Prepared Statement for SEC's Crypto Task Force March 21, 2025 Roundtable titled "How We Got Here and How We Get Out – Defining Security Status" and Responses to "Security Status" Questions in SEC Commissioner Hester Peirce's February 21, 2025 Statement Titled "There Must Be Some Way Out of Here."

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Prepared Statement

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[1] The views expressed in this statement are mine and mine alone and do not represent the views of Duke University or any affiliate thereof.

I. Introduction

I appreciate the opportunity to participate in the SEC's first Crypto Task Force roundtable and offer comments on several of Commissioner Peirce's 48 questions included in her February 21, 2025, statement titled, "There Must Be Some Way Out of Here."[2] As excited as I am to participate and comment, I must admit that whole endeavor seems performative and intended to justify a predetermined outcome. While the stated purpose of the Task Force is to develop a "comprehensive and clear regulatory framework for crypto assets,"[3] the Commission has proceeded to front-run the Task Force by either dismissing, or pausing, nearly every outstanding crypto-related case and investigation, often with prejudice. In several court submissions stipulating that ongoing crypto litigation will be dismissed, as well as in press releases announcing the dismissal, the Commission justifies the action by referencing the work of the Crypto Task Force in "helping the Commission develop the regulatory framework for crypto assets."[4] Has the Task Force already concluded that every named crypto asset in outstanding enforcement actions is not a security?

These actions open the Commission up to allegations of politicization – the very same allegations leveled at the Commission by the crypto industry just months earlier. The crypto industry raised over $238 million this past election cycle in a successful effort to support industry-friendly candidates in Congressional races.[5] And just three days before his inauguration, President Trump and the First Lady issued their own meme coins, netting the Trump Organization significant profits.[6] Is the public expected to think it is just a coincidence then when the Commission's Division of Corporate Finance issues a staff statement expressing their view that meme coins "do not involve the offer and sale of securities under the federal securities laws"?[7]

Perhaps more concerning, the Commission has paused cases involving credible allegations of fraud and misconduct. In March 2023, the Commission charged Justin Sun and three of his wholly-owned companies for the unregistered offer and sale of crypto asset securities (TRX and BTT) and for "fraudulently manipulating the secondary market for TRX through extensive wash trading."[8] And in June 2023, the Commission filed 13 charges against Binance entities and founder Changpeng Zhao. In the press release, the SEC noted that "Zhao and Binance exercise control of the platforms' customers' assets, permitting them to commingle customer assets or divert customer assets as they please"; that Binance "misled investors about

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[2] https://www.sec.gov/newsroom/speeches-statements/peirce-statement-rfi-022125
[3] https://www.sec.gov/newsroom/press-releases/2025-30
[4] *See* Joint Stipulation to Dismiss, and Releases at 1, SEC v. Coinbase, No. 23-cv-4738 (S.D.N.Y. Feb. 27, 2025), ECF Doc. 176. *See also* Press Release, SEC Announces Dismissal of Civil Enforcement Action Against Coinbase (Feb. 27, 2025).
[5] https://www.foxbusiness.com/politics/crypto-industry-election-spending-tallies-least-238m-surpassing-traditional-giants?utm_source=chatgpt.com and https://nypost.com/2024/11/16/tech/how-crypto-became-the-biggest-winner-of-trump-2-0/?utm_source=chatgpt.com
[6] Donald Trump's crypto project netted $350mn from presidential memecoin
[7] https://www.sec.gov/newsroom/speeches-statements/staff-statement-meme-coins?source=email
[8] SEC.gov | SEC Charges Crypto Entrepreneur Justin Sun and His Companies for Fraud and Other Securities Law Violations

non-existent trading controls over the Binance.US platform"; and that another Binance entity "engaged in manipulative trading that artificially inflated the platform's trading volume."[9] When the public reads that Sun "invested $30 million in November in World Liberty Financial, the Trump-backed crypto venture, becoming its largest investor" and that "representatives of President Trump's family have held talks to take a financial stake in the U.S. arm of crypto exchange Binance," are they expected to think that the Commission's decision to pause these cases is unrelated?[10]

Regulated entities have already responded to the Commission's new "regulation by non-enforcement"[11] approach in ways that will be extremely hard to reverse or remedy if the Task Force issues guidance that suggests some of these response's violate federal securities laws. For example, one day after the Commission dropped its lawsuit against Coinbase, in which the SEC alleged solana was a security, CME Group announced plans to list futures contracts on solana.[12] What would happen if the Commission later issued guidance suggesting that solana was a security? We are likely to see more cases like this in the coming weeks and months, creating a form of "policy lock-in" that cannot be reversed without disrupting market participants.

If the Commission is truly interested in providing regulatory "clarity" for crypto assets, it should look to the one source that can provide it and already has – the courts. Time and again, federal judges have ruled that the *Howey* test applies to crypto asset transactions, reaffirming that digital tokens, when offered and sold under investment schemes, are investment contracts subject to federal securities laws. Courts have dismissed industry arguments that crypto assets are inherently different from traditional securities, emphasizing that the economic reality of these transactions—not labels or novel technology—determines their legal status. In case after case, from *SEC v. Telegram* to *SEC v. LBRY* to *SEC v. Coinbase*, judges have held that crypto issuers and platforms are engaged in the unregistered offer and sale of securities. Even in cases where rulings have varied on the specific facts—such as *SEC v. Ripple*—the underlying legal principle remains unchanged: when investors purchase tokens with the expectation of profits derived from the efforts of a centralized entity, those tokens meet the definition of a security. Regulatory clarity is not elusive; it has been consistently provided by the courts. The real question is whether the Commission will continue to enforce the securities laws as written and as interpreted by the judiciary, or whether it will abandon decades of precedent in favor of a carve-out for a politically influential industry.

This statement proceeds as follows. First, I provide an overview of the *Howey* test, the legal standard that courts have consistently applied to determine whether a crypto asset qualifies as an investment contract. I then examine how courts have ruled in key cryptocurrency enforcement actions, highlighting the overwhelming judicial consensus that digital assets offered and sold under investment schemes are securities. Next, I discuss the SEC's 2023 shift in enforcement strategy, moving from case-by-case token classifications to targeting crypto exchanges, and how

[9] SEC.gov | SEC Files 13 Charges Against Binance Entities and Founder Changpeng Zhao
[10] Exclusive | Trump Family Has Held Deal Talks With Binance Following Crypto Exchange's Guilty Plea - WSJ
[11] https://www.sec.gov/newsroom/speeches-statements/crenshaw-remarks-crypto-2-0-regulatory-whiplash-022725#_ftn2
[12] https://www.wsj.com/livecoverage/stock-market-today-inflation-dow-sp500-nasdaq-02-28-2025/card/exchange-giant-cme-to-list-solana-futures-pushing-further-into-crypto-E9DNVcIn1JVbzwv4KUy0

courts have affirmed the applicability of *Howey* to these platforms. I also address state enforcement actions and private litigation, both of which reinforce the view that crypto assets are not beyond the reach of existing securities laws. Following this, I evaluate the flawed "separation theory" that some courts have adopted in crypto cases, arguing that tokens cannot be divorced from the investment schemes they enable. Finally, I respond to several of Commissioner Peirce's recent questions regarding the regulatory status of crypto assets, emphasizing that any effort to redefine securities laws to accommodate the crypto industry is not only unnecessary but would create more confusion, not less. My conclusion is clear: the courts have already provided the regulatory clarity the Commission claims to seek, and any deviation from that clarity risks undermining investor protections and the integrity of the U.S. securities markets.

II. *Howey* Overview

Until Congress decides otherwise, *SEC v. W.J. Howey Co* remains binding precedent, and the *Howey* test will be the primary legal test courts use to determine whether a cryptocurrency constitutes an investment contract, and thus a security under federal securities laws.

In *Howey*, the Supreme Court found that the term "investment contract:"

> *"[E]mbodies a flexible, rather than a static, principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits."*[13]

Along these lines, in *Reves v. Ernst & Young*, in which the Supreme Court was asked to decide whether demand notes offered by a business are securities, the Court stated that:

> *"The fundamental purpose undergirding the Securities Acts is 'to eliminate serious abuses in a largely unregulated securities market.' United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 421 U.S. 849 (1975).* ***In defining the scope of the market that it wished to regulate, Congress painted with a broad brush. It recognized the virtually limitless scope of human ingenuity, especially in the creation of 'countless and variable schemes devised by those who seek the use of the money of others on the promise of profits****, SEC v. W.J. Howey Co., 328 U.S. 293, 328 U.S. 299 (1946), and determined that the best way to achieve its goal of protecting investors was 'to define the term "security" in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security.' . . . Congress therefore did not attempt precisely to cabin the scope of the Securities Acts . . . Rather, it enacted a definition of 'security' sufficiently broad to encompass virtually any instrument that might be sold as an investment" (emphasis added).*[14]

Federal courts have repeatedly confirmed the SEC's jurisdiction in numerous crypto-related enforcement actions. In fact, the SEC has brought over 200 crypto-related enforcement actions

[13] *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).
[14] *Reves et al. v. Ernst & Young*, 494 U.S. 56 (1990).

and has won, or settled, the vast majority of them.[15] In most of these cases, the SEC has applied the *Howey* test to determine whether the cryptocurrency in question is an investment contract, and therefore a security subject to SEC registration and disclosure requirements. Although the Commission may adopt a different interpretation of *Howey* for cryptocurrencies in the future, courts are not required to follow this interpretation. Consequently, reviewing the case history can provide insight into how the *Howey Test* has been utilized and its adaptability when applied to cryptocurrency.

