

The Honorable Tana Lin

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

v.

ISHAN WAHI, NIKHIL WAHI, and SAMEER
RAMANI,

Defendants.

NO. 2:22-cv-01009-TL

BRIEF OF *AMICUS CURIAE*
BLOCKCHAIN ASSOCIATION

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INTERESTS OF *AMICUS CURIAE*

Blockchain Association (the “Association”) is the leading nonprofit membership organization dedicated to promoting a pro-innovation policy environment for the digital asset economy. The Association endeavors to achieve regulatory clarity and to educate policymakers, regulators, courts, and the public about how blockchain technology can pave the way for a more secure, competitive, and consumer-friendly digital marketplace. The Association represents nearly 100 member companies reflecting the wide range of the dynamic blockchain industry, including software developers, infrastructure providers, exchanges, custodians, investors, and others supporting the public blockchain ecosystem.

The Association is keenly interested in major litigation regarding blockchain issues, because in this nascent area, overly broad court rulings could negatively affect the blockchain industry in entirely unanticipated and unintended ways. The Association, as a leader in the blockchain industry, has a significant interest in this litigation. In this action, the Securities and Exchange Commission (“SEC”) alleges that several cryptographic tokens are “securities,” without any court having previously made such a determination, and in a manner that does not allow the users or creators of those tokens to argue otherwise. The SEC’s tactic — staking out a position that certain tokens are “securities” in litigation where those with the ability and knowledge to defend are not parties — imperils holders of those tokens, and the people, protocols, or entities that use them. Such an action may have a severely negative effect on those tokens, which is a denial of third parties’ due process rights. Such actions by the SEC — and this is not the only case in which the SEC is acting in such a manner — could deleteriously affect the Association and its members.

1 This *amicus* brief reflects the views of the Association, but does not reflect the views of
2 any individual member of the Association.

3 **INTRODUCTION AND SUMMARY OF ARGUMENT**

4
5 In this action, to support its claim that the defendants here (the “Wahi Defendants”)
6 violated the securities laws, the SEC alleges that nine particular tokens are securities. There has
7 never been any prior finding that the tokens at issue are securities. The SEC conflates the tokens
8 themselves, which are, after all, merely software, with any alleged investment contract pursuant to
9 which those tokens were allegedly sold. Worse, the token creators for those particular tokens,
10 other token holders, or users of relevant protocols powered by those tokens, are not defendants in
11 this action, and have no meaningful way to counter the SEC’s pronouncements.

12
13 Unfortunately, this case is the latest salvo in the SEC’s apparent ongoing strategy of
14 regulation by enforcement in the digital assets space. When the SEC asserts that a token is a
15 security, that pronouncement can have immediate, harmful impacts on that token, and the entities
16 or individuals that developed it or use it. People using the token in secondary markets (for software
17 development, payments, lending, derivatives, or any number of other uses that should be exempt
18 from the securities laws) might fear new securities laws implications from their use of the token.
19 Cryptocurrency trading platforms, which previously considered carefully the question of whether
20 the token was a security and concluded that it was not, are forced to consider whether they can
21 continue to list a token now that the SEC has asserted it is a security. The SEC’s allegations appear
22 to go beyond enforcing current regulations; the SEC instead is proclaiming new market rules,
23 skirting its obligations to provide the public an adequate opportunity to weigh in on those rules, as
24 would be proper under the Administrative Procedure Act (the “APA”).
25
26

1 All bad enough. But here, it's regulation by enforcement against absent third parties.
2 Because the original creators of those tokens are not parties in this case, they have no practical
3 ability to be heard on the subject. By statute, they cannot intervene. Nor would they want to, even
4 if they could — few (if any) digital asset creators want to pick a fight with the SEC, an inordinately
5 expensive and burdensome battle at best. And they should not have to. Token creators should not
6 have to bear the burdens and costs of being dragged into this case, all because a stranger to their
7 project allegedly misappropriated confidential information from his employer, another stranger to
8 the case. The SEC's allegation of a token potentially being a security thus has an effect on these
9 tokens that is immediate, negative, and practically unchallengeable.
10

11 It is devastating to the blockchain industry at large for the SEC to be able to proclaim, at
12 will, in litigation, and without meaningful review or challenge, that certain software packages are
13 securities. It gives the SEC the ability to cause great damage to the creators and users of these
14 software packages, merely by making allegations that may be proven untrue if contested in a court
15 of law, but which the SEC knows may not be contested squarely.
16

