

Securities Regulation Daily Wrap Up, BLOCKCHAIN—S.D.N.Y.: Coinbase knew it risked violating securities laws, SEC says, (Jul 11, 2023)

By [Lene Powell, J.D.](#)

The SEC aimed to preemptively puncture key defenses that Coinbase did not know its conduct might implicate the federal securities laws and that the “major questions” doctrine precludes the enforcement action.

Coinbase understood that the securities laws and rules could apply to its conduct, the SEC argued in a new filing in its enforcement action against the crypto asset trading platform. The SEC said it was a “subterfuge” that Coinbase, a multi-billion-dollar entity advised by sophisticated legal counsel, was unaware that its conduct risked violating the federal securities laws. Several actions including warning shareholders show that Coinbase made the calculated decision to take on this risk with the aim of growing its business, the SEC argued ([SEC v. Coinbase](#), July 7, 2023).

The SEC also challenged Coinbase’s assertion that crypto tokens at issue were not securities and articulated a key distinction that the “major questions” doctrine applies only to agency *regulatory* actions—not agency *enforcement*.

If the court allows Coinbase to file a motion for judgment on the pleadings, the SEC said it will move to strike certain defenses, including the major questions doctrine.

Coinbase aware of violations? Coinbase [argues](#) that it has “sought to comply with all applicable laws and regulations” but the SEC’s inconsistent stance on regulation of crypto assets has created confusion for crypto market participants. The SEC is enforcing “new and never-before disclosed standards” for regulating digital assets “at odds with SEC officials’ prior statements.” Coinbase contends that the SEC’s enforcement action violates due process because the SEC has “dramatically” expanded its definition of investment contract without formal rulemaking. Coinbase also argues that the SEC permitted Coinbase’s public offering “without once suggesting that Coinbase must register its operations.”

The SEC pushed back on these assertions. For one thing, the SEC said, Coinbase itself followed the *Howey* framework to assess whether the sale of crypto assets on the Coinbase platform would qualify as a transaction in securities.

“In other words, Coinbase adopted the very legal framework as a basis for making listing decisions that it now claims has no applicability to its activities,” wrote the SEC.

The SEC pointed to two other Coinbase actions that it says support the argument that Coinbase knew its actions might implicate the federal securities laws:

- Coinbase explicitly discouraged crypto asset issuers from using “problematic statements” in their marketing materials that are “traditionally associated with securities”;
- Coinbase warned its shareholders—including in its registration statement—that the crypto assets traded on its platform could be deemed securities and therefore that its conduct could violate the federal securities laws.

Major questions doctrine. Coinbase has argued that the “major questions” doctrine requires dismissal of the complaint because the SEC lacks the “clear congressional authorization” required to exercise “extraordinary” wholesale power over an emergent \$1 trillion industry. This is because Congress “has not yet delegated regulatory



authority over cryptocurrency” and is “actively considering regulatory structures.”

But this “misapprehends the purpose and reach of the major questions doctrine,” said the SEC. The doctrine constrains agencies’ *regulatory* assertions of authority. In contrast, this case involves the agency’s exercise of its longstanding authority to *enforce* statutory requirements. The agency was authorized by Congress in 1934 to enforce the federal securities laws through civil law enforcement actions, and has exercised that authority ever since to pursue violations of the securities laws, the SEC said.

“Coinbase cites no case, and we are aware of none, applying the major questions doctrine to an agency’s exercise of its authority to pursue statutory violations,” wrote the SEC.

Howey do it? The SEC challenged Coinbase’s “attempts to construct its own test for what constitutes an investment contract,” instead focusing on 75 years of *Howey* precedent.

The SEC argued:

- *Howey* held that an “investment contract” exists when a “transaction, scheme, or contract” involves certain economic characteristics. *Howey* did not require a common law contract, and no court has held otherwise.
- Coinbase does not cite any cases in support of its assertion that secondary market crypto asset transactions are exempt from the federal securities laws. Even accepting Coinbase’s argument that secondary market transactions do not, as a matter of law, implicate the securities laws, Coinbase’s intermediation of primary offers and sales would suffice to establish Coinbase’s liability.

Coinbase wallet. Finally, the SEC says Coinbase miscasts the SEC’s claim with respect to Coinbase Wallet. The complaint does not allege that Wallet “functions as a broker” but rather that Coinbase itself is a broker and has engaged in unregistered brokerage activity, for which it has received transaction-based compensation.

Similarly, the SEC said it has sufficiently pleaded that, through its staking program, Coinbase has engaged in the unregistered offer and sale of securities. Coinbase’s claim that the facts pleaded establish that there is no “investment of money” or “risk of loss” is belied by the very “facts pleaded,” which Coinbase simply ignores, said the SEC.

Core question. Boiling it all down, the SEC said the core question before the court is whether Coinbase acted as (1) an unregistered (2) intermediary (i.e., national securities exchange, broker, and/or clearing agency) (3) with respect to securities transactions.

The SEC said Coinbase disputes only the third question by insisting that it engages in “asset sale[s],” not in securities transactions. But the complaint pleads facts to establish that at least 13 of the crypto assets Coinbase makes available for trading are investment contracts, and thus securities, under *Howey*. This is more than sufficient to defeat a Rule 12(c) motion, said the SEC.

Next steps. The SEC told the court it will oppose a motion by Coinbase for judgment on the pleadings, if the court grants Coinbase leave to file. The SEC said it will also move to strike proposed defenses of major questions doctrine, abuse of discretion, equitable estoppel, unclean hands, and laches.

The case is [No. 1:23-cv-04738-KPF](#).

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Companies: Coinbase, Inc.

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