III. Howey Has Been Consistently Applied to Cryptocurrency Cases

a. Overview

The *Howey* test defines an investment contract as a contract, transaction, or scheme involving (1) an investment of money, (2) in a common enterprise, (3) with an expectation of profits to be derived from the efforts of others.

Courts apply this test to the economic reality of a transaction rather than to formal labels. This test has been the cornerstone for analyzing whether various cryptocurrency sales amount to sales of "securities." Notably, the *Howey* test is fact-driven and flexible – it can adapt to the "countless and variable schemes" devised by those seeking to raise funds. Both federal and state courts (applying similar state-law definitions of investment contracts) have grappled with *Howey* in the context of digital assets.

b. SEC v. Shavers (E.D. Tex. 2013)

In one of the first crypto-related securities cases, the court found that investments in a Bitcoin-based online investment scheme met the *Howey* definition of an investment contract.[16] The defendant had argued Bitcoin isn't "money" and thus the investments couldn't be securities, but the court rejected that, noting "it is clear that Bitcoin can be used as money" and that the contributions in Bitcoin were equivalent to an investment of money under Howey. The SEC was allowed to proceed with its case, establishing that schemes involving cryptocurrencies can fall under securities laws.

c. EC v. REcoin / Diamond (Zaslavskiy) (E.D.N.Y. 2018)

In a criminal enforcement context (paralleling an SEC civil action), Judge Raymond Dearie refused to dismiss an indictment alleging two initial coin offering (ICO) token schemes were

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[15] Cornerstone Research, "SEC Tightens Cryptocurrency Enforcement," January 18, 2023, https://www.cornerstone.com/insights/press-releases/sec-tightens-cryptocurrency-enforcement/; John Reed Stark, "Why 'SEC Regulation by Enforcement' is a Bogus Big Crypto Catchphrase," LinkedIn, January 23, 2023. https://www.linkedin.com/pulse/why-sec-regulation-enforcement-bogus-big-crypto-john-reed-stark/?published=t, see also SEC.gov | Crypto Assets

[16] https://www.reuters.com/article/business/u-s-judge-says-sec-can-pursue-bitcoin-related-lawsuit-idUSBRE97517G/

securities fraud.[17] The defendant, Maksim Zaslavskiy, had marketed "REcoin" (purportedly backed by real estate) and "Diamond" tokens (purportedly backed by diamonds). He argued the tokens weren't securities and that securities laws were unconstitutionally vague as applied. The court held that the indictment sufficiently alleged an investment contract under *Howey*'s "flexible" fact-specific standard, and it left the ultimate determination to the jury at trial. This was the first federal district court ruling that found cryptocurrencies can be securities under federal securities laws.[18]

d. SEC v. Telegram Group Inc. (S.D.N.Y. 2020)

The SEC sued to stop Telegram's planned distribution of "Gram" tokens, which were sold to initial purchasers via a private offering and intended for resale to the public. Judge P. Kevin Castel granted a preliminary injunction preventing the token launch, finding a substantial likelihood that the sale of Grams was an unregistered securities offering.[19] In doing so, the court looked past Telegram's contractual formalities and examined the economic reality – it treated the scheme (the initial private sale plus anticipated public distribution) as an integrated offering of securities. While Judge Castel did not flatly declare "Grams are securities" in the abstract, he concluded the scheme satisfied *Howey*: purchasers had invested money in a venture (Telegram's new blockchain) with an expectation of profit from Telegram's efforts to develop that network.

e. SEC v. Kik Interactive Inc. (S.D.N.Y. 2020)

Shortly after Telegram, Judge Alvin Hellerstein granted summary judgment for the SEC, holding that Kik's 2017 sale of "Kin" tokens was an unregistered securities offering.[20] Kik had sold Kin through a two-phase offering (a private pre-sale to accredited investors followed by a public token distribution). The court applied *Howey* and found Kin met all prongs: (1) investors paid money (including cryptocurrency) to purchase Kin; (2) in a common enterprise – Kik pooled the funds to develop the Kin ecosystem; (3) with a reasonable expectation of profits derived from Kik's efforts in boosting token value. Significantly, the court treated the pre-sale and public sale as one integrated offering for *Howey* purposes.[21] Judge Hellerstein emphasized the "economic realities" over Kik's characterization, noting that Kik's own marketing induced buyers to view Kin as an investment opportunity. This decision (the first on summary judgment in a token case) firmly concluded that Kik's token was a security, reinforcing the SEC's position that many ICOs were subject to securities laws.

f. SEC v. NAC Foundation, LLC – AML BitCoin (N.D. Cal. 2021)

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[17] https://www.jonesday.com/en/insights/2018/09/case-alleging-cryptocurrencies-are-securities-can

[18] Cryptocurrencies held subject to US federal securities laws | Knowledge | United States | Global law firm | Norton Rose Fulbright

[19] https://www.cooley.com/news/insight/2020/2020-05-07-sec-v-telegram-key-takeaways-implications

[20] https://www.gtlaw.com/en/insights/2020/10/another-significant-cryptocurrency-decision-sec-v-kik-interactive-inc-and-token-offerings-under

[21] https://www.gtlaw.com/en/insights/2020/10/another-significant-cryptocurrency-decision-sec-v-kik-interactive-inc-and-token-offerings-under

The SEC pursued an ICO involving a proposed token called "AML BitCoin." Because the token's blockchain was not yet functional, the promoters sold "ABTC tokens" as a temporary stand-in, to be swapped for the real token later.[22] The defendants argued these were not investment contracts. Judge Richard Seeborg denied the motion to dismiss, holding that the SEC's complaint adequately alleged a *Howey* investment contract. Even a "stand-in" token can be a security if buyers invest money in a venture (here, funding development of a new blockchain) with an expectation of profit from the promoter's success in launching the token and platform. The court noted that labeling something as a utility token or interim token will not evade *Howey* if the factual substance indicates an investment scheme. This case confirmed that pre-functional tokens sold to fund a project (often via SAFT arrangements) can fall under securities laws at the pleading stage.

g. SEC v. LBRY, Inc. (D.N.H. 2022)

In November 2022, Judge Paul Barbadoro granted summary judgment for the SEC, ruling that LBRY's native token "LBC" was offered as an unregistered security.[23] LBRY had not conducted an ICO; instead it mined and allocated LBC to itself and periodically sold tokens on secondary markets to fund its platform (a decentralized content-sharing network). The company argued that many users acquired LBC for its consumptive use (to publish or tip content) rather than investment. The court rejected this defense. It focused on LBRY's own statements and the economic reality that LBRY signaled to investors that LBC's value would rise with the company's efforts. Even without a formal ICO, the ongoing sales of LBC, in context, led purchasers to expect profits from LBRY's project development. The lack of a direct ICO was "not dispositive" – what mattered was that LBRY offered the token in a way that met *Howey*'s criteria. This decision reinforced that courts look at substance over form: a token can be a security even if marketed for some utility, especially if the issuer's conduct creates an expectation of profit.

h. SEC v. Ripple Labs, Inc. (S.D.N.Y. 2023)

On July 13, 2023 Judge Analisa Torres of the United States District Court for the Southern District of New York ruled on cross-motions for summary judgement filed by the SEC and Ripple in relation to ongoing litigation dating back to December 2020.[24] Judge Torres' ruling argues that a determination of an unlawful offer and sale of securities in violation of Section 5 of the Securities Act of 1933 should hinge on the facts and circumstances by which the *sale* was made. Judge Torres notes that in the original *Howey* case and its progeny, "the subject of the investment contract was a standalone commodity, which was not itself inherently an investment contract." Thus, Judge Torres points to "the plain words of *Howey*", which make clear that an investment contract for purposes of the Securities Act means a *contract, transaction[,] or scheme*." (emphasis added by Judge Torres). Judge Torres states that "XRP, as a digital token, is not in and of itself a "contract, transaction[,] or scheme" that embodies the *Howey* requirements of an investment contract."

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[22] https://www.jdsupra.com/legalnews/u-s-district-judge-rejects-argument-8264123/
[23] https://www.mofo.com/resources/insights/221110-court-rules-lbry-token
[24] SEC vs Ripple 7-13-23.pdf (uscourts.gov)

With this analysis established, Judge Torres then assesses the three categories of alleged unregistered XRP offer and sales conducted by Ripple:

- Institutional Sales under written contracts for which it received $728 million;
- Programmatic Sales on digital asset exchanges for which it received $757 million; and
- Other Distributions under written contracts for which it recorded $609 million in "consideration other than cash."

Judge Torres found that only the "Institutional Sales" constituted the unregistered offer and sale of an investment contract, as all three prongs of the *Howey* test were satisfied. For the Programmatic Sales, whereby Ripple sold XRP via cryptocurrency exchanges, Judge Torres ruled these did not constitute investment contracts because the third prong of the *Howey* test (expect profits solely from the efforts of the promoter or a third party) was not satisfied because buyers were not aware they were buying XRP from Ripple and because Ripple "did not make any promises or offers because Ripple did not know who was buying the XRP."

