted).

[190] For ease of use, the Token Proposal 2.0 is included in large part as "Appendix A" to this article.

[191] Namely, "Initial Development Team"; "Network Maturity"; "Related Person"; and "Token." Proposed Rule 195(k) *in* TP 2.0, *supra* note 186. Elsewhere within the proposal, certain terms are defined by reference to existing statutory provisions. *E.g.*, Proposed Rule 195(i) ("For purposes of Section 18(b)(3) of the Securities Act of 933, a 'qualified purchaser' includes . . . .").

any resulting proposed Rule.

Of greater moment is the definition of digital coin "issuer," which has deliberately been supplanted by the more generic term "initial development team."[192] Such an opaque reference conjures notions of multiple parties immersed in technology; however, the case law paints a different picture. More pointedly, the definition attaches only to initial, formally named Promoters, "[a]ny person, group of persons, or entity that provides the essential managerial efforts for the development of the network prior to reaching Network Maturity and makes the initial filing of a notice of reliance on this safe harbor."[193]

Such brevity excludes the assignees of the Promoter, as well as host of secondary actors and affiliates. Since the language expressly borrows from case law interpreting "efforts of others" (namely, *SEC v. Glenn Turner*),[194] other equal authorities should be referenced.[195] In that fashion, the primary ill targeted by the *Howey* test, the forced registration of deals depending on Promoter expertise, is best eradicated.

The import of this definition cannot be overstated. Crypto deals are being regulated out of concern for the uninitiated. To strike a balance, the Commission has employed a common law test best summarized by its concluding element – the oft-examined "efforts of others." Examples of this element's predominance abound in both the DAO Report[196] and the SEC cyber actions to date.[197] Limiting this class of examinees clouds the question of whether the coin "network" has proven itself to be utilitarian rather than investment-oriented.

Such an ideal state for the Promoter is called "Network Maturity," similarly included in TP 2.0's short list of definitions:

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[192] For further ease of reference, "initial development team" shall be replaced in this analysis with the truer concept, "Promoter."

[193] Proposed Rule 195, *supra* note 191, at (k)(1).

[194] Sec. & Exch. Comm'n v. Glenn Turner Enters., Inc., 474 F.2d 476, 481-83 (9th Cir. 1973).

[195] Namely, Sec. & Exch. Comm'n v. Life Partners, Inc., 87 F.3d 536, 548 (D.C. Cir. 1996) ("predominant efforts") and Sec. & Exch. Comm'n v. Koscot Interplanetary, Inc., 497 F.2d 473, 483 n.14 (5th Cir. 1974) ("significant efforts"). The Supreme Court has not ruled on the precise definition of this 4th *Howey* element.

[196] *See supra* notes 103-19 and accompanying text.

[197] *See, e.g.*, Enigma MPC, Securities Act Release No. 10755, 2020 WL 821462, at *3 (Feb. 19, 2020) ("ENG Tokens derived their value – and therefore, the ENG Token purchasers could reasonably expect a return on their investments – from the efforts of Enigma to develop its business."); CarrierEQ, Inc., Securities Act Release No. 10575, 2018 WL 6017664, at *3 (Nov. 16, 2018) ("AirFox knew that investors wanted the ability to freely trade AirTokens in the secondary market. Prior to the initial coin offering, AirFox made clear to prospective investors that it planned to enter into agreements with token exchanges to ensure that the AirToken would be traded on the secondary market.").

> (i) Not economically or operationally controlled and is not reasonably likely to be economically or operationally controlled or unilaterally changed by any single person, entity, or group of persons or entities under common control, except that networks for which the Initial Development Team owns more than 20% of Tokens or owns more than 20% of the means of determining network consensus cannot satisfy this condition; or
>
> (ii) Functional, as demonstrated by the holders' use of Tokens for the transmission and storage of value on the network, the participation in an application running on the network, or otherwise in a manner consistent with the utility of the network . . . .[198]

This definition again skews too much in favor of the Promoter. The delineation of a 20% threshold guides the promoter on how to avoid classification as Promoter; to that end, any of the aforementioned terms linked to efforts would suffice as replacement (e.g., "significant," "predominant," or "essential managerial").[199]

(ii) *The Exemption Itself*

The Exemption excludes Tokens from application of the 1933 Act, subject to a handful of conditions. Most noteworthy here is the requirement that the Promoters "intend for the network on which the Token functions to reach Network Maturity within three years."[200] Further, the Tokens must be issued for the purposes of "facilitating access to, participation on, or the development of the network"[201] (as opposed to profits).

