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Ms. Vanessa Countryman
Secretary, Securities and Exchange Commission
100 F St. NE
Washington, DC 20549

Re: File Number S7-02-22

Dear Ms. Countryman:

We write on behalf of our client Uniswap Labs, a developer of decentralized finance (“DeFi”) software, to provide comments on the Securities Exchange Commission’s Supplemental Information and Reopening of Comment Period for Amendments Regarding the Definition of Exchange (“Reopening Release”). Given Uniswap’s viewpoint as a DeFi software developer, and the Reopening Release’s focus on digital assets, this letter predominantly focuses on the Proposal’s impact on decentralized finance. However, this Proposal would not cover *only* digital asset protocols. During the initial comment period, the SEC received myriad comments warning against the incredible breadth of this Proposal, which could be interpreted to cover almost any technology that facilitates communication, including not only DeFi protocols but also technologies such as email or WhatsApp. That the Commission has to exclude them by creating loopholes and exceptions only provides evidence for how overbroad, vague, and arbitrary this proposal is.

The Reopening Release proposes to dramatically expand the definition of “exchange” in a way that, in the Commission’s view, would subject DeFi protocols to securities-law requirements that Congress intended to apply only to centralized securities market intermediaries and that the SEC refuses to update, ensuring that they are as ill-fitting as

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possible.¹ The Commission’s proposal is unlawful in a number of respects and, if adopted as a final rule, would not survive judicial review. The interpretation proposed by the Reopening Release cannot be squared with the text of the Exchange Act, which defines the term “exchange” to require, among other things, a coordinated “group of persons” who provide a “market place or facilities” for the purpose of trading “securities.” 15 U.S.C. § 78c(a)(1). Further, the Proposed Rule would essentially ban (or, at least, seriously cripple the operation of) DeFi protocols. Core separation-of-powers principles, including the major questions doctrine and the non-delegation doctrine, preclude the Commission from arrogating to itself such significant and unbounded authority to displace Congress in making such fundamental judgments about what and how the Commission may regulate, while the Due Process Clause prevents the Commission from resting on vague pronouncements that do not allow regulated parties to understand how to meet their regulatory obligations. Finally, the Commission’s explanation for the Proposed Rule fails to satisfy the Commission’s duty under the Administrative Procedure Act (“APA”) to provide a reasoned explanation for its actions and to refrain from arbitrary and capricious action.

I. Uniswap Labs and the Uniswap Protocol.

A. General Background on the Uniswap Protocol.

The Uniswap Protocol is open-source “smart contract” code that runs on the Ethereum network. In Automated Market Makers (“AMMs”) such as the Uniswap Protocol, “liquidity providers” contribute liquidity into a liquidity pool that generally contains two specific assets. Traders use self-custodied wallets to connect with the smart contract—*i.e.*, software on the Ethereum blockchain programmed to automatically execute trades, akin to a digital vending machine—and trade against the liquidity pool, swapping one asset in the pool for the other. In other words, the Uniswap Protocol consists exclusively of what the Commission refers to as “pairs trading.” Liquidity providers are remunerated for providing liquidity and bearing the associated risks through fees paid by traders. There is no central order book, no third-party custody, and no private order matching engine.

Because reserves are automatically rebalanced after each trade, a Uniswap pool can always be used to buy or sell a digital asset. Unlike traditional exchanges, traders do not

¹ The SEC’s current interpretation covers any “organization, association, or group of persons” that: “(1) [b]rings together the orders for securities of multiple buyers and sellers; and (2) [u]ses established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of a trade.” 17 C.F.R. § 240.3b-16. The suggestion that the SEC’s current rules would capture DeFi is wrong. DeFi protocols are not an organization or group, do not bring together “orders,” and do not do so for multiple buyers and sellers; rather, DeFi protocols facilitate peer-to-peer, or “one to one,” transactions through trades against specific smart contracts. The fact that DeFi protocols do not meet the current interpretation is, in fact, exactly why the SEC has proposed a new definition that would attempt to capture them.

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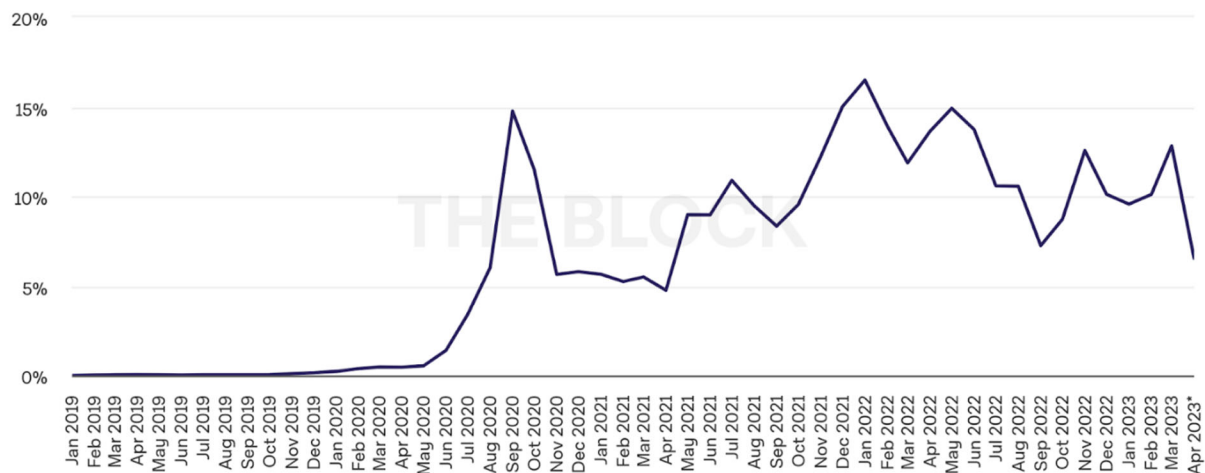
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need to match with individual counterparties to complete a trade. The Protocol provides transparent information about each trade, 24/7 liquidity, and automated trading.

An AMM structure like the Uniswap Protocol also enables anyone with a pair of crypto assets to provide liquidity. In contrast, the barriers to entry to providing liquidity to both sides of a market in a central limit order book are considerably higher, generally requiring a large amount of capital and technological sophistication. By lowering the barriers to and costs of providing liquidity, AMMs are able to compete for significant market share across the broader crypto asset market with centralized exchanges that generally use central limit order books, as illustrated by this graph (which refers to AMMs as “DEX” and to centralized exchanges as “CEX”):



DEX to CEX Spot Trade Volume (%)



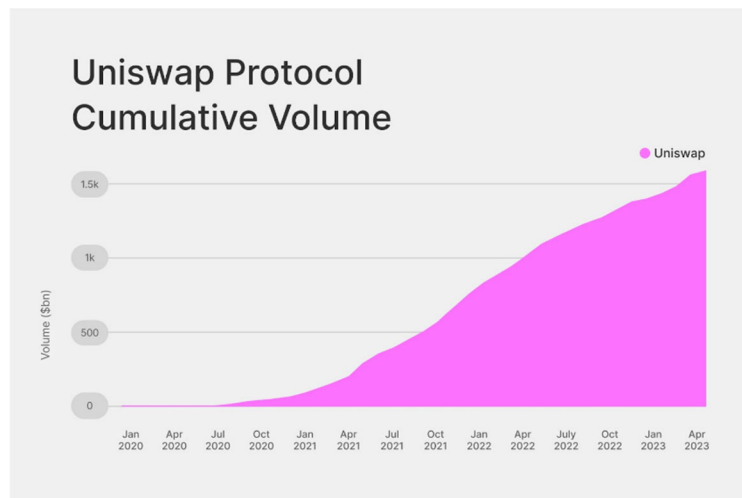
SOURCES: THE BLOCK, THE GRAPH, COINGECKO
 UPDATED: APR 7, 2023

The Uniswap Protocol is the most popular protocol on the Ethereum network by volume. Cumulative volumes occurring through the Uniswap Protocol in 2023 exceeded \$1.5 trillion across 6.5 million wallet addresses. Daily volume on the Uniswap Protocol averages over \$1 billion per day. The top five pools by volume on the Uniswap Protocol consist of some pairing of ether, bitcoin, and the stablecoins USD Coin (“USDC”) and Dai. Of the top forty pools, thirty-six have either ether or USDC in them.

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The volume on the Uniswap Protocol over time is illustrated by this graph:



Source: Uniswap Labs

Other prominent AMMs such as PancakeSwap, Trader Joe, and Curve do an additional \$200 million in volume per day. While some other AMM protocols, such as Curve, enable liquidity pools with more than two assets, all AMM protocols and also all other decentralized finance protocols consist exclusively of “pairs trading” among on-chain assets, which the Commission seeks to prohibit under its proposed regulations.²

AMMs are well positioned to assist the Commission in achieving the Commission’s own mandate of fair, orderly, and efficient markets.³ Prominent academics, such as Stephen Boyd at Stanford, David Parkes at the Harvard School of Engineering, and Christine Parlour at the Hass School of Business have been studying the impact of this innovation. Such research has shown that AMMs provide deep markets, prices that are aligned with those in centralized exchanges, and lower costs for traders.⁴ That can result in better functioning markets, even for assets that are relatively less liquid. Whereas central limit order books optimize around fleeting liquidity from high-frequency market makers, AMMs have deeper liquidity because market makers are not as incentivized by time priority. Further, AMMs are less susceptible to wash trading than centralized markets because the fees that must be paid on

² There are some decentralized protocols that use an order book model, such as 0x, but they are significantly less common than the AMM model. Such protocols constitute less than 1% of decentralized trading volume. See <https://www.theblock.co/data/decentralized-finance/dex-non-custodial>.