17 Moreover, the SEC's actions here are unnecessary to punish the alleged wrongdoing, or
18 deter future similar wrongdoing, because the SEC is not the sole government agency seeking to
19 hold the defendants accountable for allegedly unlawful conduct. The U.S. Department of Justice
20 (the "DOJ") has brought criminal charges against the Wahi Defendants for the same conduct, but
21 without improperly implicating third parties or alleging securities violations. *See U.S. v. Wahi*,
22 No. 22-cr-0392 (S.D.N.Y.). The SEC's action is therefore wholly unnecessary to punish bad
23 behaviors and is solely aligned with its effort to regulate by absentee enforcement. Such behavior
24 is improper for a government agency, and is irreconcilable with due process concerns. The SEC's
25 motive, then, is merely to backdoor a precedent that can be used in other cases — as, indeed, it is
26

1 already doing in other cases where the DOJ has brought an action, and the SEC has piled on with
2 similar allegations of securities laws violations against absent third parties.

3 More broadly, this action appears on a landscape where there is a pervasive lack of clarity
4 for the digital assets industry. Market participants across the industry already struggle to decipher
5 how securities laws apply to digital assets. Even beyond the “Securities Law 101” question of
6 whether a particular digital asset is or could be a security, many securities regulations simply do
7 not fit digital assets, particularly in secondary markets. While the SEC invites parties to “come in
8 and register,” that registration is functionally impossible, and routinely denied by the SEC, because
9 the current rules do not work for digital assets. Rather than pursue proper rulemaking under the
10 APA to address those issues, the SEC has instead issued a long history of inconsistent, incomplete,
11 and confusing public statements, and has pursued a pattern of “regulation by enforcement.” Now,
12 the SEC extends its doctrine of “regulation by enforcement” to “regulation by unchallengeable
13 allegation” — a bridge too far.
14

15
16 Federal courts should strongly disfavor the notion that the SEC can “morph” a piece of
17 software into a security, merely by alleging it is so in a third-party action. It is, of course, common
18 and routine for the SEC to allege securities fraud when the securities at issue are already widely
19 recognized to be a security — say, a stock that trades on the NASDAQ. But in this case to allege
20 that software is a security, the SEC is asserting facts that have not been proven, on legal theories
21 that have been debunked by scholars and practitioners, and against token creators that cannot
22 defend themselves.
23

24 The Association respectfully requests that any ruling this Court may make in this case
25 should carefully denote that the Court is not making any factual findings about the nature of any
26 of the tokens addressed herein, and certainly not making any finding that operates outside the four

1 corners of this case. Any such findings for the purposes of this case should explicitly carry no
 2 collateral estoppel effects (or other ill effects) against absent third parties. Otherwise, the SEC has
 3 arrogated to itself enormous and nearly unreviewable power to inflict damage on third parties,
 4 without due process.

5 ARGUMENT

6 **I. THE WAHI DEFENDANTS’ “MAJOR QUESTIONS” ARGUMENT** 7 **UNDERScores THAT THE SEC IS REGULATING IN EXCESS OF ITS** 8 **ENFORCEMENT POWER.**

9 The Wahi Defendants argue in their motion to dismiss that the SEC has exceeded its
 10 enforcement power under the “major questions” doctrine. *See* Defendants Ishan and Nikhil Wahi’s
 11 Motion to Dismiss, ECF No. 33 at 33-39. The “major questions” doctrine applies when “agencies
 12 assert[] highly consequential power beyond what Congress could reasonably be understood to have
 13 granted.” *W. Va. v. EPA*, 142 S. Ct. 2587, 2609 (2022). The agency “must point to ‘clear
 14 congressional authorization’ for the power it claims” when it addresses matters of “vast economic
 15 and political significance.” *Id.* at 2605-09. While there is no need to repeat the Wahi Defendants’
 16 detailed “major questions” doctrine argument, the Association would like to underscore how the
 17 industry — and the broader public — is being hurt by the SEC’s actions, including the tactic of
 18 decreeing that certain tokens are securities without giving the creators of those tokens a fair
 19 opportunity to respond, or giving the public an adequate notice and opportunity to be heard.