Judge Torres' ruling was largely viewed as a victory for cryptocurrency exchanges because the tokens they list are similar to XRP in that they are not in and of themselves a "contract, transaction, or scheme." Thus, if they are not listing investment contracts, they cannot be accused of operating an unregistered securities exchange. However, it is important to note acknowledge footnote 16 in Judge Torres' ruling, which says:

> *"The Court does not address whether secondary market sales of XRP constitute offers and sales of investment contracts because that question is not properly before the Court. Whether a secondary market sale constitutes an offer or sale of an investment contract would depend on the totality of circumstances and the economic reality of that specific contract, transaction, or scheme."*

Judge Torres' ruling flips securities law on its head. The securities laws were established to protect retail investors in the wake of companies raising money from the public during the 1920s based upon poor, absent, and misleading disclosures, which contributed to the stock market crash of 1929 and the resulting Great Depression. The result of Judge Torres' ruling is that wealthy and sophisticated institutional token investors get the protections provided by the securities laws while retail investors do not. This outcome is counter to the purpose and intent of securities laws.

Judge Torres' emphasis that a cryptocurrency buyer in the secondary market must know the identity of the seller in order for there to be an expectation of profit has since been ignored and rejected by multiple federal judges, including two of her fellow judges in the Southern District of New York. As detailed below, Judge Failla, in SEC v. Coinbase, declined to draw a distinction between token purchases directly from an issuer and tokens purchased in a secondary market transaction, noting, "*Howey* does not recognize such a distinction as a necessary element in its test of whether a transaction constitutes an investment contract, nor have courts, in the nearly eighty years of applying Howey, read such an element into the test. Rather, under Howey,

the Court must consider the "economic reality" of the transaction to determine whether that transaction is an investment contract."[25]

Judge Torres' logic was also rejected by Judge Jed Rakoff of the United States District Court for the Southern District of New York in SEC v. Terraform Labs Pte as detailed below.

i. SEC v. Terraform Labs & Do Kwon (S.D.N.Y. 2023)

Just weeks after Ripple, Judge Jed Rakoff reached a nearly opposite conclusion on the treatment of public sales. In an August 2023 ruling on a motion to dismiss (in an enforcement action involving the Terra/LUNA crypto assets), Judge Rakoff expressly rejected the idea that Howey distinguishes between institutional sales and secondary-market sales.[26] The SEC alleged Terraform Labs sold various tokens (including the algorithmic stablecoin UST, LUNA, and others) in unregistered transactions to both institutional and retail buyers. Rakoff held the SEC stated a plausible claim that all these sales were investment contracts, regardless of whether buyers purchased directly from the company or on exchanges. He "decline[d] to draw a distinction… based on [the] manner of sale," pointedly noting that "*Howey* makes no such distinction between purchasers". If a secondary-market buyer was induced by the issuer's marketing and expected profits from the issuer's ongoing efforts, that can satisfy *Howey* even without direct privity. Indeed, the complaint alleged Terraform engaged in extensive public promotions to entice all investors, institutional and retail alike, by touting its managerial efforts and the profit potential of its tokens. On these facts, the court saw "no meaningful difference" between a buyer in a private sale and one on an exchange – both had reason to expect profits from the defendants' efforts. Accordingly, Rakoff denied the motion to dismiss. In December 2023, in the same case, Judge Rakoff went further, granting the SEC summary judgment and holding "as a matter of law" that the Terraform tokens (UST, LUNA, etc.) were securities under Howey, reinforcing his earlier view.[27] He stated bluntly: "*There is no genuine dispute that UST, LUNA, wLUNA and MIR are securities because they are investment contracts*."

IV. *Howey* Works Equally as Well in Cases Involving Platforms

a. Overview

Rather than play a game of whack-a-mole with the tens of thousands of crypto issuers, the SEC changed its approach to cryptocurrency enforcement in the summer of 2023 when it decided to direct its limited enforcement resources towards the platforms where most crypto investors bought and sold their tokens.

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[25] Securities and Exchange Commission v. Coinbase, Inc. et al, No. 1:2023cv04738 - Document 105 (S.D.N.Y. 2024) :: Justia

[26] SEC v. Terraform Labs Pte Ltd. & Do Kwon, 23-cv-1346 (S.D.N.Y. Aug. 2023). And https://www.velaw.com/insights/forming-a-rift-district-judge-rejects-decision-in-ripple-labs-inc/

[27] https://www.nortonrosefulbright.com/en-us/knowledge/publications/16178e2d/crypto-tokens-held-to-be-securities-as-a-matter-of-law-in-big-win-for-sec

In complaints against Binance[28] and Coinbase,[29] the SEC alleged that these companies combined the functions of an exchange, broker, dealer, and clearing agency without complying with the registration provisions of the federal securities laws applicable to any of those functions.[30] The SEC made similar allegations against Kraken in November 2023.[31] Central to all three cases is the assertion that they were listing at least one unregistered security. While the SEC recently chose to dismiss or delay these three cases, most of their initial charges survived motions to dismiss, with the respective judges once again affirming the applicability of *Howey* to cryptocurrency offers and sales.

b. SEC v. Kraken

On August 24, 2024, a U.S. District Court Judge William H. Orrick of the Northern District of California denied cryptocurrency exchange Kraken's motion to dismiss in the SEC's case against them for acting as an unregistered broker, dealer, exchange, and clearing agency with respect to what the SEC refers to as "crypto asset securities."[32] The SEC's complaint alleged that 11 tokens listed on Kraken are unregistered securities. The judge's decision focused on two of these tokens, ALGO and SOL, the native tokens of the Algorand and Solana blockchains, respectively. The court found that the SEC plausibly alleged ALGO and SOL were offered or sold on Kraken as investment contracts. In so doing, the judge rejected, as other courts have, Kraken's argument that an investment contract requires "post-sale obligations" from the issuer to the purchaser who bought the token on a secondary marketplace, like Kraken. The court was clear that investment contracts are not limited to actual contracts and that the *Howey* test applies regardless of whether the transaction is on a primary or secondary market.

c. SEC v. Coinbase

On March 27, 2024 Judge Katherine Polk Failla, of the U.S. District Court for the Southern District of New York, denied Coinbase's motion to dismiss the SEC lawsuit against them, finding that the agency had a "plausible" case against the exchange (Judge Failla did dismiss the claim that Coinbase acted as an unregistered broker through its crypto wallet).[33] In her ruling, Judge Failla noted that "the "crypto" nomenclature may be of recent vintage, but the challenged transactions fall comfortably within the framework that courts have used to identify securities for nearly eighty years."[34] Judge Failla's analysis focused on the "full set of contracts, expectations, and understandings" surrounding its [the crypto asset's] sale and distribution – frequently referred to using the shorthand "ecosystem." The Judge also rejected Coinbase's arguments that there needs to be a "formal contract between transacting parties for an investment contract to

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[28] SEC.gov | SEC Files 13 Charges Against Binance Entities and Founder Changpeng Zhao
[29] https://www.sec.gov/newsroom/speeches-statements/www.sec.gov/news/press-release/2023-102
[30] The SEC's complaint against Binance also alleged that the company commingled certain customer assets and attempted to evade U.S. securities laws by announcing sham controls that they disregarded so that they could keep high-value U.S. customers on their platforms.
[31] SEC.gov | SEC Charges Kraken for Operating as an Unregistered Securities Exchange, Broker, Dealer, and Clearing Agency
[32] SEC's Case Against Kraken Will Proceed to Trial, California Judge Rules (coindesk.com)
[33] Securities and Exchange Commission v. Coinbase, Inc. et al, No. 1:2023cv04738 - Document 105 (S.D.N.Y. 2024) :: Justia
[34] Id.

exist under *Howey*," and that an investment contract cannot be present if the investor purchases the token in a secondary market transaction where the issuer is not the seller. In rejecting the latter argument, Judge Failla also rejected the approach adopted by Judge Analise Torres in SEC v. Ripple Labs.

On January 7, 2025, Judge Failla granted Coinbase's motion to certify her prior order for interlocutory appeal.[35] In her order certifying the appeal, Judge Failla emphasized that her initial ruling simply followed the "Supreme Court's directive that "in analyzing whether a contract, transaction, or scheme is an investment contract, 'form should be disregarded for substance and the emphasis should be on [the] economic reality' of the parties' arrangement.""[36] She also reiterated her previous findings that under the law, courts do not need "to distinguish between transactions on the primary market (involving institutional investors) and those on the secondary market (involving other investors)," and that there is no requirement for a contractional undertaking for an investment contract to be present.[37]

Judge Failla also rejected "Coinbase's proffered comparison to real estate transactions, which have been found not to be securities under Howey, because "real estate has 'inherent value,' whereas a crypto-asset 'will generate no profit absent an ecosystem that drives demand' — which is precisely what the issuers and promoters of the [c]rypto-[a]ssets here promised to design and build." (Id. at 58 (quoting SEC v. Kik Interactive Inc., 492 F. Supp. 3d 169, 180 (S.D.N.Y. 2020))."[38] Nonetheless, Judge Failla certified the Order for interlocutory appeal "because it presents a controlling question of law regarding the reach and application of *Howey* to crypto-assets, about which there is substantial ground for difference of opinion, and the resolution of which would advance the ultimate termination of the SEC's enforcement action."[39] The controlling question here is "whether transactions involving crypto-assets qualify as "investment contracts," and therefore "securities," within the meaning of the Securities Act."[40] In so finding, Judge Failla relied on Judge Torres' divergent ruling in *Ripple*:

> "In this District, for instance, Judge Rakoff concluded that certain crypto assets were "investment contracts" after applying the Howey test, see SEC v. Terraform Labs Pte. Ltd. ("Terraform I"), 684 F. Supp. 3d 170, 195-98 (S.D.N.Y. 2023), whereas Judge Torres appeared to draw a distinction (expressly not drawn by Case 1:23-cv-04738-KPF Document 175 Filed 01/07/25 Page 19 of 34 20 this Court (see Order 54-55)) between sales of crypto-assets to sophisticated individuals and entities (which satisfied *Howey*) and sales to public buyers (which did not satisfy *Howey*), see SEC v. Ripple Labs, Inc. ("Ripple I"), 682 F. Supp. 3d 308, 324-30 (S.D.N.Y. 2023)."[41]

[35] Securities and Exchange Commission v. Coinbase, Inc., No. 23 Civ. 4738 (KPF), 2025 WL 40782 (S.D.N.Y. Jan. 7, 2025).
[36] Id.
[37] Id.
[38] Id.
[39] Id.
[40] Id.
[41] Id.