³ See U.S. Securities & Exchange Commission, *What We Do*, <https://www.sec.gov/about/what-we-do#:~:text=For%20more%20than%2085%20years,markets%2C%20and%20facilitating%20capital%20formation>.

⁴ See Federal Reserve Bank of Atlanta’s Policy Hub, *An Introduction to Web3 with Implications for Financial Services* (May 2023), <https://www.atlantafed.org/-/media/documents/research/publications/policy-hub/2023/05/15/03--introduction-to-web3-with-implilcations-for-financial-services.pdf>.

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each AMM transaction vitiate the financial incentive to wash trade. The complete transaction transparency on on-chain AMMs also makes them potentially better positioned to facilitate fair, orderly, and efficient markets than traditional exchanges. All transaction information is available for everyone in the market to see—there are no secrets about where the liquidity is coming from or the prices that various actors are paying. When bad actors do attempt to take advantage of the market, those attempts are also public. Finally, the lack of intermediaries on decentralized protocols means the very risks that pushed Congress to regulate exchanges (such as risks that the intermediary will charge inappropriate fees, deny access in an unfair or discriminatory fashion, or abuse its customers' confidential trading information) simply do not exist in DeFi. Ironically, a proposal to reintroduce intermediaries would expose investors to the very risks Congress directed the SEC to address.

B. The Decentralized Nature of the Uniswap Protocol.

The Uniswap Protocol is a decentralized finance protocol—meaning that, like other DeFi protocols, it allows individuals to engage in transactions on public blockchains (here, Ethereum). The Uniswap Protocol is autonomous and self-executing, and it is not centrally governed or maintained.

Uniswap Labs does not control the Protocol. Rather, as is also true of many other DeFi protocols (such as the Bitcoin and Ethereum networks), the developers of the Protocol, including Uniswap Labs and its employees, lack the ability to block any transactions on the Protocol or to shut off or otherwise unilaterally change the Uniswap Protocol code. Uniswap Labs' relationship to the Protocol is thus similar to Satoshi's relationship to the Bitcoin Protocol; both may have helped invent and implement the code, but neither can control access or use of it. And no one else—including governance token holders—can block transactions or shut off the Uniswap Protocol either.

The Uniswap Protocol operates in accordance with a “governance minimization” principle. That principle holds that *automation* is a strong form of decentralization and that anything that can be automated should be, leaving as little as feasible for human governance. The majority of decisions, including approving transactions, adding new pools, and providing liquidity, are made automatically according to the code of the Protocol. The decisions that remain to be made by governance token holders are limited and include, for example, voting to create new liquidity provider fee tiers on the third version of the Protocol or adding a transaction fee. Although Uniswap Labs employees may own UNI tokens and can delegate the associated voting power, the internal policy of Uniswap Labs currently forbids its employees (and Uniswap Labs, as an entity) from voting in protocol governance decisions.

In addition to contributing to the source code for the Uniswap Protocol, Uniswap Labs develops software intended to make the DeFi ecosystem more accessible. Uniswap Labs created and operates the Uniswap App, an interface that allows users to interact with the Uniswap Protocol by connecting a self-custodied wallet. The App itself is relatively passive; it

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does not perform order-routing or handling functions, recommend transactions or assets, or value or custody assets.

But the Uniswap Labs interface is not the only way to access the Uniswap Protocol. Indeed, it is not even the dominant way. Only about 15-20% of volume (and only about 40% of total transactions) on the Uniswap Protocol originates from the Uniswap App. The remaining 80-85% of volume originates from either other interfaces or users who are sophisticated enough to write code to interact directly with the smart contracts.

Uniswap Labs is unaffiliated with other entities operating interfaces that provide access to the Uniswap Protocol and with the users who interact directly with the Protocol's smart contracts. Users who interact with the Protocol via the Uniswap App could be accessing liquidity provided by someone who did not use the App to provide that liquidity, and liquidity provided via the App can be accessed by someone using a different interface entirely, or no interface at all. Uniswap Labs has no relationship with those interfaces, and does not need to engage in agreements, formal or informal, with other interfaces providing access to the Uniswap Protocol or with traders who may or may not end up trading with users accessing the Protocol via the Uniswap App. Uniswap Labs similarly has no relationship or agreement, formal or informal, with any of the 222,052 Ethereum validators who validate transactions that occur on the Uniswap Protocol.

II. The Reopening Release Proposes Regulatory Changes That, If Adopted, Would Be Unlawful In Numerous Respects.

A. The Reopening Release Proposes an Unlawful Interpretation of the Exchange Act.

1. The Reopening Release Incorrectly Asserts the Commission's Jurisdiction Over DeFi Protocols Designed for Non-Securities Transactions.

The Commission's regulatory authority here extends only to regulation of exchanges that trade securities, *see* 15 U.S.C. § 78c(a)(1)—but the vast majority of cryptocurrency transactions are not securities transactions, and DeFi protocols are designed primarily for non-securities transactions. The agency therefore possesses no authority to regulate DeFi protocols as securities exchanges.

The Commission itself has previously taken the position that transactions in cryptocurrencies, including bitcoin and ether, are not securities transactions.⁵ In a 2018 speech,

⁵ The Exchange Act defines a "security" as "any note, stock, treasury stock, security future, security-based swap, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option,

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the then-Director of the Commission's Division of Corporation Finance explained that transactions in digital tokens are not securities transactions where "the network on which the token or coin is to function is sufficiently decentralized."⁶ He named both bitcoin and ether transactions as not being securities transactions. The Commodity Futures Trading Commission (CFTC) has likewise taken the position that "[d]igital assets such as bitcoin, ether, litecoin, and tether tokens are commodities," not securities. *In the Matter of Tether Holdings Ltd.*, CFTC Docket No. 22-04, at p.8 (Oct. 15, 2021).⁷

Because most popular digital tokens self-evidently do not fall in any of the specific categories of securities enumerated by the Exchange Act (e.g., "stocks," "debentures"), transactions in such tokens qualify as "securities" only if they are "investment contract[s]" within the meaning of the statute. *See* 15 U.S.C. § 78c(a)(10). The SEC has recognized that tokens are not intrinsically securities merely because they may be sold, at times, as part of an investment contract. As the SEC's then-Director of the Commission's Division of Corporation Finance explained in 2018, tokens are not *themselves* securities; rather, a "digital asset itself is simply code."⁸

Under the *Howey* test, "an investment contract" exists only if investors "(1) expect profits from (2) a common enterprise that (3) depends upon the efforts of others." *SEC v. Life Partners, Inc.*, 87 F.3d 536, 540 (D.C. Cir. 1996) (citing *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946)). In other words, there is no investment contract unless purchasers have been led to expect profits from the seller's ongoing efforts, such that some post-sale rights and obligations exist. *See, e.g., Warfield v. Alaniz*, 569 F.3d 1015, 1021 (9th Cir. 2009) ("Under *Howey*, courts conduct an objective inquiry into the character of the instrument or transaction offered based on what the purchasers were 'led to expect.' Accordingly, courts have frequently examined the promotional materials associated with an instrument or transaction in determining whether an investment contract is present." (citations omitted)).

When the *Howey* test is applied, it is clear that the vast majority of transactions on DeFi protocols are not securities transactions. Among other reasons, that is because DeFi protocols enable trading in the "secondary market" for digital tokens—*i.e.*, transactions involving parties who did not themselves originate, promote, or otherwise sponsor the tokens. Because no promises are made regarding ongoing efforts by the seller to deliver profits to the

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 instrument commonly known as a 'security'; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing." 15 U.S.C. § 78c(a)(10).

⁶ William Hinman, *Digital Asset Transactions: When Howey Met Gary (Plastic)* (June 14, 2018), <https://www.sec.gov/news/speech/speech-hinman-061418>.

⁷ Available at <https://www.cftc.gov/media/6646/enftetherholdingsorder101521/download>.

⁸ Hinman, *supra* note 6.

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buyer, trading in crypto assets using DeFi protocols cannot constitute a securities transaction under the *Howey* test.