20 **A. The SEC’s Complaint Has Decreed That Nine Tokens Are Securities** 21 **Without the Creators of Those Tokens Being Present.**

22 The SEC’s Complaint is predicated on its assertion that nine cryptographic tokens are
 23 securities. The SEC alleges that, in violation of Section 10(b) of the Exchange Act and Rule 10b-
 24 5 thereunder, Defendant Ishan Wahi misappropriated material nonpublic information about these
 25 tokens from his employer, and tipped Defendants Nikhil Wahi and Sameer Ramani, who
 26

1 subsequently profited off of trades in those tokens. *See* Amended Complaint dated December 22,
 2 2022, ECF No. 27 (the “Amended Complaint” or the “Am. Compl.”) at 62-64 ¶¶ 1-8. The
 3 Amended Complaint is replete with references to the nine tokens as “securities,” such as:

4 • “This case involves insider trading in certain crypto asset securities ...,” Am.
 5 Compl. ¶ 1;

6 • “People own crypto assets, such as the crypto asset securities traded in the
 7 transactions at issue in this matter ...” Am. Compl. ¶ 22;

8 • “Nikhil and Ramani traded in, at least nine crypto assets securities that meet this
 9 definition [of a security],” Am. Compl. ¶ 25;

10 • “The existence of the secondary trading market offered by platforms such as
 11 Coinbase allows market participants to buy and sell crypto assets, including crypto asset
 12 securities,” Am. Compl. ¶ 26;

13 • “... Ishan repeatedly tipped ... with material, nonpublic information in advance of
 14 Coinbase’s listing announcements of certain crypto asset securities,” Am. Compl. ¶ 38;

15 • “Nikhil and Ramani traded in securities subject to the federal securities laws
 16 because these crypto assets were investment contracts; they were offered and sold to investors who
 17 made an investment of money in a common enterprise, with a reasonable expectation of profits to
 18 be derived from the efforts of others,” Am. Compl. ¶ 100; and

19 • “These hallmarks of the definition of a security continue to be true for the nine
 20 crypto assets securities that are the subject of the trading in this complaint ...,” Am. Compl. ¶ 105.

21 However, there has never been a finding in this Court, or in any other court or
 22 administrative proceeding, that those nine tokens are securities. The SEC clearly considers this
 23 question to be central to its allegations; the Amended Complaint spends more than 100 paragraphs
 24
 25
 26

1 purporting to analyze why the SEC believes that the nine tokens are securities. Am. Compl. ¶¶
 2 95-206.

3 As evidenced by the dockets in other SEC litigations involving allegations that tokens are
 4 securities — such as *SEC v. Ripple, Inc.*, No. 20-cv-10832 (AT) (SN) (S.D.N.Y.), *SEC v. Telegram*
 5 *Grp. Inc., et al.*, No. 19-cv-9439 (PKC) (S.D.N.Y.), *SEC v. Kik Interactive Inc.*, No. 19-cv-5244
 6 (AKH) (S.D.N.Y.), or *SEC v. LBRY, Inc.*, No. 21-cv-00260-PB (D.N.H.) — as well as by the extra
 7 pages the parties requested to brief the motions to dismiss, ECF No. 23, these intensely fact-
 8 specific questions can require voluminous fact development and briefing. Thus, this case may
 9 well need to encompass nine mini-trials to determine the contested issue of whether the nine tokens
 10 are actually securities or not, in order to determine, in turn, whether Exchange Act Section 10(b)
 11 and Rule 10b-5 even apply. No doubt the Parties and the Court will have to expend enormous
 12 resources to make these determinations.
 13

14 But even if any of the token creators had any desire to be involved in federal litigation with
 15 the SEC (and it is hard to imagine they do), they will have no practical opportunity to participate
 16 in this case concerning the absolutely critical question of whether the tokens they created are
 17 considered securities. The token creators will have to rely on the Wahi Defendants — who are
 18 strangers to the projects — to make a case that the tokens are not securities. Even extensive third-
 19 party discovery of those strangers, which itself would be incredibly expensive, burdensome, and
 20 inequitable to the non-party token creators (and thus should not be countenanced here) will not
 21 result in a full and fair hearing of those issues. Even if a token creator would want to intervene in
 22 this case — and they almost certainly do not wish to, given the enormous expense and risk of
 23 litigation — that entity or individual would not be permitted to intervene in this SEC enforcement
 24 action in any event. *See Ripple Labs, Inc.*, 2021 U.S. Dist. LEXIS 190855, at *9 (S.D.N.Y. Oct.
 25
 26

4, 2021) (“intervenor[s] cannot compel the SEC to join *them* as defendants”) (emphasis in original); 15 U.S.C. § 78u(g) (parties prohibited from “consolidate[ing] or coordinat[ing]” private claims with enforcement actions brought by the SEC in which equitable relief is sought.).

Moreover, the SEC undoubtedly understands that this matter — like almost every other SEC litigation — is very likely to settle. While the numbers vary year by year, one SEC Commissioner once remarked that the SEC settled approximately 98% of its enforcement cases. See Commissioner Luis A. Aguilar, *A Stronger Enforcement Program to Enhance Investor Protection*, Sec. and Exch. Comm’n (Oct. 25, 2013), <https://www.sec.gov/news/speech/2013-spch102513laa>.