Therefore, Judge Failla found "that there is substantial ground for difference of opinion because (i) conflicting authority exists regarding Howey's application to crypto-assets."[42] The Judge specifically focused on the term "ecosystem" and the "several cases in which district courts have referred to a crypto-asset's "ecosystem." (See id. (citing Kik, 492 F. Supp. 3d at 178; SEC v. Telegram Grp. Inc., 448 F. Supp. 3d 352, 362 (S.D.N.Y. 2020); SEC v. LBRY, Inc., 639 F. Supp. 3d 211, 218 (D.N.H. 2022); Terraform I, 684 F. Supp. 3d at 197))"[43] However, "neither the Supreme Court nor any federal appeals court has yet" … expressly used the term "ecosystem" in its application of *Howey*", which therefore makes the term an "issue of first impression for the Second Circuit."[44]

d. SEC v. Binance

On June 28, 2024, Judge Amy Berman Jackson of the U.S. District Court for the District of Columbia ruled on Binance Holdings Ltd.'s motion to dismiss a lawsuit brought by the SEC.[45] The SEC alleged that Binance, its founder Changpeng Zhao (CZ), and affiliated entities violated U.S. securities laws by offering unregistered securities and operating unregistered trading platforms. In addition, unlike the Coinbase and Kraken cases, the SEC alleges that Binance made false statements to investors and engaged in acts and practices that operated as fraud upon purchasers. The court denied Binance's motion to dismiss most claims, allowing the case to proceed on key allegations of unregistered securities offerings; failure to register as an exchange, broker-dealer, and clearing agency; and fraud.

The ruling emphasizes that some Binance offerings (e.g., BNB, BNB Vault, and BAM Trading's Staking Program) meet the legal definition of an investment contract under *Howey*. Once again, a federal judge found that "[t]here is no requirement that an investment contract involve a contractual arrangement."[46] However, Judge Jackson took great pains to emphasize a "difference between the digital coins themselves and the offers to sell them" and was critical of the "SEC's suggestion that the token is "the embodiment of the investment contract"…as opposed to the *subject* of the investment contract."[47] Judge Jackson also expressed reservations about whether secondary sales of BNB (on third-party exchanges) should be considered securities transactions under U.S. law, noting that the SEC's "complaint does not include sufficient facts to support a plausible inference that any particular secondary sales satisfy the *Howey test* for an investment contract."[48] Here, Judge Jackson was critical of the inconsistent language and arguments used by SEC attorneys in various hearings. She writes:

> "Insisting that an asset that was the subject of an alleged investment contract is itself a "security" [*25] as it moves forward in commerce and is bought and sold by private individuals on any number of exchanges, and is used in any number of ways over an indefinite period of time, marks a departure from the Howey framework that leaves the

[42] Id.
[43] Id.
[44] Id.
[45] Securities and Exchange Commission v. Binance Holdings Ltd., No. 23-cv-1599 (ABJ), 2024 WL 3225974 (D.D.C. June 28, 2024)
[46] Id.
[47] Id.
[48] Id.

Court, the industry, and future buyers and sellers with no clear differentiating principle between tokens in the marketplace that are securities and tokens that aren't. It is not a principle the Court feels comfortable endorsing or applying based on the allegations in the complaint, particularly since the only term among the approximately twenty options included in the statutory definition of "security" that is being relied upon in this case is "investment contract."'"[49]

Judge Jackson correctly points out the Supreme Court's directive "that it is the economic reality of the particular transaction, based on the entire set of contracts, expectations, and understandings of the parties, that controls" the investment contract analysis.[50] As I detail below in section VIII, the economic reality of most crypto transactions in secondary markets supports the presence of an investment contract.

V. State Enforcement Action and Court Decisions

State securities regulators and Attorneys General have also pursued cryptocurrency offerings under state securities laws (often called "Blue Sky" laws). The purpose of blue-sky laws is to allow state authorities to prevent unknowing buyers from being defrauded into buying securities that appeared valuable but were in fact worthless.[51] And despite the complex federal scheme regulating securities transactions, Congress, the courts, and the SEC have made explicit that federal regulation was not designed to displace state blue sky laws that regulate interstate securities transactions.[52] Although the enactment of the National Securities Markets Improvement Act of 1996 narrowed the role of state blue sky laws by expanding the range of federal preemption, federal and state regulations each continue to play a vital role in eliminating securities fraud and abuse.[53]

State laws typically have definitions of "security" similar to federal law (many incorporate the term "investment contract" and thus apply the *Howey* test or a variant thereof). In fact, state securities regulators brought some of the very first crypto-related actions, particularly involving crypto lending products. For example, in 2018 the Texas State Securities Board entered emergency orders against BitConnect and other crypto lending schemes, finding they were selling investment contracts.[54]

In July 2021, the New Jersey Bureau of Securities announced a Summary Cease and Desist Order against BlockFi Lending, LLC (BlockFi), which raised at least $14.7 billion from the unlawful sale of unregistered securities in the form of interest-earning cryptocurrency accounts.[55] On February 22, 2022, the SEC charged BlockFi [56]with failing to register the offers and sales of its retail crypto-lending product and also charged BlockFi with violating the registration

[49] Id.
[50] Id.
[51] *See generally* Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L.REV. 347 (1991).
[52] *See, e.g.*, 15 U.S.C. § 77r(c) (1997) (preserving state jurisdiction "to investigate and bring enforcement actions with respect to ... unlawful conduct by a broker or dealer") (National Securities Markets Improvement Act of 1996).
[53] *A.S. Goldmen & Co., Inc. v. New Jersey Bureau of Sec.*, 163 F.3d 780, 782 (3d Cir. 1999).
[54] Administrative Action Report: Jan.-March 2018 | Texas State Securities Board
[55] New Jersey Division of Consumer Affairs Press Release (njconsumeraffairs.gov)
[56] https://lnkd.in/d-Xy45ec

provisions of the Investment Company Act of 1940.

On September 17, 2021, the New Jersey Bureau of Securities issued a Summary Cease and Desist Order against Celsius for offering unregistered securities in the form of interest-earning cryptocurrency products.[57] Celsius referred to these unregistered securities as its "Earn Rewards" account. On July 13, 2023, the SEC alleged the same Celsius product, what it called the "Earn Interest Program," constituted an unregistered offer and sale of securities in a complaint against Celsius and its founder and former CEO, Alex Mashinsky.[58] According to the complaint, Celsius customers invested in the Earn Interest Program by tendering crypto assets to Celsius in exchange for Celsius's promise to provide investors periodic interest payments proportional to their investments in the program. Celsius then pooled assets received from their customers and deployed them into the same revenue-generating activities, and the company paid returns to investors in the Earn Interest Program om a pro rata basis.

On March 29, 2022, the New Jersey Bureau of Securities (the Bureau) issued a Summary Cease and Desist Order against Voyager for "funding its income generating activities," in part, "through the sale of unregistered securities in the form of cryptocurrency interest-earning accounts."[59] The Bureau's order notes that "the Voyager Earn Program Account is not currently registered with any federal or state securities regulator, nor is it exempt from registration as required by law, even though the Voyager Earn Program Account is a "security" and subject to such requirements."[60] The order states that the "Earn Program Account is a security as defined in N.J.S.A. 49:3- 49(m)." The definition of security under that statute is similar to the definition in the federal securities laws and includes the term "investment contract."