The Reopening Release observes that “Section 3(a)(1) of the Exchange Act and Rule 3b-16 thereunder do not apply to market places or facilities that do not trade securities.” 88 Fed. Reg. 29448, 29450 n.28 (May 5, 2023); *see* 15 U.S.C. § 78c(a)(1) (defining an “exchange” as a place where “securities” are traded). Yet, without identifying which digital tokens the Commission considers to be “securities” or the transactions that the Commission considers to be securities transactions, and without reliance on any source that includes more than conclusory contentions from the Commission itself, the Reopening Release asserts that “it is unlikely that systems trading a large number of different crypto assets are not trading any crypto assets that are securities.” *Id.* at 29450. Based on that unsubstantiated assumption, the Reopening Release suggests that DeFi protocols are “likely meet the current criteria of Exchange Act Rule 3b-16(a),” *id.* at 29451, and further asserts that the Proposed Rule would cover an additional 15-20 DeFi protocols, *id.* at 29474, *see also id.* at 29451 (“The Commission preliminarily believes that some amount of crypto asset securities trade on New Rule 3b-16(a) Systems, and that such systems may use DLT or be ‘DeFi’ trading systems”).⁹

The Reopening Release is incorrect twice over. First, there is no reasoned basis to conclude that a protocol “[l]ikely” trades some number of “crypto assets that are securities” simply because the protocol trades “a large number of different crypto assets.” *Id.* at 29450. The Commission merely assumes that creating a smart contract could allow for securities transactions. But without identifying which, if any, “crypto assets . . . are securities,” it is impossible to conclude that any number of transactions—even a “large number”—likely includes some securities transactions. *Id.*; *see, e.g., City of Vernon, Cal. v. FERC*, 845 F.2d 1042, 1048 (D.C. Cir. 1988) (“[W]e cannot sanction an [agency’s] unexplained assertion,” as “an agency is not entitled under the APA to respond with a non sequitur.”). As a threshold matter, the Commission therefore must identify which crypto assets it considers to be “securities” and/or the transactions in such assets that it considers to be securities transactions. Only then would it be possible to collect and analyze evidence demonstrating whether such transactions do, in fact, occur on DeFi protocols and whether those transactions are indeed securities transactions. It is particularly shocking that the Commission would propose such a dramatic expansion of its regulatory authority without any empirical proof of the supposition on which the proposed expansion rests.

Second, to the extent the Reopening Release purports to interpret either current Rule 3b-16 or the Proposed Rule to apply to any DeFi protocol where even a single “security” has traded, that interpretation lacks any foundation in the Exchange Act. The Exchange Act defines the term “exchange” to mean “any organization, association, or group of persons . . . which constitutes, maintains, or provides a market place or facilities *for bringing together*

⁹ It is unclear which entities are actually covered by this estimate or how many individuals it covers, given the Commission’s vague definition of group (as discussed below).

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purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange.” 15 U.S.C. § 78c(a)(1) (emphasis added). “For” indicates purpose. *See For*, The Shorter Oxford English Dictionary (2d ed. 1936) (“With the object or purpose of,” “In order to obtain,” “Indicating the object to which the activity of the faculties or feelings is directed”); *For*, The Winston Simplified Dictionary (1931) (“for the sake of”). Thus, the Exchange Act’s definition of “exchange” extends to marketplaces *designed for the purpose of* facilitating securities transactions, but not marketplaces where securities transactions are merely incidental or unintentional. *See Intercontinental Exch., Inc. v. SEC*, 23 F.4th 1013, 1025 (D.C. Cir. 2022) (“[B]y speaking of ‘facilities *for* bringing together etc.,’ and not of ‘facilities *that* bring together,’ the statute could be limited to facilities that are maintained *for the purpose of* bringing together purchasers and sellers of securities.”). Tellingly, the Commission itself endorsed this interpretation in the Proposing Release (which preceded the Reopening Release), explaining that “a system that displays trading interest and provides only connectivity among participants without providing a trading facility to match orders or providing protocols for participants to communicate and interact would not meet the criteria of Rule 3b-16(a)” because “such providers are not *specifically designed* to bring together buyers and seller[s] of securities or provide procedures or parameters for buyers and sellers [of] securities to interact.” 87 Fed. Reg. 15496, 15507-08 (Mar. 18, 2022) (emphasis added).

Even if the Commission were right in its unsupported assumption that some number of securities transactions occur on DeFi protocols, the Commission does not (and cannot) conclude that such protocols are *for the purpose of* facilitating such transactions. To the contrary, DeFi protocols are designed for—and almost exclusively used for¹⁰—trading in non-securities crypto transactions. The statutory language cannot be stretched to cover facilities merely made available (or even maintained) for users’ purpose of primarily trading crypto *non-security commodities*, even if a very small number of errant securities transactions might happen on the facilities. Just as Congress did not intend the Commission to require GMail, Twitter, or Indiegogo to register as an exchange if a security is occasionally sold via their protocol, defining “exchange” to cover any protocol that trades even one “security” unreasonably exceeds the statutory text. In other areas of law, courts have distinguished between protocols built for infringement and those that have “significant noninfringing uses.” *Metro-Goldwyn-Mayer Studios Inc. v. Grokster, Ltd.*, 545 U.S. 913, 931-33 (2005) (citation omitted). Analogous reasoning applies here, as DeFi protocols are general-purpose technology that can be used for the trading of unregulated cash commodities (and overwhelmingly are used for that purpose) as well as trading of other types of assets.

Moreover, even if the Commission’s strained interpretation of “exchange” could be justified, the Commission has not yet attempted to offer any such justification. In fact, the Reopening Release does not acknowledge that the Commission is adopting a new interpretation *at all*. If adopted without further explanation, the Reopening Release’s assertion of jurisdiction

¹⁰ As noted, the top five pools by volume on the Uniswap Protocol consist of some pairing of ether, bitcoin, and the stablecoins USDC and Dai—none of which are securities.

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over DeFi protocols could not stand for that reason alone. *See, e.g., Sec’y of Labor, Mine Safety & Health Admin. v. Nat’l Cement Co. of California*, 494 F.3d 1066, 1076-77 (D.C. Cir. 2007) (“[U]nder *Chevron* the Secretary must ‘offer a reasoned analysis’ of her statutory reading,” including by “address[ing] the concerns raised by” regulated parties and “harmoniz[ing] her interpretation” with the statutory text); *Verizon v. FCC*, 740 F.3d 623, 636 (D.C. Cir. 2014) (“The APA’s requirement of reasoned decision-making ordinarily demands that an agency acknowledge and explain the reasons for a changed interpretation.”).

2. The Proposed Rule Is an Unlawful Interpretation of “Exchange.”

As noted above, Section 3(a)(1) of the Exchange Act provides that “[t]he term ‘exchange’ means any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such exchange.” 15 U.S.C. § 78c(a)(1).

The Commission’s existing interpretation of Section 3(a)(1) is set forth in Rule 3b-16, which provides that, subject to certain exceptions:

(a) An organization, association, or group of persons shall be considered to constitute, maintain, or provide “a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange,” as those terms are used in section 3(a)(1) of the Act, if such organization, association, or group of persons:

(1) Brings together the orders for securities of multiple buyers and sellers; and

(2) Uses established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of a trade.

17 C.F.R. § 240.3b-16 (citation omitted).

The Commission’s proposal to amend Rule 3b-16 cannot be squared with the Exchange Act’s plain terms. Even if those terms were ambiguous, the Proposed Rule is neither the best nor even a reasonable interpretation of the word “exchange” as used in and defined by the Exchange Act. *See Nat’l Cable & Telecommunications Ass’n v. Brand X Internet Servs.*, 545 U.S. 967, 986 (2005).

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a. Requiring exchange trading. As a threshold matter, the Commission’s attempt to mandate exchange trading for assets that are not securities-based swaps, securities futures, or registered securities is not rooted in its authority under the Exchange Act. Outside of limited contexts involving security-based swaps (under Sections 3C(h) and 6(h)), security futures (Section 6(l)), or registered securities (Section 11A(c)(3)), the Exchange Act does not authorize the SEC to mandate exchange trading. In other words, the Exchange Act *permits* the kind of activity the Commission seeks to ban here. By contorting its interpretation of the “exchange” definition to ban trading over DeFi protocols, the SEC would end run this limit on its authority.

b. “Market place or facilities.” The Proposed Rule misinterprets the statutory phrase “provides a market place or facilities.” 15 U.S.C. § 78c(a)(1). With respect to Rule 3b-16, the Reopening Release proposes (1) to replace the phrase “[u]ses established, non-discretionary methods” with “*makes available* established, non-discretionary methods” (or, alternatively, “[u]ses established, non-discretionary methods (whether by providing, *directly or indirectly*, a trading facility”); (2) to amend the parenthetical definition of “established, non-discretionary methods” to include “communication protocols” (or, alternatively, “negotiation protocols”), and (3) to replace the word “orders” with the phrase “trading interest,” which would include “orders . . . or any non-firm indication of a willingness to buy or sell a security that identifies at least the security and either quantity, direction (buy or sell), or price.” 88 Fed. Reg. at 29449 & n.9, 29459 (emphasis added).

In combination, those proposed changes would vastly expand the kinds of activities that fall within the definition of “exchange” to activities far afield from “constitut[ing], maintain[ing], or provid[ing] a market place or facilities for bringing together purchasers and sellers of securities.” 15 U.S.C. § 78c(a)(1). For example, under the Proposed Rule, email and chat services such as Gmail and Reddit would be treated as “exchanges” if they allow users to express a willingness to buy or sell crypto assets according to any “protocol”—a word that the Proposed Rule leaves undefined. *See Intercontinental Exch.*, 23 F.4th at 1023 (observing that it would be “an irrational extension of the SEC’s jurisdiction” to interpret “facilities,” as used in the Exchange Act’s definition of “exchange,” to include “[c]ommunications systems that incidentally facilitate the trading of securities”).