Thus, the SEC picked a time and place to issue damaging broadsides against tokens in which the creators cannot intervene voluntarily, and would not want to even if they could, and in a case that (judging by past history) is highly likely to settle rather than be adjudicated on the merits. The SEC maximized its chances of being able to allege whatever it wants, with a minimal risk of being held to account for it.

B. The SEC’s Actions Cause Damage to Protected Property Interests of Non-Parties, Without Due Process of Law, and Attempt to Create New Rules In Violation of the Administrative Procedure Act.

The SEC’s actions caused harsh consequences for those creators. The SEC’s pronouncement that a particular token is a security has also already resulted in delisting from cryptocurrency trading platforms. For example, shortly after the SEC filed the original complaint in this case, Binance.US delisted one of the tokens at issue (the only one of the nine tokens at issue in this case that was trading on its platform), “out of abundance of caution.” Nina Bambysheva, *Binance.US Delists Cryptocurrency SEC Deemed a Security*, *Forbes* (Aug. 2, 2022), <https://www.forbes.com/sites/ninabambysheva/2022/08/02/binanceus-delists-cryptocurrency->

1 sec-deemed-a-security/?sh=75f8a9b614ac. Thus, although trading platforms carefully consider
2 whether a given token is a security prior to listing that token, those platforms must then determine
3 whether they can continue to list that token or not, merely because the SEC has publicly
4 pronounced that it is a security.

5
6 Additionally, an allegation by the SEC that a given token is a security can lead to immediate
7 decreases in the value of that token. The LCX token declined from \$0.07311 on July 20, 2022
8 (the day before the original complaint was filed) to \$0.06445 on July 22, 2022 (the day after the
9 original complaint was filed) — an 11.85% decrease. *See* LCX, CoinMarketCap (last visited Feb.
10 13, 2023), <https://coinmarketcap.com/currencies/lcx/>. DFX declined from \$0.5542 on July 20 to
11 \$0.4198 on July 22, a 24.25% decrease. *See* DFX, CoinMarketCap (last visited Feb. 13, 2023),
12 <https://coinmarketcap.com/currencies/dfx-finance/>. KROM declined from \$0.4935 on July 20 to
13 \$0.3991 on July 22, a 19.13% decrease. *See* KROM, CoinMarketCap (last visited Feb. 13, 2023),
14 <https://coinmarketcap.com/currencies/kromatika/>. These decreases in value may be driven by a
15 sudden reluctance to interact with those tokens, based on a concern that the SEC could pursue
16 some securities laws violations against users of a token that the SEC has suddenly deemed to be a
17 security.

18
19 The full scope of the damage the SEC has caused is difficult to know, in large part because
20 there will necessarily be a chilling effect on future projects, and the blockchain industry in general,
21 as token creators may be concerned that the crucial question of whether the token they create is a
22 security will be decided in an action in which they are not a party, without any prior warning or
23 fair opportunity to respond.

24
25 This case is not an outlier; it is part of an SEC pattern. The SEC recently filed a complaint
26 for securities fraud against an individual, Avraham Eisenberg, in connection with an alleged

1 scheme to manipulate the MNGO token. In that complaint, the SEC decreed that MNGO was a
 2 security, and that the creator of the MNGO token “offers and sells MNGO tokens in unregistered
 3 transactions.” *SEC v. Eisenberg*, No. 23-cv-503, ECF No. 1 (S.D.N.Y. 2023). The creators of the
 4 MNGO token were not parties to that case — similar to the SEC’s tactics here. Regardless of the
 5 merits of the SEC’s allegations against the Wahi Defendants, or against Avraham Eisenberg, the
 6 SEC’s pattern of alleging legal conclusions adverse to token creators who are not parties to a case
 7 is a disturbing pattern.
 8

9 Similar to its actions here, in *Eisenberg* the SEC’s lawsuit followed actions by other
 10 government entities. Both the DOJ and the Commodity Futures Trading Commission initiated
 11 actions against Mr. Eisenberg prior to the SEC’s suit. *See U.S. v. Eisenberg*, No. 23-cr-00010-
 12 RMB (S.D.N.Y.); *Commodity Futures Trading Comm’n v. Eisenberg*, No. 23-cv-00173-LGS
 13 (S.D.N.Y.). The SEC did not need to go out on a limb to obtain justice against alleged perpetrators.
 14 But the SEC filed these actions anyway, illustrating that the SEC’s motivation is not merely to
 15 punish alleged wrongdoers, or even to deter future wrongdoing, but rather to regulate by
 16 enforcement by setting forth new positions, in ways that cannot be meaningfully challenged.
 17