On October 19, 2023, the New York Attorney General filed a lawsuit against Gemini Trust Company (Gemini), Genesis Global Capital, LLC and its affiliates (Genesis), and Digital Currency Group, Inc. (DCG) for defrauding more than 230,000 investors, including at least 29,000 New Yorkers, of more than $1 billion.[61] The NY AG alleges that "the pooled investment program that Gemini and Genesis Capital referred to as "Gemini Earn" constituted securities under the Martin Act." According to the complaint, "Earn is a security under the Martin Act because Earn investors provided their cryptocurrency assets to Genesis Capital with the expectation of receiving promised yields from Genesis Capital's efforts in deploying investors' pooled assets."[62] The complaint also notes that Genesis Capital's Chief Legal Officer knew Earn was an unregistered security: "Genesis Capital's Chief Legal Officer acknowledged several months before the launch of Earn that the program "may be viewed as an investment contract under the securities laws.""[63] In February 2024, Genesis settled the lawsuit, agreeing to establish a victims' fund of up to $2 billion to compensate defrauded investors.[64] This

[57] _Celsius Cease and Desist 9.17.21.pdf (nj.gov)
[58] https://www.sec.gov/files/litigation/complaints/2023/comp-pr2023-133.pdf
[59] Voyager Summary Order.pdf (nj.gov), ¶1
[60] *Id.* at ¶ 27
[61] https://ag.ny.gov/sites/default/files/court-filings/nysoag-complaint-against-gemini-et-al.pdf
[62] *Id.*, at ¶ 193
[63] *Id.*, at ¶ 191
[64] NYAG Reaches $2 Billion Settlement with Bankrupt Crypto Firm Genesis Global Capital in Connection with Gemini Earn Crypto Investment Program | Practical Law

settlement also prohibited Genesis from operating in New York. In June 2024, Gemini agreed to a settlement involving the return of approximately $50 million worth of digital assets to affected investors. Additionally, Gemini was banned from operating any cryptocurrency lending programs in New York.[65]

Although the above state matters did not always produce published judicial opinions, they reflect a consensus among regulators that many crypto assets and crypto financing arrangements meet the "security" definition. This is why the North American Securities Administrators Association ("NASAA") has consistently urged Congress to not advance "legislation that would undermine existing securities laws and the important investors those laws were enacted to protect."[66] To that end, NASAA prepared "Core Principles for Evaluating Federal Legislation Relating to Digital Assets" which encourages "compliance with existing securities laws" and notes that the "best way to protect investors and promote innovation is to urge unregistered participants to register themselves and their activities, products, and professionals promptly."[67]

It is noteworthy that state securities regulators in both "red" and "blue" states have consistently interpreted their existing authorities, which are similar to those of the SEC, to encompass the offer, sale, and trading of crypto assets in various contexts. And yet, only the SEC feels the need to now provide regulatory "clarity."

VI. NFTs

As has been publicized by technologists and in the popular press: "With NFTs, the thing you've bought does not tend to give you ownership of the underlying item (image, game asset, etc.) in any way you would normally transfer physical or digital art."[68] Rather, NFTs contain links to an asset hosted elsewhere and they do not convey ownership of the copyright, storage, or usage rights to the asset itself. As explained by software programmer Molly White, when someone buys an NFT, "[t]hey've paid to have their wallet address etched into a database alongside a pointer to something."[69]

Some NFTs could be considered "securities" subject to SEC regulations. Specifically, an NFT could be classified as a security if it meets *Howey's* definition of investment contract.

In May 2021, NBA Top Shot creator Dapper Labs was sued for allegedly selling its NFTs

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[65] https://ag.ny.gov/press-release/2024/attorney-general-james-recovers-50-million-crypto-firm-gemini-defrauded

[66] NASAA-Letter-to-Congress-Regarding-Our-Core-Principles-and-Positions-on-Various-HFSC-Discussion-Drafts-Related-to-Digital-Assets-4.11.23-F.pdf and NASAA-Urges-Congress-to-Preserve-the-Existing-Securities-Regulatory-Framework-as-Congress-Considers-Digital-Assets-Market-Structure-Legislation_6.20.23_F.pdf

[67] NASAA-Letter-to-Congress-Regarding-Our-Core-Principles-and-Positions-on-Various-HFSC-Discussion-Drafts-Related-to-Digital-Assets-4.11.23-F.pdf

[68] NFTs Don't Work the Way You Might Think They Do | WIRED

[69] Id.

as unregistered securities.[70] NBA Top Shot is a basketball collectibles platform that allows users to buy, sell, and trade video highlights, called Moments, as NFTs. At issue in the lawsuit is whether the Top Shot NFT collectibles are investment contracts, and therefore securities. In February 2023, United States District Judge Victor Marrero denied Dapper Labs' motion to dismiss the amended complaint.[71] As noted by Judge Marrero: "When a person purchases a Moment, the owner does not acquire any rights to the basketball highlight depicted by the NFT or the underlying artwork or other intellectual property, and thus does not acquire any rights to exploit the highlight with the express permission of the NBA, NBAPA, and Dapper Labs."[72] The court's analysis was highly fact-specific: it noted that Dapper Labs controlled the Flow blockchain on which these NFTs traded and that the value of the NFTs could rise based on Dapper's ongoing efforts and the network's popularity. Judge Marrero found "that Plaintiffs' allegations render each consideration under *Howey* facially plausible." As to the first prong of *Howey*, both parties agreed that there was an investment of money. For the second prong, common enterprise, the Court found that Plaintiffs adequately allege horizontal commonality. For the final *Howey* prong, "a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others," the Court found that "Defendants' public statement and marketing materials objectively led purchasers to expect profits." However, the court cautioned that not all NFTs will be securities, and its ruling was limited to the particular scheme and facts alleged. In June 2024, Dapper Labs settled the lawsuit for $4 million; as part of the settlement, plaintiffs can no longer claim that Top Shot NFTs are securities.

On August 28, 2023, the Securities and Exchange Commission charged, and subsequently settled with, Impact Theory, for conducting an unregistered offering of securities in the form of NFTs.[73] The SEC alleged that the three tiers of NFTs offered and sold by the company, known as KeyNFTs, were unregistered investment contracts, per *Howey*. Impact Theory used the NFT offering proceeds for "development," "bringing on more team," and "creating more projects."[74] The company communicated extensively via Discord to promote their NFTs: "In advance of the Offering, Impact Theory hosted several live speaking events on Discord (a voice, video, and text communication service), [and] posted recordings of those events on the company's Discord channels for the public to view."[75] The SEC also relied on statements made by KeyNFT investors on the company's discord channel to demonstrate that purchasers expected a return on their investment: "Given these statements, numerous prospective and actual purchasers of KeyNFTs stated on Impact Theory's Discord channels that they viewed KeyNFTs as investments into the company and understood Impact Theory's statements to mean that the company's development of its projects could translate to appreciation of the KeyNFTs' value over time."[76]

In September 2023, the SEC charged, and settled with, Stoner Cats 2 LLC (SC2) for

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[70] Crawley, Jamie. "Dapper Labs Sued on Allegations NBA Top Shot Moments Are Unregistered Securities." *CoinDesk*, 14 Sep. 2021, https://www.coindesk.com/markets/2021/05/14/dapper-labs-sued-on-allegations-nba-top-shot-moments-are-unregistered-securities/.
[71] 2023.02.22 Dapper MTD Order.pdf (dropbox.com)
[72] friel-v-dapper-labs-inc.pdf (skadden.com)
[73] Impact Theory, LLC (sec.gov)
[74] Id.
[75] Id
[76] Id

conducting an unregistered offering of securities in the form of NFTs called Stoner Cats.[77] The proceeds from the sale of Stoner Cat NFTs were used to build an animated web series. In their order, the SEC highlighted several aspects of the Stoner Cats offering that revealed "[I]nvestors in Stoner Cats NFTs had a reasonable expectation of obtaining a profit based on SC2's [the issuer] managerial and entrepreneurial efforts."

1. There was a secondary market for Stoner Cats holders to trade and profit off their NFTs.
2. The SEC also points to the fact that Stoner Cats NFT "owners" did not actually control the intellectual property associated with Stoner Cats.
3. Secondary market re-sales of Stoner Cats generated royalties for the original issuer (SC2).
4. SC2 used social media to promote the profit potential of Stoner Cats NFTs.

On August 16, 2024 Miami federal court judge Federico Moreno denied, in part, Shaquille O'Neal's motion to dismiss in a class action lawsuit that alleges O'Neal and Astrals LLC engaged in the offer and sale of unregistered securities in the form of Astrals NFTs and the related Galaxy token.[78] Judge Moreno applied the elements of *Howey* to the Astrals NFTs and concluded that "plaintiffs have plausibly alleged that they were led to reasonably expect profits from the Astrals purchases."[79]

VII. Private Litigation

Apart from government enforcement, private plaintiffs have filed numerous civil suits alleging that various cryptocurrencies were sold in violation of securities laws or that exchanges facilitated unregistered securities sales. These cases likewise turn on *Howey* and are often the only opportunity for millions of crypto fraud and scam victims to recover damages. As recently noted by Kobre & Kim attorneys, Sydney Johnson and Calvin Koo, "[h]istorically the private plaintiffs' bar has stepped in to pursue litigation in the wake of decreased regulatory enforcement (or at least the perception of it), whether it be suits alleging violation of the federal antitrust laws or financial misconduct in violation of the securities laws following the 2008 crisis."[80]

Should the SEC take a hands-off approach or choose not to apply *Howey* to various crypto offerings going forward, it would severally curtail the ability of private plaintiffs – who have a private right of action for the sale of unregistered securities – to recover damages. And, as Johnson and Koo note, courts are not bound by the SEC's new interpretation of when a digital asset is a security. For example, on October 23, 2024, United States District Judge Vernon Broderick denied, in part, Defendants TRON Foundation, Justin Sun, and Lucien Chen's motion to dismiss a class action complaint alleging that Defendants promoted, offered and sold unregistered securities through an initial coin offering of the digital asset TRX.[81] Even though

[77] https://www.sec.gov/litigation/admin/2023/33-11233.pdf
[78] Order on Motion to Dismiss for Failure to State a Claim – #91 in Harper v. O'neal (S.D. Fla., 1:23-cv-21912) – CourtListener.com
[79] Id.
[80] https://www.coindesk.com/opinion/2025/03/12/the-sec-s-retreat-from-crypto-enforcement-may-invite-more-private-lawsuits
[81] https://www.courtlistener.com/docket/17043396/114/clifford-v-tron-foundation/

the lead plaintiffs bought TRX in secondary market transactions on Binance, Judge Broderick ruled that TRON could still be held liable as a statutory seller of unregistered securities under Section 12(a)(1) of the Securities Act and that control person liability applies to Justin Sun. In his ruling, Judge Broderick noted that the SEC's 2019 "Framework for 'Investment Contract' Analysis of Digital Assets" (the "Framework") represents the ""the SEC's nonbinding interpretation of *Howey*" and its potential application to cryptocurrency."[82] Thus, any future guidance promulgated by the SEC will also be considered nonbinding by the courts.