DeFi protocols such as the Uniswap Protocol are not “constitut[ing], maintain[ing], or provid[ing] a market place or facilities for bringing together purchasers and sellers” within the meaning of the governing statutory language. 15 U.S.C. § 78c(a)(1). When the Exchange Act was enacted, a “market place” was defined as “[a]n open square or place in a town where markets or public sales are held.” *Market place*, Webster’s New International Dictionary of the English Language (2d ed. 1935); *see also Market*, The Winston Simplified Dictionary (1931) (“a public or private place for the sale or purchase of provisions”); *Market*, The Comprehensive Standard Dictionary of the English Language (1934) (“A place where things can be bought or sold”). Although it may be possible to interpret the statutory phrase “market place” to reflect new ways of constituting virtual “places,” such as a centralized digital exchange,

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the fundamental requirement of “place” remains. The key feature of DeFi protocols is that they *do not* provide a single, centralized market, but rather enable users to engage with one another in decentralized transactions. Meanwhile, the basic definition of a “communications protocol” is “a system of rules that allows two or more entities of a communications system to transmit information via any variation of a physical quantity.”¹¹ Protocols are essentially language rules, and decidedly not captured by any notion of “place.”

A DeFi protocol also would not qualify within the meaning of the statute as a “facility,” which includes a “system of communication to or from the exchange” only if (among other things) it is “maintained by or with the consent of the exchange.” 15 U.S.C. § 78c(a)(2). As discussed above, the developers of DeFi protocols—including Uniswap Labs—lack any meaningful control over such protocols. Further, protocols do not need to be “maintained”—they exist forever after they are deployed.

c. “Group of persons.” Without proposing any amendments to Rule 3b-16 itself, the Reopening Release purports to interpret the statutory phrase “group of persons” to include any group that “exercises control, or shares control, over the organizational, financial, or operational aspects of a market place or facilities for bringing together buyers and sellers of securities.” 88 Fed. Reg. at 29454. The Reopening Release further states that an “important factor[]” in “determining which persons would be included in the group of persons” constituting an “exchange” is “whether the persons act in concert.” *Id.*

The Reopening Release’s reinterpretation stretches those concepts well past their breaking point. As to “control,” the Reopening Release suggests that “[c]ontrol could occur through several means, including, among other things, ownership interest, corporate organizational structure and management, significant financial interest, or the ability to determine or modify participant access, securities traded, operations or trading policies, or non-discretionary methods of the market place or facilities.” *Id.* at 29455. Notably, the Reopening Release sets forth the Commission’s position that “[t]he ability to exercise control over a market place or facilities is not limited solely to . . . operational control.” *Id.*

As to “acting in concert,” the Reopening Release explains that “actors can form a group of persons if they act in concert to perform, or exercise control or share control over, *different functions* of a market place or facilities for bringing together buyers and sellers of securities that, *taken together*, satisfy the elements of existing Exchange Act Rule 3b-16(a) or Rule 3b-16(a), as proposed to be amended.” *Id.* at 29456 (emphasis added). In other words, the proposal rests on the remarkable assertion that unaffiliated persons can “act in concert” without *any coordination*, so long as the sum of their activities constitutes an “exchange.”

¹¹ Wikipedia, *Communication protocol*, https://en.wikipedia.org/wiki/Communication_protocol#:~:text=A%20communication%20protocol%20is%20a,and%20possible%20error%20recovery%20methods (last accessed June 13, 2023).

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Taken together, the Commission’s proposed interpretation of “group of persons” would extend to completely unaffiliated individuals who have no relationship with each other and who each exercise some control—but not total or dispositive control—over one aspect of the purported exchange. That interpretation is as unworkable as it is unreasonable. To begin with, although the Reopening Release lists several actions that might lead the Commission to conclude that an entity is exercising control over an exchange, conspicuously absent from that list is the ability to *turn that exchange on or off*, even though that ability is the obvious hallmark of control. Of course, as to DeFi projects, no such ability exists, because once a smart contract is deployed, it exists forever; smart contracts cannot be turned off.

The Reopening Release fails to address the fact that, under the Commission’s proposed interpretation, responsibility for the deployment of permanent code amounts to permanent responsibility. The Commission is clear that when “an organization deploys a smart contract,” even one that “cannot be significantly altered or controlled,” that organization is “responsible for compliance with federal securities laws for that market place.” *Id.* at 29456. The Commission is much less clear about how it plans to address organizations that deployed permanent, immutable code and therefore have compliance obligations for that code, but now wish to cease operations. This is particularly salient given that the Commission itself admits that, if the proposal were to be adopted as it currently stands, then many such companies likely would go out of business given the onerous costs of compliance. *See, e.g., id.* at 29485.

The solution the Commission proposes to the quandary of immutable code is for miners and validators to fork the offending code.¹² *Id.* at 29483 & n.361. But that “solution” reflects a basic misunderstanding about the workings of blockchain technology. Miners and validators do not create forks of existing chains. Developers write new code, and miners and validators agree to verify transactions on the new smart contracts instead of the old ones. In addition, and crucially, the new code does not *replace* the old code—a fork is not a change to the existing smart contract. Both versions of the blockchain continue to exist, with users choosing the version of the code with which they wish to interact and validators choosing the version on which they wish to validate transactions. That is true even for the example the Commission gives in the Reopening Release. *See id.* There was a hard fork after the 2016 Ethereum hack, but the prior version of the blockchain continues to exist and people continue to use it.

An additional problem created by the Commission’s understanding of “control” is that multiple, completely separate entities would each have “control” over the same market place. That is because, under the Commission’s interpretation, any “person that . . . can determine or modify . . . the securities made available for trading or the access requirements and conditions for participation would be exercising control.” *Id.* at 29455. Under that view, it

¹² That idea is mentioned in passing, with no discussion of the basis on which the Commission could order miners and validators to fork the code in question. Miners and validators do not “control” underlying DeFi protocols in any way, just as internet service providers do not control the websites that their customers access. In addition, given the global nature of blockchain technology, many miners and validators are located outside of the United States.

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would be possible for not only a contributor to the development of a DeFi protocol but also every one of hundreds of interfaces that provide access to that protocol to separately exercise “control” over the market place in question. Indeed, the Commission admits in the Reopening Release that its new interpretation would apply to (among other individuals) holders of governance tokens, organizations that deploy new protocols, developers, miners, and validators. *Id.* at 29455-56. It is thus unclear why the “group” would not extend to unaffiliated software developers who crafted basic Internet protocols, layer 1 blockchain protocols, or other underlying technology. That interpretation turns the definition of “control” on its head and, in doing so, creates confusion as to who is responsible for which aspects of compliance. Yet the Commission offers no guidance on how it expects entities that have overlapping compliance obligations to fulfill those obligations, much less an explanation for why it is reasonable to expect disparate entities having no connection to each other—other than the fact that they all provide access to (or contributed code to) the same protocol—to overcome the immense coordination challenges necessary to satisfy the regulatory burdens imposed upon securities exchanges. That is in stark contrast to the Commission’s assertions that, as to non-DeFi companies, a “group of persons” will not exist even among affiliated entities under certain conditions. *See* 88 Fed. Reg. at 29454 n.66.

The Commission’s novel and implausible interpretation of “group of persons” finds no support in caselaw. The Reopening Release cites *Intercontinental Exchange*, 23 F.4th 1013, but that decision actually undermines the Commission’s interpretation, as it observes that even “[u]naffiliated entities *engaged in joint ventures or other concerted activity* . . . may not, depending upon the circumstances, be considered a ‘group of persons’ for the purposes of” the Exchange Act. *Id.* at 1024 (emphasis added). That is a far cry from the Commission’s interpretation, which appears to require no “concerted activity” at all. Indeed, *Intercontinental Exchange* warns against adopting the sort of expansive definition that the Commission now advances, explaining that although “the outer boundary of the term ‘group of persons’ remains murky, . . . vigilance is necessary to ensure the term is not stretched too far.” *Id.* at 1025. By including in the definition of “group of persons” individuals merely working on the same technology—regardless of whether they have had any contact, much less made any agreement, and regardless of whether they have any ongoing operational control—the Commission does just that: it “stretche[s]” the meaning of “group of persons” “too far.” *Id.* at 1025.

3. The Commission’s Proposed Interpretation Would Receive No Judicial Deference.

For the foregoing reasons, it is clear that Congress in the Exchange Act “has ‘unambiguously foreclosed the [Commission’s] statutory interpretation.’” *Vill. of Barrington, Ill. v. Surface Transp. Bd.*, 636 F.3d 650, 659 (D.C. Cir. 2011) (citation omitted). If the Commission were nonetheless to adopt the proposal in the Reopening Release as its final rule, a court upon judicial review would be compelled to hold unlawful and set aside such interpretation as “in excess of” the Commission’s “statutory jurisdiction, authority, or limitations.” 5 U.S.C.

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§ 706(2)(C); *see also Vill. of Barrington*, 636 F.3d at 659-60 (“Because at *Chevron* step one [the courts] alone are tasked with determining Congress’s unambiguous intent,” courts must interpret the relevant statute “without showing the agency any special deference”).

Even if the Commission’s proposed interpretation were not foreclosed by the statutory text (which it is), no deference to such a final rule would be warranted, and neither the courts of appeals nor the Supreme Court would extend such deference.