Regarding the legal scope of the exemption, the exemption needs to expressly reference both the 1933 Act and the 1934 Act. Both of the Acts have expressly worded definitional sections, and either can be used as a predicate for application of the securities laws against various parties and concerning numerous activities.[202] To avoid the very unexpected applications contemplated by industry advocates, any resulting SEC rule would benefit from a blanket reference to the dual

[198] Proposed Rule 195, *supra* note 191, at (k)(2).
[199] *See supra* note 195 and accompanying text.
[200] Proposed Rule 195, *supra* note 191, at (a)(1).
[201] *Id.* at (a)(3).
[202] *See, e.g.*, Reves v. Ernst & Young, 494 U.S. 56, 61 (1990) (addressing allegations of accountant fraud tied to definitions of "security" located in both Section 2 of the 1933 Act and Section 3 of the 1934 Act).

definitions within the Acts.[203]

Regarding the three-year grace period, some specific reference could be made to the source of this largesse. While the "Preamble" to TP 2.0 mentions this presumptive time period as serving varied purposes, such a delay in registration and disclosure could be interpreted as gamesmanship tilted in favor of Promoters: The time period for a claim under Section 5 is limited to three years by the statute of repose found in Section 13 of the 1933 Act.[204] This specter could be removed by adding to any resulting proposed SEC rule a clause guaranteeing the Commission's right to amend this grace period.

Further, a reference to Promoter intentions without elaboration simply opens the issue for debate. Indeed, in a variety of securities law provisions, similar language requiring evidence of intent has spelled the ultimate disuse of the provision.[205] If a Promoter intends in good faith to use proceeds solely for development, then this should be stated in writing upfront. Such a promise is routinely required in registered offerings and appears in the clearly labeled "Use of Proceeds" section required by Item 504 of Regulation S-K.[206]

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[203] Curiously, TP 2.0 makes almost random reference to Section 6 of the 1934 Act, which requires registration of securities "exchanges." *See* Proposed Rule 195, *supra* note 191, at (g). That reference is not required, as the failure to locate a "security" precludes any related trading platform outside the reach of the Acts.

[204] Section 13 of the 1933 Act, although a bit cryptic itself, has long been interpreted as limiting actions premised upon the sale of an unregistered security to three years from the conclusion of the offering. *See* 15 U.S.C. § 77m (precluding private actions under Section 12(a)(1) "more than three years after the security was bona fide offered to the public").

[205] *See, e.g.*, Section 18 of the 1934 Act, which establishes a private cause of action for misleading SEC filings. That provision, although well meaning, contains an intent requirement long-blamed for its succumbing to Rule 10b-5 as the plaintiff's weapon of choice. *See* John A. Occhipinti, *Section 18 of the Securities Exchange Act of 1934: Putting the Bite Back into the Toothless Tiger*, 47 FORDHAM L. REV. 115 (1978).

[206] An omnibus tool, Regulation S-K instructs issuers on numerous filing requirements. Regarding the planned use of offering proceeds, issuers are advised as follows:

> State the principal purposes for which the net proceeds to the registrant from the securities to be offered are intended to be used and the approximate amount intended to be used for each such purpose. Where registrant has no current specific plan for the proceeds, or a significant portion thereof, the registrant shall so state and discuss the principal reasons for the offering.

17 CFR § 229.504 (2013).

(iii) *The Disclosures*

The Promoters must file a "notice of reliance" and an "exit report" with the SEC. These formal statements, serving to bookend the three-year period in which "network maturity" is reached, would include such details as an indication of the Promoters[207] and the efforts at "decentralization"[208] (i.e., minimizing Promoter participation in the network). The latter is hauntingly familiar of juridical interpretations of *Howey's* fourth element where it requires an explanation of the Promoter's "ongoing involvement"[209] and "continuing activities."[210]

Indeed, such concerns are hinted at in TP 2.0's verbiage establishing a "[w]arning to token purchasers" that purchases involve "a high degree of risk and the potential loss of money." The last exemptive development – to address the growing field of crowdfunding – required proof of a minimal degree of assets available for investment.[211] Surely, the purchase of tokens, a speculative undertaking, is worthy of the same requirement, at least as long as the network is in its initial three-year development phase.