Despite Judge Broderick's ruling, on February 26, 2025, the SEC, Justin Sun, the Tron Foundation, and several related parties filed a joint motion to stay the SEC's ongoing enforcement case against Sun and his companies.[83] Filed on March 22, 2023, the SEC's complaint alleged the unregistered offer and sale of securities in the form of TRX and BitTorrent (BTT). In addition, the SEC "charged Sun and his companies with fraudulently manipulating the secondary market for TRX through extensive wash trading" and for "orchestrating a scheme to pay celebrities to tout TRX and BTT without disclosing their compensation."[84] Given recent SEC actions, the case appears to be heading toward dismissal, in which case, the SEC would be willfully ignoring Judge Broderick's ruling.[85]

Similar circumstances are likely to occur if the SEC offers a different interpretation of *Howey*'s application to cryptocurrencies compared to what has been accepted under the leadership of the previous two chairmen. The SEC may therefore end up creating regulatory confusion, not clarity. The Commission's decision to dismiss its case against Coinbase only enhances this confusion. That case was pending appellate review on the issue of whether secondary market transactions of crypto assets qualify as investment contracts, and had the Second Circuit agreed to hear the case, there would have finally been binding appellate court precedent, albeit only in the Second Circuit. As Johnson and Koo state in their article, "lower courts will continue to lack guidance from a higher court" on *Howey*'s application to crypto asset transactions, "leaving private plaintiffs free to argue that the federal securities laws apply."[86] Thus, the Commission may end up, inadvertently, ushering in a wave of private litigation targeting crypto firms and their founders.

VIII. Confronting the Separation Theory

a. Overview

The notion that the object of an investment contract is separate from the investment contract itself is sometimes referred to as the "separation theory." Until Judge Torrres' ruling in Ripple, no court had adopted the separation theory in a crypto-related case. Since Ripple, two other

[82] Id.
[83] https://www.dlnews.com/articles/regulation/billionaire-justin-sun-gets-sec-pause-in-fraud-case/
[84] https://www.sec.gov/newsroom/press-releases/2023-59
[85] The court or a jury could still ultimately find that TRX is not a security.

[86] https://www.coindesk.com/opinion/2025/03/12/the-sec-s-retreat-from-crypto-enforcement-may-invite-more-private-lawsuits

judges, the Honorable Amy B. Jackson (SEC v. Binance) and William H. Orrick (SEC v. Kraken), relied on the separation theory and quoted from Judge Torres ruling in Ripple: "*Howey* and its progeny have held that a variety of tangible and intangible assets can serve as the subject of an investment contract . ... In each of these cases, the subject of the investment contract was a standalone commodity, which was not itself inherently an investment contract."[87] Judge Jackson went so far as to title a section of her Binance order "The Court finds it necessary to distinguish between the digital coins themselves and the offers to sell them." Justice Jackson writes: "The Court notes that several of the district courts presented with SEC enforcement actions involving crypto currencies have taken pains to differentiate the alleged investment contracts from the tokens themselves."

Judge Jackson cites as evidence, the SEC v. Telegram case, SEC v. Terraform case, and SEC v. Ripple case. However, a closer examination of these cases reveals that only the Ripple Court "differentiate[d] the alleged investment contracts from the tokens themselves."[88] Judges Jackson and Torres quotes Judge Castel in SEC v. Telegram: "While helpful as a shorthand reference, the security in this case is *not simply the Gram*, which is little more than alphanumeric cryptographic sequence... . This case presents a "scheme" to be evaluated under *Howey* that consists of the full set of contracts, expectations, and understandings centered on the sales and distribution of the Gram."[89] By saying "not simply the Gram," Judge Castel is NOT saying that a Gram in and of itself is not a security. Rather, Judge Castel takes pains to demonstrate that the Gram is instrumental to the entire Telegram scheme. In fact, the above quote from Judge Castel's ruling is included in a section titled, "The Gram Purchase Agreements and Associated Understandings and Undertakings, Including the Expected Resales into the Secondary Market, Are Viewed as One Scheme Under Howey." Thus, Judge Castel rejected Telegram's argument that "delivery of the newly created Grams to the Initial Purchasers"', and their resale, are not subject to securities laws because, "Grams would have "functional consumptive uses… Grams would be a commodity."[90]

Telegram wanted Judge Castel to separate the tokens themselves from the securities "scheme" they were issued under and find that Grams were commodities. Judge Castel declined, writing: "This Court finds as a fact that the economic reality is that the Gram Purchase Agreements the anticipated distribution of Grams by the Initial Purchasers to the public via the TON Blockchain are part of a single scheme." Notice, even resale of the Gram itself is explicitly part of "scheme" because it is the ultimate mechanism by which profits are realized. The explicit design of Telegram's scheme dictates that the only way to receive the profit "promised" by Telegram is to rely on Telegram's efforts to increase the value of Gram in the secondary market.

Judge Castel made numerous other statements showing that he held the Grams themselves to be securities. He wrote, "The Second Circuit has held that securities do not come to rest with investors who intend a further distribution." He goes on to say that "The Grams would not and were not intended to come to rest with the Initial Purchasers but instead were intended to move

[87] SEC vs Ripple 7-13-23.pdf
[88] Securities and Exchange Commission v. Binance Holdings Limited et al., No. 1:23-cv-01599-ABJ, 2024 WL 3225974 (D.D.C. June 28, 2024).
[89] In Securities and Exchange Commission v. Telegram Group Inc. et al., No. 19 Civ. 9439 (PKC)
[90] Id

from the Initial Purchasers to the general public. Therefore, this two-step process represents a public distribution [of securities] ..."[91]

Judge Castel's assertion that the public "needs the protection of the [Securities] Act" is grounded in the reality that Grams are the means of participating in Telegrams scheme and not simply commodities or stand-alone tokens. In footnote 9 of his order, Judge Castel states: "The ability to sell their Grams, and thereby exit the common enterprise, does not mean that the Initial Purchasers are not part of a common enterprise while they continued to possess Grams."[92] Thus, Grams are the means of entering and exiting the common, profit-seeking enterprise with Telegram.

b. SEC v. Terraform Labs Revisited

In her Binance order, Judge Jackson also quotes from Judge Rakoff's order denying Terraform Lab's motion to dismiss: "Nor must the Court restrict its *Howey* analysis to whether the tokens themselves –apart from any of the related various investment "protocols" – constitute investment contracts."[93] Judge Rakoff goes on to explain that such a restrictive interpretation is unnecessary because the cryptocurrencies at issue were not standalone tokens, but rather, were paired with the "various investment "protocols.""[94] He wrote: "the Court declines to erect an artificial barrier between the tokens and the investment protocols with which they are closely related for the purposes of its analysis."[95]

Judge Rakoff further explains, "…, the term "security" [] cannot be used to describe any crypto-assets that were not somehow intermingled with one of the investments "protocols," did not confer a "right to ... purchase" another security, or were otherwise not tied to the growth of the Terraform blockchain ecosystem… But this conclusion is only marginally of interest, because, to begin with the coins were never, according to the amended complaint, standalone tokens."[96] Judge Rakoff held that when a token issuer, by means of a token, offers a "promise of profits" consisting of an "investment protocol or "[tying the token] to the growth of the … ecosystem,"; then that token itself is NOT a stand-alone commodity, it is a security.[97]

c. Looking Outside the Instrument

Judge Jackson's assertion that judges Castel and Rakoff "[took] pains to differentiate the alleged investment contracts from the tokens themselves," is simply wrong. Rather, their pains in looking "outside the instrument itself" "prove that [the tokens] being sold were securities under the Act".[98] As I have detailed, many courts trying to determine the security status of cryptocurrencies have analyzed the entire scheme a cryptocurrency, or token, is a part of. For example, in his order denying Defendant Ian Balina's motion for summary judgement in his case

[91] Id.
[92] Id.
[93] gov.uscourts.nysd.594150.51.0.pdf
[94] Id
[95] Id.
[96] Id.
[97] Id
[98] SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344 (1943)

against the SEC, United States district court judge David Alan Ezra explained that "… when a Court analyzes whether something is a security, the Court will look to substance over form… Therefore, the Court will not consider express disclaimers in a contract when determining the character of the security. See SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 352–55 (1943) (courts consider may look "outside the instrument itself" to consider the character of an instrument)."[99] Judge Ezra then held, "For the reasons stated above, and because the SPRK tokens meet all three prongs of the *Howey* test, the Court holds that the SPRK tokens are securities as a matter of law."[100]

Further, in Securities and Exchange Commission v. Sergii "Sergey" Grybniak, Federal District Court Judge Eric Komitee denied the defendants' motion to dismiss in case involving an ICO. Judge Komitee, writing after Judge Jackson's order in Binance, adopted a different interpretation of the Telegram case. Citing the Telegram, Kik, and Balestra Courts as cited in Freil v. Dapper Labs, Judge Komitee found that "… the overwhelming majority of courts assessing digital tokens sold in ICOs have concluded that they are investment contracts within the meaning of the Securities Act". He then proceeded to hold that the tokens before him were securities, "I reach the same conclusion here as to the OPP tokens."[101] Likewise, Judge Mastroianni, in SEC v. Rivetz Corp., granted the SEC's motion for summary judgement after finding that the Rivets ERC-20 token ("RvT" token) "were securities, specifically investment contracts as the Supreme Court defined the term in SEC v. W.J. Howey…".[102]

These rulings are entirely consistent with prior case law. In every securities case the court looked outside of the instrument itself to determine whether the relevant instrument is the means of participation in a securities "scheme" and thus, a security. Why? Because the proof that any instrument is a security, extends outside of the instrument itself. In the *Joiner* case, the facts and circumstances that proved that the land interests at issue were securities existed outside of the interests themselves. It is the same in the *SEC v. Howey*.