18 The SEC’s strategy bypasses procedural due process protections that should be afforded to
 19 those token creators. A “procedural due process claim hinges on proof of two elements: (1) a
 20 protected liberty or property interest and (2) a denial of adequate procedural protections.” *ASSE*
 21 *Int’l, Inc. v. Kerry*, 803 F.3d 1059, 1073 (9th Cir. 2015). Whether the tokens are centrally-
 22 controlled by an identifiable group, or held by a decentralized and diffuse group of individuals or
 23 entities, a protected property interest exists. Both token creators and token holders suffer a severe
 24 impediment to the value of their property, without any practical opportunity to contest the SEC’s
 25 allegations, a denial of adequate procedural due process protections. In *ASSE*, for example, the
 26

1 Ninth Circuit found that the plaintiff's due process claims should not have been dismissed where
 2 it "did not have a meaningful opportunity to rebut significant portions of the evidence that the
 3 [State] Department used against it" in levying sanctions. 803 F.3d at 1079. In that case, the court
 4 found a due process violation even where the harmed party was a party in the case, and was able
 5 to contest the violation. Here, by contrast, the harmed parties have no meaningful opportunity to
 6 be heard, and are even prevented by law from making the attempt, as explained above. The
 7 violation of their due process rights is even more acute.
 8

9 Finally, the SEC's attempt to utilize actions against third parties to create new rules violates
 10 the APA, which "sets forth the procedures by which federal agencies are accountable to the public
 11 and their actions subject to review by the courts" and "requires agencies to engage in reasoned
 12 decision making." *Dep't of Homeland Sec. v. Regents of the Univ. of Cal.*, 140 S.Ct. 1891, 1905
 13 (2020) (citations and quotation marks omitted). Agency actions can "be set aside if they are
 14 arbitrary or capricious." *Id.* (citation and quotation marks omitted). Under the APA, for a
 15 legislative rule to "be valid," it must "go through notice and comment." *Kisor v. Wilkie*, 139 S.Ct.
 16 2400, 2420 (2019).
 17

18 The SEC's use of this litigation or similar actions to make new rules concerning when a
 19 token is or is not considered a security is not consistent with the APA's rulemaking requirements.
 20 While the SEC clearly has the authority to bring enforcement actions for violations of currently
 21 existing federal securities regulations, the SEC is using this case (along with the *Eisenberg* case)
 22 to create new rules. The allegations against the absent token projects are not merely that their
 23 tokens are securities. Taken together, the allegations attempt to carve out new rules for a variety
 24 of different tokens, used for a variety of different purposes (some vastly different from others),
 25 and assert that they are still securities even when they are tokens being traded on a spot market,
 26

far away from their original issuance. *See Ripple Labs, Inc.*, Brief of *Amicus Curiae* The Blockchain Association, ECF No. 706 (S.D.N.Y.) (setting forth some of the many different ways in which tokens can be utilized). This position is not enforcement of an existing regulation. It is promulgating new rules for the industry, telling the industry what it can and cannot do, all without the procedural protections of the APA. The APA establishes a “basic presumption of judicial review [for] one ‘suffering legal wrong because of agency action.’” *Abbott Lab’ys v. Gardner*, 387 U.S. 136, 140 (1967). Here, there is no effective judicial review of the agency action against the token creators.

To be blunt, this type of litigation is an abuse of the SEC’s authority. It sidesteps due process. Merely by proclaiming that a token is a security, the SEC gives certain tokens a “scarlet letter,” impairing their value, hampering any secondary market trading of the token, and interfering with technological development — all without providing token creators any meaningful ability to respond. It hands the SEC an enormous amount of unreviewable power to damage a burgeoning sector of the U.S. economy, while avoiding any democratic rulemaking processes or other input.

C. Market Participants Are Not on Notice Regarding What Is or Is Not a Security.

The SEC’s actions in this case are emblematic of the inappropriate way it has handled matters of “vast economic and political significance.” The notion that a token theoretically could be offered as part of an investment contract is certainly well-known, but a host of unanswered questions remain, both as to the basic question of what is a security, and the more complicated but equally important questions of what rule-abiding market participants may do with their tokens even if they were classified as securities. The SEC has shown little willingness to answer those questions. The Association, as an industry group, can certainly state that its members do not have

1 a clear sense of what is or is not considered a security, much less how tokens could or should be
2 treated and traded on spot markets in a manner consistent with securities laws.