Concurrently, the TP 2.0 "disclosures" section would be well served to include the actual warning to investors. Such has been required of newcomers to margin accounts for over twenty years. The dire, cautionary statements contained in the required "Margin Disclosure Statement" serve to minimize allegations of predatory lending by broker dealers while ensuring that the industry professional focuses on the means of investor.[212] A similar, universal bulleting of investor risks could only help a network gain credibility.

Also, the required disclosure of 5% of Promoter tokens is far too subjective. If seeking to ensure market stability, such limitation should be more properly tied to the outstanding "float" of tokens. Such a notion has long worked well within SEC Rule 144,[213] which provides a safe harbor for the laymen selling restricted securities when such a sale is minimal in market impact.

Stated otherwise, the required disclosures would gain broader acceptance if

[207] *Id.* at (c).

[208] *Id.* at (f)(1)(i)(A).

[209] *Id.* at (f)(1)(i)(B).

[210] *Id.*

[211] Adopted by the SEC in 2015, Regulation Crowdfunding requires issuers to ensure that investors meet both minimal asset requirements and receive disclosures related to the offering. *See Regulation Crowdfunding*, SEC. & EXCH. COMM'N, https://www.SEC.gov /smallbusiness/exemptofferings/regcrowdfunding (Mar. 17, 2021).

[212] *See* FINRA, Rule 2264, Margin Disclosure Statement (2011).

[213] One condition that must be met by the seller of restricted securities (i.e., securities issued under an exemption) is the submission of Form 144 when such sale constitutes 1% or more of the float for any 3-month period. 17 C.F.R. § 230.144(e).

including differing versions for differing audiences. TP 2.0 essentially acts as an exemption from registration; the most enduring exemptions have been required to disclose in parallel fashion to the SEC and the potential investors.[214] Such duplicate course for required disclosures could only inure to the benefit of a Promoter; moreover, in its current form, the disclosures are overwrought with technicalities and formalities that would pause the reading of professional and layman alike.[215]

(iv) The Need for Grandfathering of Existing Exemptions

A grandfathering of existing pronouncements and cases needs to be ensured. While allowance has been made to exempt from safe harbor usage all tokens previously registered with the Commission,[216] the "law" of Tokens since 2013 has already rendered the Securities Act of 1933 inapplicable to certain products and/or transactions.

For example, on a mundane level, broker dealers have expressly lobbied for and gained exemption from the Securities Act for activities undertaken in the role of custodian for customer digital assets.[217]

Further, issues have sometimes obtained relief from the Securities Act for carefully crafted digital activities. For example, in April 2019, the SEC Division of Corporate Finance delivered the most evenhanded Commission message yet when it issued a No Action Letter to a company called TurnKey Jet, Inc.[218] That letter advised the prospective issuer of digital tokens that enforcement action would not be taken by the SEC in the absence of registration if the issuer had a fully developed platform, the tokens could only be transferred to investor wallets, the tokens had a nominal value, and the issuer did not market the tokens as

[214] *See, e.g.*, 17 C.F.R. § 230.251 (requiring, under Regulation A, an "offering statement" for the Commission and a parallel "offering circular" for the investor); 17 C.F.R. § 230.503 (requiring, under Regulation D, Form D to be filed with the Commission); and 17 C.F.R. § 230.152 (requiring, under Regulation Crowdfunding, similar disclosures for the SEC and the investors).

[215] *See, e.g.*, Proposed Rule 195, *supra* note 191, at (b)(1) (requiring information like the source code and token economics to be provided on a freely accessible public website before an Initial Development Team may file a notice of reliance on the safe harbor).

[216] *Id.* at (h) (requiring a degree of SEC action to act as a complete shield in the exclusion).

[217] Seward & Kissel LLP, *SEC Permits Specialized Broker-Dealers to Custody Digital Asset Securities* (Jan. 8, 2021), https://www.sewkis.com/publications/sec-permits-specialized-broker-dealers-to-custody-digital-asset-securities/ (noting that outgoing Chair Jay Clayton announced the permissive framework on his last day in office).