When Judge Torres, in her Ripple ruling, wrote that "*Howey* and its progeny have held that a variety of tangible and intangible assets can serve as the subject of an investment contract . ... In each of these cases, the subject of the investment contract was a standalone commodity, which was not itself inherently an investment contract," she failed to examine the material difference between the role that XRP plays in Ripple's security scheme and the role that prior subjects played in their respective schemes.

The Supreme Court has defined a security as the creation and offer of an investment relationship. "[Congress] recognized the virtually limitless scope of human ingenuity, especially in the creation of "countless and variable schemes devised by those who seek the use of the money of others on the promise of profits… [Congress] enacted a definition of "security" sufficiently broad to encompass virtually any *instrument* that might be sold as an investment."[103]

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[99] U.S. Securities and Exchange Commission v. Balina
[100] Id
[101] SEC v. Grybniak, No. 20-CV-327(EK)(MMH), 2024 BL 336288, 2024 Us Dist Lexis 172840 (E.D.N.Y. Sept. 24, 2024), Court Opinion
[102] SEC v. Rivetz Corp., No. 21-30092-MGM, 2024 BL 436454, 2024
[103] Reves v. Ernst & Young, 494 U.S. 56

All of the “countless and variable” types of securities schemes are defined by one common element, an economic relationship where an entity/issuer offers a “promise of profits” in exchange for investment.

A product consisting of a "promise of profits", which is intangible, can only be offered or purchased if it is made tangible through a security instrument. These instruments embody the relationship and “promise” being offered. In other words, they are necessarily unique to a particular issuer's scheme because they serve as the means of participation in it. As noted by the Supreme Court in *Joiner*, “… the term "security" was defined to include by *name or description many documents* in which there is common trading for speculation or investment.”[104]

Crucially, most securities schemes can be categorized by the profit mechanism through which issuers "promise" to reward their investors. The two broad categories are (a) earnings-distribution: schemes involving forms of yield or interest; and (b) investment-instrument-capital-appreciation: schemes where a token or other investment-instrument unique to the issuer is devised, the value of which is primarily reflective of and dependent on the issuer’s efforts.

The profits in both categories are derived primarily by the efforts of the issuer. In the first type of scheme, the security issuer generates and delivers the “promised profit” from the actual earnings of the enterprise in the form of yield, interest, or dividends, to holders of the security instrument. In the second type of scheme, the issuer does NOT generate the “promised profit” from the earnings of the enterprise, rather the efforts of the issuer determine the value of the investment-instrument itself.

In siding with the SEC in finding that the institutional sales of XRP constituted unregistered investment contracts, Judge Torres wrote that, “Based on the totality of circumstances, the Court finds that reasonable investors, situated in the position of the Institutional Buyers, would have purchased XRP with the expectation that they would derive profits from Ripple’s efforts. From Ripple’s communications, marketing campaign, and the nature of the Institutional Sales, reasonable investors would understand that Ripple would use the capital received from its Institutional Sales to improve the market for XRP and develop uses for the XRP Ledger, thereby increasing the value of XRP.”[105]

Essentially, Ripple issued an investment-instrument unique to Ripple, XRP, and sold it. In addition, as noted by Judge Torres, Ripple develops, markets, and drives the adoption of the XRP software ledger/network and helps develop the secondary market, which in turn increases the market price of XRP.

Ripple’s “product” was deemed a security even though it does NOT involve any earnings-distribution from the Ripple/XRP Software Enterprise. Earnings-distribution is not the only way to “promise”, generate and deliver, profit to investors. Ripple offered investment-instrument-capital-appreciation by “the efforts of Ripple”, generating and delivering profit to institutional investors from the association between the value of the XRP in the secondary market and Ripple’s efforts. Despite widespread discussions about the novelty of crypto, Ripple’s profit

[104] SEC v. Joiner
[105] SEC vs Ripple 7-13-23.pdf

mechanism is not anything new. In its fundamental nature it is identical to the approach used by stock issuers, where an investment "token" is devised whose value in the secondary markets is primarily reflective of the issuer's efforts.

Judge Torres held that institutional sales of XRP were securities, i.e. that the profits that Ripple "promised" were derived "solely from the efforts of others". What profits did Ripple promise? The price appreciation of XRP. Further, how would institutional investors be harmed if Ripple's efforts failed? The price depreciation of XRP. Thus, in holding that Ripple's scheme met the requirements of Howey, judge Torres held that the market value of XRP appreciates or depreciates "solely from the efforts" of Ripple. In other words, the market value of XRP is primarily reflective of and dependent on Ripple's efforts.

Because XRP itself is the investment vehicle through which Ripple generates and delivers the "profits" that Ripple "promised" to institutional investors, XRP itself is NOT a stand-alone commodity, it is Ripple's security instrument. It is impossible to participate in Ripple's security scheme without XRP, and impossible not to participate having purchased XRP.

d. Crypto Tokens are NOT Merely the "Subject" of Their Respective "Schemes"

There is a key difference between the "subject" of a securities scheme and the security instrument itself, which is simply the means of participation. No one received *Howey*'s "promised" earnings-distributions by simply purchasing the "subject," an orange grove. On the contrary, because Ripple "promised profits" by impacting the price of XRP, all purchasers of XRP receive "profit" through Ripple's efforts.

Because crypto tokens are fungible, it is impossible for Ripple's "promise of profits" to be paired with some XRP tokens and not all XRP tokens. Whereas the fortunes of 99% of orange grove owners had no relation to *Howey*, the fortunes of ALL XRP holders are dependent on Ripple. Thus, XRP is not merely the "subject" of Ripple's scheme, it is the security instrument (the necessary AND sufficient means to participate in Ripple's security scheme). In cryptocurrency securities schemes, the "promise of profits" consists of the issuer's impact on the market price of the token itself. Therefore, the "promise" and its execution are inherently paired with the token itself. In short, tokens sold as securities are themselves securities.

IX. Lessons Learned from Countless Crypto Court Cases

e. Economic Reality Over Labels

Courts consistently look past the terminology of "utility token," "currency," or "membership" and examine what investors were led to expect. If a project's promotional materials and conduct create an expectation of profits from the developers' efforts, the token is likely to be deemed a security – regardless of whether it has some consumptive use.

f. *Howey*'s Flexibility

The rulings reinforce that *Howey* is adaptable. It has been applied to novel crypto constructs – from pre-functional tokens (*NAC/AML BitCoin* case) to NFTs (*Dapper Labs* case) – with courts often analogizing these to the "countless schemes" *Howey* envisioned. While the Ripple court did explicitly note that the same token can be sold in different ways, some of which invoke securities laws and some of which may not, multiple other courts have rejected this interpretation. Most courts have rejected, or not entertained, the "separation theory," and when the economic reality of ALL transactions in a given cryptocurrency are assessed, regardless of where they occur, courts have consistently found the presence of an investment contract.

g. Common Enterprise and Decentralization

One area of some debate is the "common enterprise" element of *Howey*. In most of the above cases, courts found a common enterprise by noting the pooling of funds or the direct link between the fortunes of the issuer and the fortunes of token investors. No court has squarely rejected an SEC case on the ground that a token ecosystem was *too decentralized* to form a common enterprise – yet. The implication is that as long as an identifiable promoter or company is driving the value of the token, the common enterprise prong is satisfied. Truly decentralized cryptocurrencies (like Bitcoin itself, when not part of a fundraising scheme) might fall outside *Howey*, but those have not been the target of enforcement or litigation so far.

h. State-Federal Alignment

State courts and regulators so far have aligned with the federal position – there hasn't been a state high court case diverging from *Howey* in the crypto context. If anything, states like New York (via the Martin Act) have an even lower bar (no need to prove investor expectation of profit with the same rigor). The implications are that crypto projects cannot easily avoid securities laws by focusing on certain states; a token deemed a security federally will almost always be one at the state level too. Conversely, if a token somehow was not a security under *Howey*, it likely wouldn't be one under most state laws either (except potential outliers with different tests). Companies must navigate both federal SEC enforcement and state regulators, who often collaborate (e.g., the NYAG acted simultaneously with the SEC in Coinseed.)[106]

X. Addressing the First Four Questions Posited by Commissioner Peirce on February 21, 2025

a. Overview

On February 21, 2025, Commissioner Peirce issued a statement titled "There Must Be Some Way Out of Here."[107] The statement included 48 questions that the Crypto Task Force is currently "wrestling" with. The first four questions pertain to the "security status" of crypto assets and I answer them in earnest below.