First, no *Chevron* deference would be warranted, for a number of reasons. It is unlikely that *Chevron* deference will survive, in any form, for very much longer.¹³ But even under the Supreme Court’s current interpretation of the *Chevron* deference doctrine, an agency’s interpretation is not entitled to deference—even if reasonable in some sense—unless that interpretation is the one dictated by application of traditional tools of statutory interpretation. In *AHA v. Becerra*, 142 S. Ct. 1896, 1906 (2022), the Supreme Court addressed a decision of the D.C. Circuit that deferred to an agency’s statutory interpretation on the ground that, while a different interpretation had “force,” the statute did not expressly forbid what the agency did and the agency’s “belief” in its approach was not “unreasonable.” *AHA v. Azar*, 967 F.3d 818, 833 (D.C. Cir. 2020). The Supreme Court unanimously reversed—without concluding that the statute unambiguously foreclosed the agency’s interpretation, or even that the agency’s interpretation was unreasonable. Rather, the Court said, it had itself “employ[ed] the traditional tools of statutory interpretation” and, having done so, did “not agree with [the agency’s] interpretation.” 142 S. Ct. at 1906. Here, as discussed above, no court applying traditional interpretive tools could agree with the statutory interpretation set forth in the Reopening Release, and that interpretation therefore would not be entitled to deference.

In any event, the interpretations set forth in the Reopening Release are not within the zone of reasonableness, and therefore would not be entitled to *Chevron* deference even on a broader understanding of the scope of that doctrine. As explained above, the words “securities” and “exchange” in the Exchange Act, on any reasonable reading, do not stretch nearly so far as the Commission is attempting to stretch them here. *See* pp. 6-14, *supra*.

That is particularly so given the sweeping changes that adoption of the Proposed Rule would wreak. That rule would have wide economic effects, and could even drive most or all of a multibillion dollar business out of operation—as the Reopening Release admits. *See* pp. 18-21, *infra*. Any deference to an agency is at its nadir when that agency tries to use general rulemaking powers to remake the face of an industry, and the economy more generally, in that way. *See, e.g., Util. Air Regul. Grp. v. EPA*, 573 U.S. 302, 324 (2014). Those are exactly the kinds of decisions that courts assume Congress keeps in its own hands, rather than delegating them to an administrative agency. *See id.*

¹³ The Supreme Court recently granted certiorari in *Loper Bright Enterprises v. Raimondo*, No. 22-451, to consider whether the Court should overrule or further narrow *Chevron*.

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In addition, the Commission can claim *Chevron* deference “only if the agency has offered a reasoned explanation for why it chose that interpretation.” *Vill. of Barrington*, 636 F.3d at 660. This the Commission has not done. Instead, the Reopening Release is built on a series of unsubstantiated (and sometimes unarticulated) assumptions about, *inter alia*, whether “securities” are traded on DeFi protocols, *see* 88 Fed. Reg. at 29450-51; what constitutes a “communication” or “negotiation” protocol, *see id.* at 29460; and how unaffiliated individuals might feasibly “act in concert” to exercise “control” over a DeFi protocol, *see id.* at 29453-58. Where, as here, an agency has “fail[ed] or refuse[d] to deploy [its] expertise—for example, by simply picking a permissible interpretation out of a hat—it deserves no deference” whatsoever. *Vill. of Barrington*, 636 F.3d at 660.

It is hardly surprising that the Reopening Release fails to persuasively apply the Commission’s expertise to the interpretive questions analyzed therein, as the Commission *lacks expertise* in the regulation of crypto assets or the functioning of DeFi protocols. The Reopening Release forthrightly concedes as much, admitting several times over that the Commission lacks the information necessary to adequately assess the implications of its proposed interpretation, and asking the public to provide that information. *See, e.g.*, 88 Fed. Reg. at 29473-74 (“The Commission lacks information on the entities involved providing New Rule 3b-16(a) Systems in the market for crypto asset securities, and consequently, is uncertain as to the precise number of such entities.”); *id.* at 29474 (“The Commission lacks information on current crypto asset market practice”); *id.* at 29476 (“The Commission preliminarily believes that actual [compliance] costs may be higher than [its] estimates and discussions express,” but “[b]ecause it lacks certain data, the Commission is unable to provide an estimate as to how much higher costs may be.”); *id.* at 29482 (“[T]he Commission lacks sufficient detail about the variety of protocols whose systems use [certain] technologies, or their options to comply” with the Proposed Rule.). In light of the Commission’s conceded lack of expertise in the area, courts would not afford the Reopening Release any deference, under *Chevron* or otherwise. *See Vill. of Barrington*, 636 F.3d at 660 (“[A]mong ‘[t]he principles underlying’ *Chevron* deference is the need for an agency to apply ‘more than ordinary knowledge’—i.e., ‘agency expertise’—when ‘fill[ing] . . . gap[s] left, implicitly or explicitly, by Congress’” (quoting *Mayo Found. for Med. Educ. & Rsch. v. United States*, 562 U.S. 44, 55-56 (2011))).

Indeed, the SEC makes several factual errors in the Reopening Release that reveal a lack of understanding as to how this technology works. For example, the SEC proposes that miners and validators hard fork noncompliant protocols to make them compliant. *See* 88 Fed. Reg. at 29483 & n.361. That proposal reveals a misunderstanding of both the relationship between transaction validators and hard forks, as well as the relationship between the forked chain and the original (which still exists and could still be used by traders and validated by foreign validators). Similarly, the Commission’s discussion of entities “acting in concert” if “one entity agrees with another entity to combine aspects of each other’s market places or facilities,” *id.* at 29454, reflects a misunderstanding of interoperability, one of the central premises of blockchain technology. The power of open blockchains is that this kind of

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agreement is not required—developers can build products on top of other public projects without ever interacting with the developers of those projects (or even knowing who they are). The SEC also mischaracterizes the pervasiveness of wash trading across the digital asset ecosystem, writing that “[b]ecause . . . wash trading renders volume data unusable, the Commission is also unable to determine the share of trading that takes place on various types of platforms; or the amount of concentration in volume among various exchanges.” *Id.* at 29471. That is false. There is little to no wash trading on decentralized finance protocols, partly because the fees required per transaction vitiate any incentive to wash trade by making it extremely costly. In other words, the majority of volume on DeFi protocols is almost certainly not a result of wash trading, and the SEC should therefore easily be able to make determinations about DeFi protocol volume (especially considering the abundance of information available on the subject on public block explorers like etherscan). That the SEC’s discussion of wash trading included no recognition of the fact that there is very little to no wash trading on DeFi protocols reveals its misunderstanding of basic facts about this technology.

Second, the interpretation proposed in the Reopening Release would not be entitled to any deference under *Skidmore*, which entitles an agency interpretation to “only as much deference as its persuasiveness warrants.” *Brown v. United States*, 327 F.3d 1198, 1205 (D.C. Cir. 2003), *as amended* (May 6, 2003); *see generally United States v. Mead Corp.*, 533 U.S. 218 (2001). In making that assessment, a court “must examine ‘the thoroughness evident in [the agency’s] consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade.’” *Brown*, 327 F.3d at 1205 (quoting *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944)). For the reasons discussed above, the Reopening Release flunks each of those tests. The Commission’s proposed interpretation is hardly thorough; on the contrary, it simply assumes key premises, including the threshold question of whether DeFi protocols trade “securities” at all. The Reopening Release candidly admits the limits of its own reasoning, highlighting over and over again pertinent information that the Commission lacks and making a number of mistakes about how relevant technology works. And the Reopening Release proposes to dramatically expand the meaning of “exchange” to reach a wide swath of activities never before subject to the Commission’s regulatory reach. In sum, the statutory interpretations embedded in the Reopening Release do not reflect any thoroughness or special expertise and entirely lack the “power to persuade.” *Skidmore*, 323 U.S. at 140.

B. The Commission’s Proposed Interpretation of the Exchange Act Is Unconstitutional.

Even if a plausible argument somehow could be made that the Proposed Rule is compatible with the text of the governing statute, the Proposed Rule nevertheless cannot withstand scrutiny. It is unconstitutional on several different grounds.

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1. The Regulatory Authority Asserted in the Reopening Release Violates the Separation of Powers.

If adopted, the Commission’s proposed interpretation would effectively ban or, at the least, significantly cripple the DeFi industry. That result is a product of several unfounded assertions and problematic proposals, some of which independently ban DeFi and others of which combine to create a regime that is impossible for DeFi protocols to comply with. The unfounded assertions include the notion that most digital assets are securities (even though, as noted above, few are) and that any protocol where even one security trades must be treated as an “exchange” (with no option for the protocol to merely remove that security). The problematic proposals include a ban on “pairs trading” without recognition that many DeFi protocols rely upon such trades; the refusal to consider adapting legacy, technologically specific rules for DeFi even when those rules conflict with actual DeFi technology; and the requirement that the disparate, unaffiliated individuals who contribute to the functioning of any given DeFi protocol—from developers to governance token holders to validators—must somehow “form an organization or association . . . which would be responsible” for bringing DeFi protocols “into compliance with Regulation ATS.” 88 Fed. Reg. at 29483.

Recognizing the insurmountable burdens that “exchange” treatment would impose upon DeFi protocols, the Reopening Release candidly “acknowledges that the[] costs [of compliance] may cause *some or all* of the entities that make available [DeFi protocols] to cease the activities that make them responsible for the system’s compliance, potentially resulting in the system’s exit from the market.”¹⁴ 88 Fed. Reg. at 29484 (emphasis added); *see also id.* at 29484 & n.368. And those protocols that are not forced out of the market entirely would, in the Commission’s view, be forced to “significant[ly] alter[] . . . the manner in which such systems operate” in order to “compl[y] with the applicable regulations.” *Id.* at 29485; *accord id.* (“[i]n cases of a system using” distributed ledger or blockchain technology “the manner in which the system functions may have to be altered to make compliance with registration requirements possible”).