[218] Turnkey Jet, Inc., *supra* note 125.

potentially appreciating in price.[219]

Separately, "stable coins" used for the temporary storage of investor assets after conversion by broker dealers have been in use for several years.[220]

It is axiomatic that full registration can cripple business models. Indeed, the SEC's Form S-1 confesses that nearly a thousand hours are required for its completion.[221] Yet, TP 2.0 in its present state goes too far in attempting to create a clean slate. Even apart from existing law on exemptions, there exists authority among practitioners[222] and yesteryear's courts[223] alike for adherence to the spirit

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[219] The SEC listed the following restrictions in support of its position:

> 1) [TurnKey Jet] will not use any funds from Token sales to develop the TKJ Platform, Network, or App, and each of these will be fully developed and operational at the time any Tokens are sold;
> 2) The Tokens will be immediately usable for their intended functionality (purchasing air charter services) at the time they are sold;
> 3) TKJ will restrict transfers of Tokens to TKJ Wallets only, and not to wallets external to the Platform;
> 4) TKJ will sell Tokens at a price of one USD per Token throughout the life of the Program, and each Token will represent a TKJ obligation to supply air charter services at a value of one USD per Token;
> 5) If TKJ offers to repurchase Tokens, it will only do so at a discount to the face value of the Tokens (one USD per Token) that the holder seeks to resell to TKJ, unless a court within the United States orders TKJ to liquidate the Tokens; and
> 6) The Token is marketed in a manner that emphasizes the functionality of the Token, and not the potential for the increase in the market value of the Token.

Id. at *1.

[220] *See* Richard Satran, *U.S. regulator's approval of stablecoin payments provides regulatory building block, compliance challenge*, RUETERS (Jan. 14, 2021), https://www.reuters.com/article/bc-finreg-stablecoin-approval/u-s-regulators-approval-of-stablecoin-payments-provides-regulatory-building-block-compliance-challenge-idUSKB N29I2XZ (approving the limited use of stablecoins for commerce in what the author called "training wheels" enabling the creation of compliance controls for more expansive uses of digital currencies in the future).

[221] Xgains4keeps Inc., Registration Statement Under the Securities Act of 1933 (Form S-1) (Feb. 2, 2012).

[222] *See* CONCANNON ET AL., *The Yellow Brick Road for Consumer Tokens: The Path to SEC and CFTC Compliance an Update*, BLOCKCHAIN & CRYPTOCURRENCY REGULATION 2020 64, 65 (2d ed. 2020), https://www.lw.com/thoughtLeadership/the-yellow-brick-road-for-consumer-tokens-path-to-SEC-and-cftc-compliance-an-update ("The SEC made clear [since 2017] that to the extent instruments have the indicia of investment contracts, they should be offered and sold in compliance with the securities laws.").

[223] *See, e.g.*, *id.* at 65 (discussing Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 756 F.2d 230 (2d Cir. 1985)) (acknowledging a security could

of the *Howey* test (i.e., the identification of truly passive investors gaining from the efforts and expertise of issuer-promoters). To that end, a more proper balance would arguably need to expand the definition of developers, provide for parallel disclosures to investors, and comfort industry tacticians that allowances gained to date shall not be lost.

(v) <u>*The Need for Protections Against Related Civil Litigation*</u>

If the first attempt at rulemaking is to provide safe harbor for issuers, then such a rule must obviate parallel civil litigation. More to the point, class actions should be precluded for activities during the three-year period. The Commission has achieved such demarcation in the past without intolerable damage to investor protection.[224] Moreover, investors are still left with – among other things – actions sounding fraudulent, at both the state and federal level.[225]

D. Recap of Analysis

TP 2.0 is a difficult read. Its primary aim of educating Promoters and their counsel make it divergent from traditional rulemaking. Countervailing legal precepts are unsupported. At its core, it seeks to shield an overbroad (unnamed) class of potential defendants.

Still, the notion of a sunset safe harbor is useful. The debate thereon shall make legal discussions more proactive while acknowledging what we all already know: Cryptocurrency arrangements in the form of digital tokens are not going away. Concurrently, the field is often abused by fraudsters seeking an advantage over the uninitiated, and thus, the SEC cannot be marginalized.

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be found where "the issuer's marketing efforts centered on the establishment of a secondary market and the opportunity for purchasers to profit from the enterprise" despite the nature of the product being offered).

[224] For example, Regulation FD, adopted in 2000, includes the following warning:

> **No effect on antifraud liability.**
> No failure to make a public disclosurepublic disclosure required solely by § 243.100 shall be deemed to be a violation of Rule 10b-5 (17 C.F.R. § 240.10b-5) under the Securities Exchange Act.