[106] New York AG Obtains Default Judgment Against Crypto Platform
[107] https://www.sec.gov/newsroom/speeches-statements/peirce-statement-rfi-022125

b. Question 1

Question 1 asks: What type of regulatory taxonomy would provide a predictable, legally precise, and economically rational approach to determining the security status of crypto assets and transactions in such assets without undermining settled approaches for evaluating the security status of non-crypto assets and transactions?

Such a taxonomy already exists, and it is called the *Howey* test. Although the *Howey* test "has been refined in the more than seventy years since it was first announced, it remains the guiding principle" for distinguishing between securities and non-securities.[108] As noted by the SEC's former Enforcement Director, Gurbir Grewal, "*Howey* has proven to be a remarkably flexible and resilient test that courts have since applied to find a wide variety of offerings to be investment contracts and, thus, securities."[109] Grewal goes on to note that the list "includes offerings related to whiskey, cosmetics, self-improvement courses, and pay phones, as well as a surprising number of creatures: earthworms, beavers, chinchillas, and even cattle embryos."[110] That list now also includes cryptocurrencies, crypto assets, tokens, digital assets, or whatever label issuers and promoters attach to blockchain-based assets.

In 2019, the SEC released a "Framework for 'Investment Contract' Analysis of Digital Assets," which provided additional details on when a digital asset has the characteristics of an investment contract and "whether offers and sales of a digital asset are securities transactions."[111] In footnote 11 in the SEC's Framework, the SEC notes that "Based on our experiences to date, investments in digital assets have constituted investments in a common enterprise because the fortunes of digital asset purchasers have been linked to each other or to the success of the promoter's efforts."[112] This remains just as true today. Numerous courts have reinforced *Howey*'s applicability to crypto assets since the Framework was released. The Commission may consider reviewing this record to evaluate whether additional factors should be included in an updated "Framework." But, from my perspective, the original "Framework" stands up well.

c. Question 2

Question 2 asks: Should the Commission address when crypto assets fall within any category of financial instruments, other than investment contracts, that are specifically listed in the definition of "security" in the federal securities laws?

No. The record is clear, most crypto assets are either going to be investment contracts or notes under federal securities laws. Although the term "note" is included in the statutory definition of a security, case law has determined that not every "note" is a security. The definition specifically

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[108] Thomas Lee Hazen, Tulips, Oranges, Worms, and Coins—Virtual, Digital, or Crypto Currency and the Securities Laws, 20 N.C. J. L. & Tech. 493, 503 (2019).
[109] SEC.gov | What's Past is Prologue: Enforcing the Federal Securities Laws in the Age of Crypto
[110] Id
[111] U.S. Securities and Exchange Commission, "Framework for 'Investment Contract' Analysis of Digital Assets," April 3, 2019, https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets.
[112] SEC.gov | Framework for "Investment Contract" Analysis of Digital Assets

excludes notes with a term of less than nine months and courts have carved out a range of exemptions over the years for commercial paper type notes such as purchase money loans and privately negotiated bank loans. To reconcile these varying cases, the U.S. Supreme Court in *Reves v. Ernst & Young* established the "family resemblance test," to determine whether a note is a security. The "family resemblance" analysis requires:

- A consideration of the motivation of the seller and buyer (e.g. is the seller looking for investment and the buyer looking for profit?);
- The plan of distribution of the note (e.g. is the product being marketed as an investment?);
- The expectation of the creditor/investor (e.g. would the investing public reasonably expect the application of the securities laws to the product); and
- The presence of an alternative regulation (e.g. will the product be registered as a banking product and the offered registered as a bank?).

Defining the conditions under which crypto assets fall into other security categories under federal securities laws is unnecessary and will likely lead to confusion rather than clarity.

d. Question 3

Question 3 asks: Certain crypto assets are used in a variety of functions inherent to the operation of a blockchain network, such as mining or staking as part of a consensus mechanism or securing the network, validating transactions or other related activities on the network, and paying transaction or other fees on the network. These technology functions may be conducted directly or indirectly, such as through third-party service providers. What types of technology functions are inherent to the operation of a blockchain network? Should the Commission address the status of technology functions under the federal securities laws and, if so, what issues should be addressed?

Technology is constantly evolving, which means blockchains are constantly evolving, as are the "functions" inherent to any "blockchain network." Any attempt by the Commission to define which functions and their related crypto-asset are within or outside the regulatory perimeter will quickly be overwhelmed and made obsolete by new technological developments. This is why *Howey* is such a powerful tool. As the *Howey* Court noted, the term "investment contract:"

> *"[E]mbodies a flexible, rather than a static, principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits."*[113]

Furthermore, just because a crypto asset serves a "function inherent to the operation of a blockchain network" does not mean that it cannot be an investment contract. In fact, Courts have addressed this argument in several ways, typically finding that the existence of utility does not necessarily prevent a token from being classified as a security. For example, Kik argued that Kin

[113] *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

tokens had a functional use within its digital ecosystem, including allowing users to tip and purchase digital content. The court rejected Kik's utility defense, finding that even though Kin could be used in-app, the economic reality was that it was marketed as an investment. In addition, Telegram argued that Grams were meant to be used as a currency on the Telegram Open Network (TON) blockchain and had inherent utility. But, Judge Castel looked past the stated utility and instead examined how Grams were marketed and sold. Judge Castel emphasized that Grams were not yet usable at the time of the sale, and Telegram was actively working to develop the TON network, which investors were relying on for the value of Grams to increase. LBRY also argued that its LBC token was used for publishing, tipping, and interacting with content on the LBRY blockchain, providing real utility to users. While the court acknowledged LBC's functionality, Judge Barbadoro held that the dominant expectation of buyers was profit. Therefore, the fact that some buyers may have used LBC for its intended consumptive purpose did not negate the fact that it was offered and sold as an investment. Finally, in SEC v. Terraform Labs, Judge Rakoff explicitly rejected the idea that a token's utility alone prevents it from being a security, finding that just because UST and LUNA were used in a functional way did not outweigh the fact that Terraform marketed them with an expectation of profits.

These cases emphasize the importance of examining the economic reality behind each crypto-asset. Courts consistently reject the idea that utility alone prevents a token from being a security. Marketing and sales context matter more than technical functionality; if buyers are led to expect profits, the token likely meets *Howey*. There is no need for the Commission to provide additional "clarity" on this subject when the courts have already provided plenty of clarity.

e. Question 4

Question 4 asks: Users of liquid staking applications receive a so-called "liquid staking token." This token represents their staked crypto asset, and the token can be used in other activities, all while continuing to participate in the proof-of-stake protocol. Should the Commission address the status of liquid staking tokens under the federal securities laws, and, if so, what issues should it address?

Once again, *Howey* is up to the task of determining when a "liquid staking token", or "LST", is an investment contract.

1. An investment of money – Users deposit crypto assets into staking protocols in exchange for LSTs.
2. In a common enterprise – The staking pool and protocol could constitute a common enterprise, especially if returns depend on pooled efforts.
3. With an expectation of profit – LST holders typically earn staking rewards (often compounding in value).
4. Derived from the efforts of others –If LST holders rely on the protocol developers, validators, or staking providers to maintain the staking mechanism and ensure reward distribution, then LSTs involve reliance on third-party managerial efforts.

If centralized staking programs introduce profit expectations based on the liquidity and composability of the LST, then the LST is likely an investment contract that needs to be registered by the staking program provider. However, decentralized liquid staking models differ because users retain custody of their LSTs and interact with smart contracts rather than an intermediary-controlled platform. But as the CFTC's 2024 Technologically Advisory Committee's DeFi report found, decentralization exists along a spectrum across multiple dimensions (governance, asset, user, application, data, network, protocol, hardware). Determining when these dimensions are decentralized enough to ensure profits don't come from others' efforts is futile. It is best to rely on *Howey* and its focus on the asset's economic reality.

XI. Conclusion

The question of whether crypto assets are subject to federal securities laws is not a matter of regulatory ambiguity – it is a matter of law, and the courts have answered it definitively. Time and again, courts have applied the *Howey* test to conclude that when digital assets are offered and sold as part of an investment scheme, they constitute investment contracts and are thus subject to SEC oversight. This is not an exercise in novel legal interpretation but rather a straightforward application of decades-old precedent designed to protect investors from exactly the type of speculative, opaque, and often fraudulent schemes that have come to define much of the crypto industry.

Yet, instead of reinforcing the clarity that courts have already provided, the Commission appears to be abdicating its enforcement role. By pausing or dismissing nearly every major crypto-related enforcement action, the SEC is signaling to market participants that compliance with securities laws is optional for the crypto industry. This shift is not about fostering innovation – it is about political expediency. If the Commission continues down this path, it will not only undermine investor protections but also risk creating a two-tiered regulatory system in which crypto issuers and intermediaries operate with impunity while traditional financial institutions remain subject to robust oversight.

The legal framework to regulate crypto assets exists, and courts have affirmed its applicability. The real issue is whether the SEC will continue to enforce these laws or allow an industry defined by speculative hype and financial misconduct to dictate the terms of its own regulation. If investor protection remains the Commission's guiding principle, it must return to the enforcement approach that has already been validated by the courts. Anything less is a failure of the SEC's core mission.