The Commission’s attempt to manipulate its regulatory powers to drive an entire industry out of business runs afoul of constitutional separation of powers principles. The Commission’s interpretation either asserts regulatory authority that, under the major questions doctrine, Congress *has not* granted to the agency, or it exercises legislative power that, under the nondelegation doctrine, Congress *may not* grant to the agency.

¹⁴ As discussed above, the Commission does not explain how the persons it deems “responsible” for compliance could even take the dramatic and final step of exiting the market, given that many smart contracts cannot be turned off once deployed. *See* 88 Fed. Reg. at 29484 (asserting without explanation that “smart contracts can be controlled after deployment” but admitting that, “in some instances, the functions of miners or validators may be needed to exert such control”).

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a. Major questions doctrine. The Supreme Court has explained that, “[w]hen an agency claims to discover in a long-extant statute an unheralded power to regulate ‘a significant portion of the American economy,’ we typically greet its announcement with a measure of skepticism.” *Util. Air Regul. Grp.*, 573 U.S. at 324 (quoting *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 159 (2000)). That is because “both separation of powers principles and a practical understanding of legislative intent” counsel against “read[ing] into ambiguous statutory text the delegation claimed to be lurking there.” *West Virginia v. EPA*, 142 S. Ct. 2587, 2609 (2022) (citation omitted). Thus, under the major questions doctrine, courts “expect Congress to speak clearly if it wishes to assign to an agency decisions of vast ‘economic and political significance,’” *Util. Air Regul. Grp.*, 573 U.S. at 324 (citation omitted)—and, where Congress has failed to do so, the agency is foreclosed from taking the challenged action.¹⁵

Whether to effectively ban DeFi is just the kind of “decision[] of vast ‘economic and political significance,’” *id.*, that falls within the scope of the major questions doctrine. Unquestionably, that decision would have vast economic impact. The Uniswap Protocol alone has facilitated more than a trillion of dollars of transactions, and trillions more have flowed through the broader DeFi ecosystem. A recent study estimates that if current growth rates continue, the DeFi industry will create as many as 4 million new jobs by 2030.¹⁶

Critically, the vast economic effects of a functional ban on DeFi would arise primarily because the proposed rule change would block *non-securities* transactions that are not within the Commission’s jurisdiction, including the trading of bitcoin, ether, and stablecoins. In other words, in service of regulating the small number of incidental securities transactions that purportedly take place on DeFi protocols, the Commission is prepared to decimate the entire DeFi industry—the large majority of which lies beyond even the broadest interpretation of the Commission’s statutory authority. The major questions doctrine precludes the Commission from crippling such a large swath of economic activity. *See Gundy v. United States*, 139 S. Ct. 2116, 2141-42 (2019) (Gorsuch, J., dissenting) (noting that, under the major questions doctrine, the Court has “rejected agency demands that we defer to their attempts to rewrite rules for billions of dollars in healthcare tax credits, to assume control over millions of small greenhouse gas sources, and to ban cigarettes”).

The Commission’s interpretation also reflects a sharp break with the agency’s historic position on cryptocurrency regulation. Chairman Gensler testified shortly after his confirmation that it is “only Congress that could really address” the regulation of crypto exchanges, conceding that the Commission does not have the statutory authority to promulgate a

¹⁵ Although the major questions doctrine sometimes serves as a tool of statutory interpretation, *see* p. 15, *supra*, it has independent significance as a separation-of-powers check on agency authority, *see, e.g., West Virginia v. EPA*, 142 S. Ct. at 2607-08.

¹⁶ *See* Electric Capital, *U.S. Share of Blockchain Developers Is Shrinking* (Apr. 24, 2023), <https://cryptofoinnovation.org/u-s-share-of-blockchain-developers-is-shrinking/>.

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rule that, merely two years later, the agency is now proposing.¹⁷ And the Commission itself recognized in its Strategic Plan for 2022-2026 that “the SEC must pursue new authorities from Congress where needed” to address areas such as “the rapid growth in crypto assets.”¹⁸ The Commission’s newfound confidence that it may regulate DeFi protocols into extinction is “not only unprecedented,” but it would “effect[uate] a fundamental revision of the statute, changing it from one sort of scheme of regulation into an entirely different kind” whereby entire technologies—and industries built upon them—could be forced to “cease” operating “altogether.” *West Virginia v. EPA*, 142 S. Ct. at 2612 (citation and internal quotation marks omitted) (alterations accepted).

“There is little reason to think Congress assigned such decisions to the [Commission].” *Id.* On the contrary, Congress has introduced more than 80 bills covering digital assets and has held well over 100 hours of hearings on the subject across multiple committees. For example, the chairmen of the House Financial Services and Agriculture Committees recently released a draft bill that would provide a framework for regulating crypto assets.¹⁹ The introduction of this bill makes clear that, in the eyes of many members of Congress, the Commission does not presently have authority to engage in such regulation. And the fact that the bill gives significant regulatory authority to the CFTC—which regulates commodities—further highlights that many members do not agree with the Commission assessment that a majority of digital token transactions are securities transactions. Congress’s active interest in cryptocurrencies and DeFi technologies demonstrates that “[t]he basic and consequential tradeoffs involved in” regulating such industries “are ones that Congress would likely have intended for itself.” *Id.* at 2613.

It simply stretches credulity to think that, in enacting the Exchange Act nearly a century ago, Congress intended to delegate such weighty choices about emerging technologies to the Commission. When Congress enacted the Exchange Act in 1934, it was a very different world than the one in which the Commission is operating today; at that time, the idea of DeFi protocols and the associated technology would have been beyond anyone’s wildest imagination. Just as the Supreme Court decided in *West Virginia* that the Clean Air Act, passed in the 1970s, was not enacted with any thought that it would be used to regulate CO2 emissions that cause climate change, because no one anticipated that problem when the law was passed, *see id.* at 2612, a court would be very likely to conclude that the Exchange Act was not enacted with any thought that the Commission could undertake the regulation of new technology reflected in the Proposed Rule.

¹⁷ The Hill, *With Washington Recommitted to Innovation, Cryptocurrencies Need a Congressional Fix* (June 18, 2021), <https://thehill.com/opinion/finance/559148-with-washington-recommitted-to-innovation-cryptocurrencies-need-a/>.

¹⁸ U.S. Securities & Exchange Commission, *Strategic Plan: Fiscal Years 2022-2026*, at p. 11, www.sec.gov/files/sec_strategic_plan_fy22-fy26.pdf.

¹⁹ See Financial Services Committee, *McHenry, Thompson, Hill, Johnson Release Digital Asset Market Structure Proposal* (June 2, 2023), <https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=408838>.

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Against this backdrop, the Exchange Act is woefully lacking in the sort of “‘clear congressional authorization’ to regulate” DeFi protocols that the major questions doctrine demands. *Id.* at 2614 (citing *Util. Air Regul. Grp.*, 573 U.S. at 324). The Exchange Act merely gives the Commission the “power to make such rules and regulations as may be necessary or appropriate to implement the provisions of [the Act] . . . or for the execution of the functions vested in [the Commission] by [the Act].” 15 U.S.C. § 78w(a)(1). Nowhere in that generic grant of rulemaking authority does the Exchange Act give the Commission the power to ban an entire industry. “Extraordinary grants of regulatory authority are rarely accomplished through” such “‘modest words,’ ‘vague terms,’ or ‘subtle device[s].’” *West Virginia v. EPA*, 142 S. Ct. at 2609 (alteration in original; quoting *Whitman v. Am. Trucking Ass’ns*, 531 U.S. 457, 468 (2001)).

b. Nondelegation doctrine. If, on the other hand, the text of the Exchange Act were broad enough to authorize the Commission’s proposed interpretation (which it is not), then the statute itself would violate the nondelegation doctrine. *See Nat’l Fed’n of Indep. Bus. v. Dep’t of Lab., Occupational Safety & Health Admin.*, 142 S. Ct. 661, 668 (2022) (Gorsuch, J., concurring) (explaining that “the major questions doctrine is closely related to . . . the nondelegation doctrine” and that “courts have cited the nondelegation doctrine as a reason to apply the major questions doctrine”). “The nondelegation doctrine bars Congress from transferring its legislative power to another branch of Government.” *Gundy*, 139 S. Ct. at 2121. Consequently, “when Congress confers decisionmaking authority upon agencies[,] Congress must ‘lay down by legislative act an intelligible principle to which the person or body authorized to [act] is directed to conform.’” *Whitman*, 531 U.S. at 472 (alteration and emphasis in original; quoting *J.W. Hampton, Jr., & Co. v. United States*, 276 U.S. 394, 409 (1928)). “The legislature must make clear the ‘general policy’ to be pursued and ‘the boundaries of this delegated authority.’” *Sanchez v. Off. of State Superintendent of Educ.*, 45 F.4th 388, 401 (D.C. Cir. 2022) (quoting *Am. Power & Light Co. v. SEC*, 329 U.S. 90, 105 (1946)).