3 In the past, the SEC has pointed to its enforcement actions and public statements to support
4 its assertion that the law is clear, particularly including the *Report of Investigation Pursuant to*
5 *Section 21(a) of the Securities Exchange Act of 1934: The DAO*, Sec. and Exch. Comm’n (July 25,
6 2017), <https://www.sec.gov/litigation/investreport/34-81207.pdf> (the “DAO Report”). But the
7 DAO Report itself is ineffective in putting participants on notice as to whether transactions
8 involving any particular token can be considered a security. For example, the DAO Report, which
9 concerns initial issuances rather than spot market trading, repeatedly uses vague and conditional
10 language, such as the “U.S. federal securities laws may apply to various activities, including
11 distributed ledger technology, depending on the particular facts and circumstances...” DAO Rep.
12 at 10. It states that “[w]hether or not a particular transaction involves the offer and sale of a
13 security—regardless of the terminology used—will depend on the facts and circumstances,
14 including the economic realities of the transaction.” *Id.* at 17-18. It also acknowledges case law
15 that would, given the right facts and circumstances, render a token a non-security. *Id.* at 14 (citing
16 *Williamson v. Tucker*, 645 F.2d 404, 422-24 (5th Cir. 1981)). Aside from merely citing *Howey*,
17 the DAO Report does not provide further clarity for which issuances are securities, and which are
18 not. It stands for the proposition that a token could be offered as part of an investment contract,
19 but provides little further concrete guidance.

20 All blockchain projects are different, and there are numerous issuances of and uses for
21 tokens that are not for investment purposes. The blockchain industry is much broader than the
22 DAO tokens at issue in the nearly six-year-old DAO Report.

Other than through enforcement actions, the SEC’s last guidance on the question of whether a token was a security in April 2019, a near-lifetime ago in a sector where technology is evolving at lightning speed. *See Framework for “Investment Contract” Analysis of Digital Assets*, U.S. Sec. and Exch. Comm’n (Apr. 3, 2019), <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets> (the “2019 Framework”). But this guidance, too, fell woefully short. As an initial matter, the division of the SEC that issued the guidance — the Strategic Hub for Innovation and Financial Technology (“FinHub”) — disclaimed that it represented the views of the SEC, limiting the ability of industry participants to rely on it. *See* 2019 Framework at n.1. Adding to the confusion, that guidance provided a list of over sixty factors for analyzing whether a token is a security — without weighting any particular factors, or explaining whether any of them were dispositive. It actually created more confusion in the industry. *See, e.g.,* DINNGO, *The Known and the Unsaid from the SEC’s Framework* (Aug. 20, 2019), <https://medium.com/dinngo-exchange/the-known-and-the-unsaid-from-the-secs-framework-ad8b2a7c6d2c> (“from a crypto exchange’s perspective, [the SEC’s 2019 Framework] has muddied the waters rather than clearing them”). However, the 2019 Framework did recognize that tokens qualifying as securities at the time of an initial sale sometimes “should be reevaluated at the time of later offers or sales,” an explicit acknowledgment of the distinction between initial sales and spot market transactions on a secondary market.

As for enforcement actions themselves, it is impossible to parse them for some kind of unified theory as to what is or isn’t a security, because each SEC enforcement decision is based on the unique facts and circumstances of that case. And the vast majority of those enforcement actions remain unadjudicated by a court or jury, often resulting in an immediate settlement, or never proceeding beyond the pleading stage of litigation. The lack of certainty — especially for fact

1 patterns that are not identical to the “2017-era initial coin offering” cases that the SEC has
2 repeatedly brought — forces many token creators to consider structures that are unnecessarily
3 disadvantageous, or counsels them to move outside the borders of the United States altogether.

4 Even the SEC’s own commissioners don’t believe that the SEC has delivered clear enough
5 guidance. In 2021, for example, Commissioner Hester M. Peirce and then-Commissioner Elad L.
6 Roisman criticized a settlement with a digital assets exchange that publicized upcoming digital
7 token offerings. *See* Public Statement, Hester Peirce and Elad Roisman, *In the Matter of*
8 *Coinschedule*, U.S. Sec. and Exch. Comm’n (July 14, 2021), [https://www.sec.gov/news/public-](https://www.sec.gov/news/public-statement/peirce-roisman-coinschedule)
9 [statement/peirce-roisman-coinschedule](https://www.sec.gov/news/public-statement/peirce-roisman-coinschedule). The Commissioners were “disappointed that the
10 Commission’s settlement ... did not explain which digital assets ... were securities, an omission
11 which is symptomatic of our reluctance to provide additional guidance about how to determine
12 whether a token is being sold as part of a securities offering or which tokens are securities.” *Id.*
13 (emphasis in original). They added that “[t]here is a decided lack of clarity for market participants
14 around the application of the securities laws to digital assets and their trading.” *Id.*