17 C.F.R. § 243.102.

[225] TP 2.0's attempts at preserving the applicability of anti-fraud provisions is a bit confused. Proposed Rule 195, *supra* note 191, at (d) ("Limitation"). The proposal expressly incorporates Section 12(a) of the 1933 Act (a provision that is intent-neutral) and Section 17 of the 1933 Act (the lesser of the SEC's anti-fraud provisions). *Id.* Rule 10b-5 is the Commission weapon of choice. *See supra,* note 63; *see also* FAIRNESS, INC., *supra* note 39, at Ch. IV.

Nonetheless, any safe harbor designed to alleviate regulatory uncertainty must take care not to erase precedent and pronouncement with a ten-year head start.

Of greatest import is the preclusion of the *Howey* analysis. At its core, that famed standard seeks to identify those individuals buying a dream of profits from little effort; its four elements address both the investor's expectations (element 3) and practical examinations (consideration offered, element 2; degree of promoter efforts, element 4).[226]

Accordingly, TP 2.0 is a salutary beginning; to shore up its legality as it moves toward formal rule proposal for a safe harbor from *Howey*, this Article suggests the following initial amendments:

1. Regarding definitions, "development team" must be broadened, made more neutral, and made clearer by being termed "Promoter."
2. Likewise, "related persons" must include those third parties who would own or tout the coins.
3. Regarding disclosures, these should be made upfront and simplified.
4. Likewise, such disclosures should include a warning for investors.
5. Regarding broker-dealers, the existing custodial exemption should be codified.
6. Regarding technicalities, these should be moved to an "Appendix" or reserved for any attendant SEC adopting release.
7. Regarding the three-year time period for exemption, stronger support needs to be offered for a number oddly specific to the relevant time limitation for Section 5 actions.
8. Overall, the process must migrate to APA Section 553 rulemaking, both for purposes of finality and for the avoidance of cloistered input.

As stated effectively by Commissioner Peirce, with a new SEC Chairman comes new opportunity.[227] The SEC can avail itself of this fresh start to avoid the morass occasioned by another 70 disciplinary decisions speaking to multiple legal issues and concerns.

IV. CONCLUSION: THE NEED FOR A 3.0 SOLUTION

Cryptocurrency has taken a wild ride since 2008, with early players incurring

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[226] Sec. & Exch. Comm'n v. W.J. Howey Co., 328 U.S. 293, 301 (1946); *see also supra* notes 82-87.

[227] TP 2.0, *supra* note 186.

liabilities from charges ranging from ill-preparedness[228] to illegal sales.[229] It cannot be overstated that the potential for anonymity in two-party transactions can predominate all other factors, and that each incident of "ransomware" attacks (i.e., a crime enabled by cryptocurrency) furthers public mistrust.[230] SEC regulation is unavoidable, but novel and difficult. Adding to the regulatory uncertainty has been the empirical, dual-sided coin of agency indifference and overreach.[231] Naturally, investor introductions to the bold technology have warned of a world fraught with peril.[232]

Against this omnipresent, challenging backdrop, the SEC publicly emerged as the primary regulator of alt-currency.[233] Although the states have also

[228] Anthony Back, *Blockchain & Crypto Hype Cycle: Where We're at and What's Coming Next*, THE BLOCKCHAIN REV. (Nov. 5, 2018), https://medium.com/blockchain-review/blockchain-crypto-hype-cycle-where-were-at-and-what-s-coming-next-c71cd3f60688. *See also* Peter J. Henning, *For Bitcoin, Square Peg Meets Round Hole Under the Law*, N.Y. TIMES (Dec. 9, 2013), http://dealbook.nytimes.com/2013/12/09/for-bitcoin-square-peg-meets-round-hole-under-the-law/; Princess Clark-Wendel, *How Safe Is Your Wallet from a Cyber-Attack?*, FORBES (July 28, 2014, 11:00 AM), https://www.forbes.com/sites/sungardas/2014/07/28/how-safe-is-your-bitcoin-wallet-from-a-cyber-attack/?sh=62f0ad736f2c; Vitalik Buterin, *Bitfloor Hacked, $250,000 Missing*, BITCOIN MAG. (Sept. 5, 2012), http://bitcoinmagazine.com/2139/bitfloor-hacked-250000-missing/.