As noted above, the Exchange Act grants the Commission authority to “make such rules and regulations as may be necessary or appropriate to implement the provisions of [the Act].” 15 U.S.C. § 78w(a)(1). Although that provision may “sufficiently guide[] executive discretion” as to some day-to-day regulatory choices, *Gundy*, 139 S. Ct. at 2123, “[t]he amount of guidance the legislature must provide ‘varies according to the scope of the power congressionally conferred,’” *Sanchez*, 45 F.4th at 401 (quoting *Whitman*, 531 U.S. at 475). Where, as here, the authority claimed by the agency is one of substantial economic consequence, “Congress must give ‘substantial guidance.’” *Id.* (quoting *Whitman*, 531 U.S. at 475).

If it were true that the Exchange Act’s delegation of rulemaking authority empowers the Commission to effectively ban DeFi protocols, then the Exchange Act would run afoul of the nondelegation doctrine. Beyond a broad admonition to “consider among other matters the impact any . . . rule or regulation would have on competition,” 15 U.S.C. § 78w(a)(2), the statute provides no guidance for the Commission to follow in determining how to regulate new financial technologies, much less criteria that could justify banning such

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technologies and the industry they support. And to the extent the Exchange Act were to authorize the Commission to regulate as an “exchange” any protocol that trades *any* securities, no matter how minimal or incidental such trading is, the statute fails to provide any intelligible principle by which the Commission may judge the appropriate boundaries of its jurisdiction.

To avoid the serious constitutional questions that would be raised if the Exchange Act granted the Commission the unbounded discretion the agency claims, a reviewing court would construe the statute narrowly to withhold such authority. *See, e.g., Mistretta v. United States*, 488 U.S. 361, 373 n.7 (1989) (explaining that non-delegation doctrine supports “giving narrow constructions to statutory delegations that might otherwise be thought to be unconstitutional”); *Indus. Union Dep’t, AFL-CIO v. Am. Petroleum Inst.*, 448 U.S. 607, 646 (1980) (where one interpretation of a “statute would make such a ‘sweeping delegation of legislative power’ that it might be unconstitutional under the” nondelegation doctrine, “[a] construction of the statute that avoids this kind of open-ended grant should certainly be favored” (citation omitted)). Thus, if the Commission proceeds with adopting its proposed interpretation, it can expect a court to conclude that it lacks authority to promulgate the Proposed Rule. And, to the extent that a court were to conclude that such authority existed, the court would necessarily have to find such authority to be unconstitutional under the non-delegation doctrine.

2. The Proposed Rule Fails to Provide Regulated Parties Fair Notice in Violation of the Due Process Clause.

The Proposed Rule presents yet another constitutional problem: it does not give adequate notice to regulated parties about what conduct is prohibited and is therefore unconstitutional under the Due Process Clause. “Entities regulated by administrative agencies have a due process right to fair notice of regulators’ requirements.” *Fortyone v. City of Lomita*, 766 F.3d 1098, 1105 (9th Cir. 2014). Indeed, courts generally “apply a more stringent standard of notice to civil regulations than civil statutes.” *FTC v. Wyndham Worldwide Corp.*, 799 F.3d 236, 251 (3d Cir. 2015). Where an agency purports to “exercise[] its authority to fill gaps in a statutory scheme,” “parties are entitled to have ‘ascertainable certainty’ of what conduct is legally required by the regulation.” *Id.* (citation omitted).

The Proposed Rule wholly fails to give adequate notice of what conduct is required with respect to DeFi protocols. As a threshold matter, the Reopening Release refuses to identify which digital assets (or transactions therein) the Commission considers to be “securities,” leaving DeFi protocols guessing about whether the Proposed Rule applies to them at all.

Next, the Proposed Rule proposes to insert the term “communication protocol” into the definition of exchange, but fails to elaborate on what constitutes a communication protocol or to define that term in any way. The fact that the term “communication protocol” is so vague that it could cover almost anything has already been noted by many commenters, and is in fact partly the basis for the reopening of the comment period. But rather than address the

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ambiguity, the Reopening Release simply suggests that the Commission might substitute a different undefined phrase, “negotiation protocol,” for “communication protocol”—again without explaining what activities constitute a “negotiation protocol.”

The Commission has already had to exempt specific protocols that seem to fall within the definition (*e.g.*, OEMS technology) as a result of the Proposed Rule’s use of such broad terminology. The need for such brute-force exemptions for specific favored parties is powerful evidence that the Proposed Rule is vague and that its outer boundaries are unclear to industry participants. Promulgating a vague rule and then carving out exceptions after the fact runs counter to the very purpose of agency rulemaking: providing clarity to industry participants and obviating the need for ad hoc decision-making.

Finally, although the Reopening Release devotes dozens of pages to discussing the definition of “group of persons,” the Commission never arrives at an actual conclusion about the meaning of that term. Rather, the Reopening Release admits that there is a large array of individuals who may be included in the phrase “group of persons,” ranging from developers to validators, and leaves it to those individuals—many of whom “are unsophisticated participants in financial markets . . . [who] may not appreciate the significance of maintaining a system that meets the definition of exchange,” 88 Fed. Reg. at 29484—to determine for themselves whether they have compliance obligations under the Proposed Rule.

The Commission acknowledges that there is “uncertainty . . . associated with the broad formulation of the Proposed Rules,” but assumes that the only downside to such uncertainty may be “increased legal costs.” 88 Fed. Reg. at 29482. That dramatically underestimates the problem. If adopted as it now stands, the Proposed Rule would introduce so much uncertainty into the DeFi ecosystem that many protocols would, by the Commission’s own admission, choose to exit the market rather than attempt to decipher how to comply. Where, as here, “a regulated party acting in good faith would” be unable “to identify, with ‘ascertainable certainty,’ the standards with which the agency expects parties to conform,” the agency has failed to “fairly notif[y]” regulated parties “of the agency’s interpretation.” *General Elec. Co. v. EPA*, 53 F.3d 1324, 1329 (D.C. Cir. 1995), *as corrected* (June 19, 1995) (citation omitted). Without further clarification, a final rule in the same form as the Proposed Rule would be unconstitutional due to violation of the fair notice doctrine.

C. The Proposed Rule Is Arbitrary and Capricious.

The APA requires a reviewing court to “hold unlawful and set aside agency action[s]” that are “arbitrary, capricious, [or] an abuse of discretion.” 5 U.S.C. § 706(2)(A). “The APA’s arbitrary-and-capricious standard requires that agency rules be reasonable and reasonably explained,” *Nat’l Tel. Co-op. Ass’n v. FCC*, 563 F.3d 536, 540 (D.C. Cir. 2009), and forbids an agency from “rel[ying] on factors which Congress has not intended it to consider,” *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). If the

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Commission were to adopt the proposal set forth in the Reopening Release, the resulting rule would be arbitrary and capricious for several independent reasons.

1. The Proposed Rule Fails to Justify its Impact on Competition.

A rule is arbitrary and capricious if the agency “neglected to consider a statutorily mandated factor.” *Public Citizen v. Fed. Motor Carrier Safety Admin.*, 374 F.3d 1209, 1216 (D.C. Cir. 2004). The Exchange Act includes at least one such requirement: the Commission must “consider among other matters the impact any . . . rule or regulation would have on competition” and “shall not adopt any such rule or regulation which would impose a burden on competition not necessary or appropriate in furtherance of the purposes of” the Exchange Act. 15 U.S.C. § 78w(a)(2).

Although the Reopening Release acknowledges that the Proposed Rule “may cause *some or all* of the entities that make available [DeFi protocols] to . . . exit from the market,” 88 Fed. Reg. at 29484 (emphasis added), it fails to analyze the harms of that outcome as a cost of the rule, or to explain why that substantial “burden on competition” is “necessary or appropriate in furtherance of the purposes of” the Exchange Act, 15 U.S.C. § 78w(a)(2). That dearth of analysis is perhaps unsurprising, as the Commission repeatedly admits in the Reopening Release that it lacks sufficient evidence or information to make an informed decision. The Commission concedes, for instance, that it “lack[s] sufficient data on crypto asset securities,” 88 Fed. Reg. at 29476; “lacks sufficient detail about the variety of platforms whose systems use [certain] technologies,” *id.* at 29482; and is “uncertain as to how precise [its compliance cost] estimates are,” *id.* at 29476. Absent such key information, the Reopening Release simply asserts that the Proposed Rule “could promote competition and incentivize innovation,” *id.* at 29485, while simultaneously admitting that the Proposed Rule could “adversely affect[] competition,” *id.* at 29487, and result in “less innovation,” *id.* at 29482.

Similarly, the Reopening Release acknowledges that, with respect to DeFi protocols, the “actual costs [of the Proposed Rule] may be higher than [the Commission’s] estimates and discussions express” while “the benefit[s] . . . may be reduced.” *Id.* at 29475-76. Given that the costs may be higher than estimated and the benefits may be lower, and the Commission is unable to estimate by how much, the costs of the Proposed Rule may very well far outweigh the benefits. Until the Commission can reasonably analyze that question, it lacks a sufficient basis on which to promulgate the Proposed Rule. *See American Radio Relay League, Inc. v. FCC*, 524 F.3d 227, 237 (D.C. Cir. 2008) (“It is not consonant with the purpose of a rule-making proceeding to promulgate rules on the basis of inadequate data” (citation omitted)).