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17 In a speech by Commissioner Peirce just last month, she acknowledged that the SEC’s
18 reference “to the crypto assets themselves as securities” indicates an “imprecise application of the
19 law [that] has created arbitrary and destructive results for crypto projects and purchasers.” Hester
20 M. Peirce, *Outdated: Remarks before the Digital Assets at Duke Conference*, U.S. Sec. and Exch.
21 Comm’n, (Jan. 20, 2023), [https://www.sec.gov/news/speech/peirce-remarks-duke-conference-](https://www.sec.gov/news/speech/peirce-remarks-duke-conference-012023)
22 [012023](https://www.sec.gov/news/speech/peirce-remarks-duke-conference-012023). And, even just last week, Commissioner Peirce observed, in connection with a settlement
23 related to a “cryptocurrency staking program,” that “[u]sing enforcement actions to tell people
24 what the law is in an emerging industry is not an efficient or fair way of regulating ... A
25 paternalistic and lazy regulator settles on a solution like the one in this settlement: do not initiate
26

1 a public process to develop a workable registration process that provides valuable information to
 2 investors, just shut it down.” Hester M. Peirce, *Kraken Down: Statement on SEC v. Payward*
 3 *Ventures, Inc., et al.*, U.S. Sec. and Exch. Comm’n (Feb. 9, 2023),
 4 <https://www.sec.gov/news/statement/peirce-statement-kraken-020923>.

5
 6 Even past the overarching question of whether a particular token is a security, numerous
 7 other questions confound the issue of whether a token transaction in the spot market could be
 8 treated as a security. The now-infamous June 2018 “Hinman Speech” asked the basic question:
 9 even if a token was originally offered to purchasers as part of an investment contract, at what point
 10 can it become a non-security? See William Hinman, *Digital Asset Transactions: When Howey*
 11 *Met Gary (Plastic)*, Remarks at the Yahoo Finance All Markets Summit: Crypto, U.S. Sec. and
 12 Exch. Comm’n (June 14, 2018), <https://www.sec.gov/news/speech/speech-hinman-061418>. The
 13 following year, FinHub’s aforementioned April 2019 guidance made a brief, unofficial, and
 14 unsatisfactory attempt at an answer. Since then, silence.

15
 16 In the *Ripple* case pending in the S.D.N.Y., the SEC’s rejoinder to these deep, persistent
 17 industry concerns was that “transactions between two public investors not involving Ripple’s
 18 affiliates, dealers, or underwriters would be exempt from Section 5’s registration requirements,
 19 despite such transactions involving securities,” because such “public” transactions would not
 20 involve an issuer, underwriter, or dealer. *Ripple Labs, Inc.*, ECF No. 674 at 45 n.25 (S.D.N.Y.),
 21 *citing* 15 U.S.C. § 77d(a)(1). Thus, the SEC asserts that the requirement to “register” tokens would
 22 not impact the business of subsequent users of that token.

23
 24 That answer provides no solace. If the SEC were to initiate such an action against such a
 25 downstream user, seller, or purchaser, that person has the burden to show that the tokens were
 26 exempt from the registration requirement. See *SEC v. Telegram Grp. Inc.*, 448 F. Supp. 3d 352,

1 365 (S.D.N.Y. 2020). Such exemptions are “construed strictly.” *Id.* at 366. Those questions hang
2 over this case — the Wahi Defendants have the burden to show exemptions (or non-security status)
3 relating to tokens whose issuance they may know nothing about.

4 Even if a downstream user of tokens is exempted from the registration requirements of 15
5 U.S.C. § 77(e), the question of whether the token was originally considered to be a security
6 undoubtedly matters to future transactions in the spot market. The token would have to trade as a
7 security, on securities exchanges or over-the-counter (“OTC”). And compliance with all of the
8 ongoing rules for registered securities would lead to a host of new “square peg, round hole”
9 problems. What is the mechanism for users to take such tokens off-exchange? How would users
10 be able to build software on top of the tokens? What would happen if the original creator went
11 bankrupt and the tokens were de-listed by the exchanges? Would the tokens then trade OTC?
12 Since “only broker-dealers qualified with FINRA as market makers can apply to quote securities
13 on the OTCBB,” *see Over-the-Counter Market*, U.S. Sec. and Exch. Comm’n (May 9, 2013),
14 <https://www.sec.gov/divisions/marketreg/mrotc.shtml>, what if no brokers were approved to broker
15 such transactions? Since “companies that want to have their securities quoted on the OTCBB must
16 seek the sponsorship of a market maker as well as file current financial reports with the SEC or
17 with their banking or insurance regulator,” *id.*, what happens if there are no such qualified market
18 makers? Or no “company” to file current financial reports? The SEC has not begun to scratch the
19 surface of all these unanswered questions, and more. In that context, it is impossible to conclude
20 that the industry is on fair notice — not just of the elementary question of whether a token can
21 even be a security, but if so, the myriad of questions about how that could possibly work consistent
22 with securities regulations.
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1 These questions may seem far afield, or theoretical, but they are centrally relevant to this
 2 case. The SEC has decided to label tokens securities, unilaterally causing them damage, without
 3 any possibility for the token or its creator to defend itself, without answering a host of questions
 4 about how those tokens could fit into a securities regulation framework. And, if a token could not
 5 possibly fit into a securities regulation framework, if there is literally no way to register a particular
 6 token as a security, it is reasonable to conclude that the reason is because the token is not a security.
 7