[229] *See* Mridhula Raghavan & Sophie Knight, *U.S. Authorities Probe Bitcoin Exchanges over Illegal Transactions*, REUTERS (May 19, 2014, 6:23 PM), http://www.reuters.com/article/2014/05/20/us-usa-crime-bitcoin-idUSBREA4J01P20140520; Donna L. Leger, *Bitcoin Pioneer Facing Federal Charges Quits Foundation*, USA TODAY (Jan. 28, 2014, 1:23 PM), http://www.usatoday.com/story/tech/2014/01/28/shrem-resigns-from-bitcoin-foundation/4961903/; United States v. Ulbricht, 31 F. Supp. 3d 540 (S.D.N.Y. 2014).

[230] *See, e.g.*, Jonathan Greig, *Healthcare Organizations in Ireland, New Zealand and Canada Facing Intrusions and Ransomware Attacks*, ZDNET (May 20, 2021), https://www.zdnet.com/article/healthcare-organizations-in-ireland-new-zealand-and-canada-facing-intrusions-and-ransomware-attacks/.

[231] Jenna Greene, *Playing Hot Potato: Regulators May Be Interested in Overseeing Bitcoin, but It's Not Clear Which Can or Will.*, CORP. COUNSEL (June 1, 2014, 12:00 AM), http://www.corpcounsel.com/id=1202655860491/Playing-Hot-Potato.

[232] Frank J. Diekmann, Opinion, *Diekmann: The Risk in the Currency & the Currency of Risk*, CREDIT UNION J. (Apr. 25, 2014), https://www.cujournal.com/conference/creditunions/opinion/diekmann-the-risk-in-the-currency-amp-the-currency-of-risk; *Bitcoin: More than a Bit Risky*, FINRA (May 7, 2014), https://www.finra.org/investors/alerts/bitcoin-more-bit-risky.

[233] *See Virtual Currencies: The Oversight role of the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission: Hearing Before the S. Comm. On Banking, Housing, & Urban Affairs*, 115th Cong. 36 (2018) (statement of Jay Clayton, Chairman of the U.S. Sec. & Exch. Comm'n).

unpredictably taken occasional harsh stances,[234] a federal agency that has neither lobbied Congress for statutory change nor issued its own rules is largely setting the agenda. The attentive student thus plumbs SEC pronouncements and disciplinary and similarly centered private claims for guidance while being cognizant of the inevitable, more cemented regulation that lies ahead.

As of the fall of 2021, technology investment terms are proliferating.[235] "Non-fungible-tokens"[236] are inexplicably garnering millions of investment dollars; meanwhile, a crude form of investor activism is tempting novices into gamesmanship with hedge funds and registered professionals.[237] It has become readily accepted that half of all new online brokerage accounts shall commence on an app that is approximately eight years old.[238]

In the context of this wild frontier, the delayed governmental response to the $2 trillion market in cryptocurrency[239] is alarming. To wit, the majority of the cases brought by the SEC could have been brought against dubious promoters similarly touting running shoes; the overwhelming majority of these actions – while high profile – have been settled without meaningful contests.

Congress has adopted the spirit and letter of Token 2.0 by introducing in October 2021 a bill repeating most of the phrases and aims on Commissioner Peirce's wish list.[240] The bill garnered little press and has not quelled the storm surrounding Chair Gensler's anticipated rulemaking.

Therefore, the Token Proposals, as catalysts, are priceless. More specifically,

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[234] Evan Weinberger, *Fidelity Gets New York Charter for Bitcoin Trading*, BLOOMBERG L. (Nov. 19, 2019, 10:02 AM), https://www.bloomberglaw.com/bloomberglawnews/banking-law/X3MUHR0000000?bna_news_filter=banking-law#jcite.

[235] *See, e.g.*, Max Read, *There's Nothing to Do Except Gamble/Welcome to the non-fungible, memeified, cryptodenominated, degenerate future of finance.*, N.Y. MAG. (Apr. 12, 2021), https://nymag.com/intelligencer/2021/04/nft-future-of-money.html (noting that pandemic stimulus has resulted in "$372 billion handed out to nearly half of the people in the country with no strings attached").

[236] Robyn Conti & John Schmidt, *What You Need To Know About Non-Fungible Tokens (NFTs)*, FORBES ADVISOR, https://www.forbes.com/advisor/investing/nft-non-fungible-token/ (May 14, 2021, 12:17 PM).