Worse still, the Reopening Release expressly privileges old technology over new technology and market incumbents over newcomers. Several of the changes to the existing regulatory language proposed in the Reopening Release (*i.e.*, changing “communication protocol” to “negotiation protocol” and changing “uses” to “makes available”) were spurred by comments received from traditional finance groups. *See* 88 Fed. Reg. at 29460 & nn.123, 128

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(citing comments from SIFMA, Broadridge, the Managed Funds Association, and the American Securities Association as grounds for considering a switch from “communication protocol” to “negotiation protocol”). And the Proposed Rule creates exceptions for incumbents while making no such concessions to DeFi protocols. For instance, in response to concerns about the impact the Proposed Rule could have on systems used by incumbents, such as so-called “OEMS technology,” the Reopening Release clarifies that “the proposed amendments to Rule 3b-16 were not designed to capture within the definition of exchange the activities of brokers, dealers, and investment advisers who use an OEMS to carry out their functions.” *Id.* at 29461. Further, the Commission defined “group of persons” in the context of DeFi to go far beyond affiliated parties to those with no relationship with one another, while, for *non*-DeFi companies, a “group of persons” will not exist even among affiliated entities under certain conditions. *Id.* at 29454 n.66. Although the Reopening Release acknowledges that DeFi protocols *also* “may have difficulties in complying with” the Proposed Rule and may “exit the market” or “restructure their technology” as a result, *id.* at 29484-85, the Reopening Release offers no proposals to ameliorate those harsh consequences.

The Reopening Release acknowledges that “the Proposed Rules could give traditional financial services firms a competitive advantage” but claims that, “[b]ecause the Commission lacks information on the degree to which such market participants would incur greater costs of compliance, the Commission cannot estimate the extent of this advantage.” *Id.* at 29487. That is insufficient to satisfy both the Commission’s burden of reasoned decision-making under the APA and the Commission’s more specific obligation under the Exchange Act to refrain from adopting any rule that “would impose a burden on competition” that is not “necessary or appropriate.” 15 U.S.C. § 78w(a)(2). Moreover, in privileging traditional financial services by crafting exceptions for them and refusing to do the same for DeFi, the Reopening Release relies on a factor Congress did not intend the Commission to consider, *i.e.*, the protection of incumbent firms and technologies.

2. The Commission Purports to Propose a Ban on Pairs Trading Without Any Explanation.

Buried within the “economic analysis” section of the Reopening Release, the Commission makes a startling assumption: that the Proposed Rule would require DeFi protocols to “stop enabling” the “trading of crypto asset securities for crypto assets that are not securities.” 88 Fed. Reg. at 29482. The Commission nowhere explains *why* that would be the case. It is unclear whether the Commission believes that such a prohibition is the necessary consequence of some pre-existing regulation on “exchanges,” or whether the Commission intends—either in the Proposed Rule or by some future regulatory action—to ban pairs trading going forward.²⁰ Either

²⁰ To the extent the Commission intends to ban pairs trading in the Reopening Release or the Proposed Rule, the APA requires the Commission to straightforwardly articulate that prohibition. See *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (“[T]he requirement that an agency provide reasoned explanation for its action would

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way, the Reopening Release entirely lacks a “satisfactory explanation” for the Commission’s action, “including a ‘rational connection between the facts found and the choice made.’” *Motor Vehicle Mfrs. Ass’n*, 463 U.S. at 43 (citation omitted).

Certainly, the scant analysis offered in the Reopening Release falls far short of providing “a reasoned explanation.” *Fox Television Stations*, 556 U.S. at 516. For example, the Commission notes that “[m]arket places or facilities of, and the functions performed by, national securities exchanges and ATSs trade only securities quoted in and paid for in U.S. dollars.” 88 Fed. Reg. at 29451. But the Commission does not explain whether that practice is legally required by statute or regulation, the result of practical or technical limitations, or simply the product of exchanges’ own decision-making. The Commission also does not explain why DeFi protocols must (or should) follow the same course. And the Commission does not address why pairs trading is not permitted but ETF portals are (and may indeed receive preferential treatment), or answer the question of whether the SEC intends to permit securities-for-securities trading or securities-for-fiat trading. *Id.* at 29463. Instead, the Reopening Release simply observes that non-security-for-security pairs trading “may give New Rule 3b-16(a) Systems a competitive advantage over platforms that currently meet regulatory requirements for exchanges.” *Id.* at 29474. But the fact that newcomers may have an advantage over incumbents is not, in and of itself, a reasoned basis upon which to ban a new practice or technology—particularly because the Reopening Release admits elsewhere that, far from creating an even playing field, “the Proposed Rules could give traditional financial services firms a competitive advantage.” *Id.* at 29487.

Perhaps most troubling, the Reopening Release does not come to grips with the fact that a ban on pairs trading is, in actuality, a ban on AMMs and on all on-chain trading. Although other types of exchanges may be able to survive such a ban by following the Commission’s advice to “arrange for a fiat currency market for the relevant crypto asset security, and a separate fiat currency market in a separate entity for the non-security crypto asset, so that it can arrange for a pair of trades to take place that closely replicates the desired trade,” *id.* at 29482, AMMs engage *only* in pairs trading and, if one excludes stablecoins, on-chain trading never involves fiat. AMMs and on-chain trading cannot survive a ban by providing support for other means of trading instead. The Commission itself admits this, acknowledging that “[f]or systems that wish to complete the transaction entirely on-chain, such arrangements are likely to be impossible.” *Id.* Yet nothing else in the Reopening Release even acknowledges that AMMs and on-chain protocols will both be forced out of business by a pairs trading ban, much less explains why that draconian result is “necessary or appropriate in furtherance of the purposes of” the Exchange Act. 15 U.S.C. § 78w(a)(2); *see also Motor Vehicle Mfrs. Ass’n*, 463 U.S. at 43 (agency action is arbitrary and capricious if it “entirely failed to consider an important aspect of the problem”).

ordinarily demand that it display awareness that it *is* changing position. An agency may not, for example, depart from a prior policy *sub silentio* or simply disregard rules that are still on the books.”).

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3. The Commission Has Failed to Respond to Significant Comments.

Finally, if the Commission were to proceed with its current proposal without change and without additional explanation, the resulting rule would be arbitrary and capricious for another reason: the Commission would have “fail[ed] to respond to ‘significant points’ and consider ‘all relevant factors’ raised by the public comments.” *Carlson v. Postal Regul. Comm’n*, 938 F.3d 337, 344 (D.C. Cir. 2019) (citation omitted). The Reopening Release itself illustrates that failure. For example, as discussed above, the Reopening Release does not respond to concerns raised by commenters regarding which digital assets the Commission believes to be “securities.” The Reopening Release derisively refers to that lack of clarity as “supposed uncertainty,” 88 Fed. Reg. at 29450, but the Commission conspicuously fails to actually address the question—despite the fact that, as many courts and commenters have noted, an answer is needed. *See, e.g., In re Voyager Digital Holdings, Inc.*, 649 B.R. 111, 119 (Bankr. S.D.N.Y. 2023) (“Regulators themselves cannot seem to agree as to whether cryptocurrencies are commodities that may be subject to regulation by the CFTC, or whether they are securities that are subject to securities laws, or neither, or even on what criteria should be applied in making the decision. This uncertainty has persisted despite the fact that cryptocurrency exchanges have been around for a number of years.”).

Another example is the Commission’s lack of response to concerns raised by commenters regarding how DeFi protocols are expected to comply with the Proposed Rule. For example, multiple commenters questioned how DeFi trading systems could comply with broker-dealer requirements. The Commission’s “response” to that concern in the Reopening Release was simply to reiterate its belief that “[t]he federal securities laws apply equally to systems that trade securities, use [distributed ledger technology], and meet the criteria of Rule 3b-16 as to any other exchange.” 88 Fed. Reg. at 29457. The Reopening Release provides no further commentary on how the Commission expects DeFi protocols to comply with broker-dealer requirements, and instead just asserts that “the use of [distributed ledger technology] . . . does not make compliance incompatible with the federal securities laws.” *Id.* Considering that the agency elsewhere acknowledges that many would “exit the market,” *id.* at 29485, and concedes that it lacks the information to understand the costs imposed, that generic statement about distributed ledger technology is not a meaningful response to the comments pertaining to existing, widely used DeFi protocols.

Finally, the Commission has failed to address comments explaining that the decentralization and disintermediation that the Commission seeks to ban here may protect users from risks that Congress directed the Commission to address. *See* DeFi Education Fund Comment Letter, at p. 6 (“DeFi protocols have no employees to supervise, no financial risk for users from broker activity or custody, and no interaction between a broker and customers that could result in unlawful sales practices or other unfair and discriminatory dealing”). For example, an intermediary could charge inappropriate fees, deny access in an unfair or

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discriminatory fashion, or abuse their customers' confidential trading information. These are the very risks Congress had in mind when it decided to regulate exchanges. By forcing DeFi protocols to cede control to some centralized operator, the proposal would ironically and impermissibly expose investors to the very abuses that Congress was seeking to prevent.

III. Conclusion

The Commission's proposal to redefine "exchange" to include DeFi protocols is an unreasonable interpretation of the Exchange Act, violates the Constitution, and fails the basic requirement of reasoned decision-making. The Proposed Rule should not be adopted. If it is adopted, it will not survive judicial review.

Very truly yours,

s/ Donald B. Verrilli, Jr.

Donald B. Verrilli, Jr.