8 One team of prominent securities lawyers recently published an exhaustive review of
 9 nearly a century of appellate case law and related legal scholarship to demonstrate that the SEC's
 10 position that most fungible blockchain-based crypto assets themselves are securities under current
 11 law is inconsistent with the Supreme Court's definition of the term "investment contract" as
 12 developed by federal appellate courts. *See* Lewis Rinaudo Cohen, Gregory Strong, Freeman
 13 Lewin, & Sarah Chen, *The Ineluctable Modality of Securities Law: Why Fungible Crypto Assets*
 14 *Are Not Securities*, DLx Law (Nov. 10, 2022), [https://dlxlaw.com/wp-](https://dlxlaw.com/wp-content/uploads/2022/11/The-Ineluctable-Modality-of-Securities-Law-DLx-Law-Discussion-Draft-Nov.-10-2022.pdf)
 15 [content/uploads/2022/11/The-Ineluctable-Modality-of-Securities-Law-DLx-Law-Discussion-](https://dlxlaw.com/wp-content/uploads/2022/11/The-Ineluctable-Modality-of-Securities-Law-DLx-Law-Discussion-Draft-Nov.-10-2022.pdf)
 16 [Draft-Nov.-10-2022.pdf](https://dlxlaw.com/wp-content/uploads/2022/11/The-Ineluctable-Modality-of-Securities-Law-DLx-Law-Discussion-Draft-Nov.-10-2022.pdf). *See also* Jai Massari, *Why Cryptoassets Are Not Securities*, Harvard
 17 Law School Forum on Corporate Governance (Dec. 6, 2022),
 18 <https://corpgov.law.harvard.edu/2022/12/06/why-cryptoassets-are-not-securities/>.
 19

20 The lack of clarity on these key issues has plagued the blockchain industry, stifled
 21 innovation, and created an arbitrary and ever-shifting playing field, where a well-meaning, careful,
 22 and thoughtful token creator that believes in good faith that it is not violating any securities
 23 regulations can be suddenly branded a bad actor by the SEC, with no chance to respond.
 24

25 Here, if the Court finds that the tokens themselves are not securities, then the SEC cannot
 26 prevail in this case. At a minimum, this Court should lay down a marker: before the SEC brings

1 enforcement actions against blockchain industry participants for failing to abide by securities laws
2 and regulations, those laws and regulations must be clear, understandable, and sensible. Because
3 the token or its creator cannot defend itself here, we respectfully submit that the Court should be
4 very reticent to make any findings that could cause collateral damage to third parties. To the extent
5 the Court is required to reach any findings about the nature of the tokens at issue in this case, the
6 Court should be clear that such findings have no collaterally preclusive effect outside this
7 litigation.
8

9 A software token has a fundamentally different technological nature than a traditional
10 security. It is not at all obvious that a token, which can be easily divorced from an investment
11 contract under which it was sold, even if it was originally sold as part of an investment contract,
12 is itself a security. Indeed, the better weight of case law and scholarly authority is that a token is
13 merely software, not itself the embodiment of an investment contract. For the SEC to simply
14 announce that a particular token is a security gives the SEC inordinate, unchecked power to harm
15 individual technology projects, and American innovation as a whole. For the SEC to do so in an
16 action against a stranger to that project deprives the affected entities and individuals of any
17 meaningful chance to respond. The United States federal government should not be allowed to
18 trample the due process owed to bystanders in order to pursue an unrelated wrongdoer.
19

20 CONCLUSION

21 The Association respectfully requests that the Court consider the issues presented herein
22 when determining the motion to dismiss.
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1 DATED this 13th day of February, 2023.

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