[237] Caitlin McCabe, *A Week Inside the WallStreetBets Forum That Launched the GameStop Frenzy*, WALL ST. J. (Feb. 13, 2021, 2:41 PM), https://www.wsj.com/articles/a-week-inside-the-wallstreetbets-forum-that-launched-the-gamestop-frenzy-11613212202.

[238] Robinhood, which commenced online operations in 2013, boasts that approximately half of 2020's new investors used its famed app. *See* Sheelah Kolhatkar, *Robinhood's Big Gamble*, THE NEW YORKER (May 10, 2021), https://www.newyorker.com/magazine/2021/05/17/robinhoods-big-gamble.

[239] *See* Conway, *supra* note 33.

[240] *See* Clarity for Digital Tokens Act, H.R. 5496, 117th Cong. (2021). The measure was introduced by Congressman McHenry of North Carolina.

Token Proposal 2.0 forces serious rulemaking while prioritizing the issue on a crowded SEC agenda.[241] It recognizes existing law, precedential compromises, and market realities. Most importantly, it moves the debate on proper SEC response to the Division of Corporate Finance and away from the Division of Enforcement; regarding the latter, it is worth repeating the old adage that a hammer sees everything as a nail.

A more public forum for the rulemaking process and input is ultimately and undeniably required.[242] Yet, Commissioner Peirce has succeeded in jumpstarting a debate that Commission officials in recent years have conveniently ignored. Indeed, the latest official word from the Commission acknowledges that bitcoin more readily fits under the commodity statutes[243] and that a Congressional statute is required.[244] Those stances only prolong inaction.

For its part, the SEC Division of Enforcement has fought a laudable fight against a largely anonymous foe. The seriousness of this battle cannot be overstated: on a recurring basis, fraudsters are luring the uninitiated into complex schemes to purchase, trade, and/or digitally hold cryptocurrency.[245] Alt-currency launched Silk Road[246] and simultaneously provided the most provocative return on investment available. The Commission would be ignoring its raison d'etre should

[241] It bears noting that new SEC Chairman Gary Gensler is experienced enough to end regulatory impasse in digital currency regulation. A former CFTC Chairman, Mr. Gensler taught a class on cryptocurrency at MIT. *See* Peter Dizikes, *MIT Sloan's Gary Gensler to be Nominated for Chair of Securities and Exchange Commission*, MIT NEWS (Jan. 19, 2021), https://news.mit.edu/2021/gary-gensler-nominated-chair-sec-0119.

[242] Namely, since 1946, the Administrative Procedures Act has required that all agency rulemaking be transparent by requiring publication in the Federal Register and the opportunity for public comment thereon. 5 U.S.C. § 553 (2018).

[243] *See* Robert Schmidt & Ben Bain, *From Archegos to Crypto, Gensler Signals Cop Is Back on Beat*, BLOOMBERG L. (May 7, 2021, 5:25 AM), https://www.bloomberg.com/news/articles/2021-05-06/from-archegos-to-crypto-sec-chief-signals-cop-is-back-on-beat.

[244] *See* De, *supra* note 147 ("[F]ederal securities regulator, Gensler said the SEC's authority is restricted to securities and products or asset managers that might invest in cryptocurrencies. But he suggested Congress could take a role in bringing greater regulatory clarity, particularly around exchanges.").

[245] *See, e.g.*, Sec. & Exch. Comm'n, *Investor Alert: Watch Out for Fraudulent Digital Asset and "Crypto" Trading Websites*, INVESTOR.GOV (Apr. 24, 2019), https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-alerts/investor-3.

[246] A "dark web" phenomena, the Silk Road website sold illegal drugs and offered other nefarious services until its anonymous founder/operator was located by the FBI and prosecuted by the DOJ. He is serving a life sentence in prison. Nathan Reiff, *Who is Ross Ulbricht?*, INVESTOPEDIA, https://www.investopedia.com/tech/ross-ulbricht-dark-net-pirate/ (Oct. 3, 2021).

it focus solely on investor education and capital formation.[247] Further, to its credit, the agency commenced its litigation with a Ponzi schemer, and deliberately moved to announce its position on tokens before the vast majority of cyber actions. Yet, the fact remains that the issuance of digital coins is a growing business model, and that SEC disciplinary action can sometimes take funds away from third-party purchasers/investors.[248]

Formal registration of a coin issuance – likely as an "IPO" - remains costly; moreover, the IPO itself is waning in popularity.[249] Further, those opposing direct government regulation have succeeded in directing the narrative towards the free market.[250] A decade ago, the policy needed to be driven by the government litigators. Now, cryptocurrency is backed by institutions and invested in by millions. Indeed, the next (and possibly larger) battle is already here: The manipulation of the numerous cryptocurrency markets. SEC applications of those platforms to Section 9(a) of the 1934[251] Act would do much to quell unrest among American investors.[252] Adding to the time pressure is the undeniable fact that the SEC's generous "whistleblowing" rewards – aided by a skilled marketplace of

[247] Since its historic inception, the Commission's purpose has been tied to a three-part mission, although enforcement of the federal securities laws may often seem to be its most fervent priority. *See What We Do*, SEC. & EXCH. COMM'N, https://www.SEC.gov /about/what-we-do (Dec. 18, 2020) (listing the three, equal goals of protecting investors, facilitating capital formation, and protecting markets).

[248] Purchasers of Ripple coins have sued to intervene in the pending SEC lawsuit. *See* Word on the Block, *Lawyer for 11,000 XRP holders pushing to fight SEC in Ripple lawsuit*, FORKAST (Apr. 8, 2021, 2:14 PM), https://forkast.news/video-audio/xrp-fight-sec-ripple-lawsuit/.

[249] Apart from the cheaper alternative of a SPAC offering, IPOs subject the issuer to liability under Section 11 of the Securities Act of 1933. 15 U.S.C. § 77k; *See* Tom Huddleston Jr., *What is a SPAC? Explaining one of Wall Street's hottest trends*, CNBC (Jan. 30, 2021, 9:00 AM), https://www.cnbc.com/2021/01/30/what-is-a-spac.html. The notorious Section 11 provision, imposing liability for even negligent misstatements or omissions, does not accord the issuer itself the due diligence defense. 15 U.S.C. § 77k(b).

[250] The latest relevant bill in Congress is titled "Elimination Barriers to Innovation Act of 2021" and would include officials from the SEC and CFTC as voices among many in a "working group" suggesting regulation. *See* Nikhilesh De, *US Lawmakers Introduce Bill to Clarify Crypto regulations*, COINDESK (Mar. 9, 2021, 7:16 AM), https://www.coindesk.com/lawmakers-digital-asset-regulation.

[251] 15 U.S.C. § 78i(a).

[252] *See* Patrick McHale & Yueqi Yang, *Bitcoin Tumbles After Musk Implies Tesla May Sell Cryptocurrency*, BLOOMBERG L. (May 16, 2021, 2:52 PM), https://www.bloomberg.com/news/articles/2021-05-16/musk-implies-tesla-may-sell-or-has-sold-bitcoin-holdings (explaining that tweets by Tesla CEO Elon Musk "lopped nearly $10,000 off the price of Bitcoin in hours last Wednesday after saying Tesla wouldn't take it for cars.").

attorneys - will expand to include tips on wrongdoing in digital asset deals.[253]

The Commission is no longer on mute, but perhaps its mighty voice needs to move past the Ponzi schemers and techno developers to scold the mega-players that move crypto prices like pawns on a chessboard.[254] Time is not an ally in this conflict, for the number of cryptocurrencies proliferates as the attendant dollar volumes grow exponentially.[255] The merciless clock started by Nakomoto needs to be reset, the SEC is the best clocksmith, and such adjustment needs to be characterized by compromise rather than court pleadings. Against this difficult, dynamic, new Millenia backdrop, Commissioner Peirce's proposal serves as a ready blueprint for the tsunami of opinions that shall ultimately crystallize into SEC rule.

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[253] *See, e.g.*, *Cryptocurrency Fraud*, CONSTANTINE CANNON LLP (Jan. 3, 2022), https://constantinecannon.com/practice/whistleblower/whistleblower-types/financial-investment-fraud/ cryptocurrency-fraud/ (stating "as crypto scams and fraud becomes more common, it will continue to be crucial for whistleblowers to help the SEC, CFTC, and IRS with their enforcement efforts"). Since created in response to the Dodd-Frank Act of 2010, the SEC Office of the Whistleblower has awarded over $900 million to qualified tipsters. *See Whistleblower Awards Over $1 Billion for Tips Resulting in Enforcement Actions*, U.S. SEC. & EXCH. COMM'N. (June 4, 2020), https://www.sec.gov/page/whistleblower-100million.

[254] *Cryptocurrency Fraud*, *supra* note 253.

[255] *See* Conway, *supra* note 33.