

[Securities Regulation Daily Wrap Up, BLOCKCHAIN—S.D.N.Y.: Coinbase suffers setback as district court rules for SEC on key crypto issues, \(Mar. 28, 2024\)](#)

Securities Regulation Daily Wrap Up

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

The court's rulings that transactions in certain crypto tokens are investment contracts aligns with other Southern District of New York decisions in *SEC v. Telegram* and *SEC v. Terraform*.

Resolving key disputes, a federal district court greenlighted an SEC enforcement action against Coinbase, Inc., operator of the largest crypto trading platform in the U.S. The court denied Coinbase's motion for judgment on the pleadings, finding the SEC plausibly claimed that Coinbase operated as an unregistered intermediary of securities and engaged in the unregistered offer and sale of securities. However, the court dismissed a count that Coinbase acted as an unregistered broker (*SEC v. Coinbase, Inc.*, March 27, 2024, Failla, K.).

The court also decided important foundational issues, finding the SEC's enforcement action did not implicate the major questions doctrine and the SEC did not violate Coinbase's rights under the Due Process Clause or Administrative Procedure Act.

While the district court's rulings may be appealed to the Second Circuit, the decision provides guidance on broadly applicable issues for the crypto industry.

Investment contracts. Resolving a key question on which the entire enforcement action hinged, the court found the SEC plausibly alleged that at least some crypto-asset transactions on Coinbase's platform and through Prime constitute investment contracts.

While the court acknowledged that the novel nature of crypto assets could suggest a paradigm shift, it concluded that at least some crypto assets fall within the federal securities laws.

"[T]he '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," the court wrote.

The court noted that the Securities Act sets out an expansive definition of the term "security" that includes the undefined term "investment contract." Further, the Supreme Court has made it clear that form should be disregarded for substance and the emphasis should be on the economic reality of the parties' arrangement.

Moreover, SDNY decisions in *Telegram* and *Terraform* suggest that there need not be a formal contract between transacting parties for an investment contract to exist under *Howey*. Courts should consider the full set of contracts, expectations, and understandings surrounding a cryptoasset's sale and distribution, and should look to what the offeror invites investors to reasonably understand and expect.

The court concluded that the SEC adequately alleged that purchasers of certain cryptoassets on the Coinbase Platform and through Prime invested in a common enterprise and were led to expect profits solely from the efforts of others, thereby satisfying the *Howey* test for an investment contract.

Securities intermediary. Next, the court found that the SEC adequately pleaded that Coinbase acted as a securities intermediary.

- Coinbase provides a marketplace that, among other things, "bring[s] together purchasers and sellers of [crypto-asset] securities" and matches and executes their orders;
- Coinbase also "engage[s] in the business of effecting transactions in securities for the account of others" by, for example, soliciting potential investors, holding itself out as a place to buy and sell crypto-asset

securities, facilitating trading in crypto-asset securities by opening customer accounts and handling customer funds and assets, and charging transaction-based fees;

- Coinbase “acts as a custodian of securities” by requiring customers to deposit their crypto-asset securities in Coinbase-controlled wallets, creating a system for the central handling of securities to settle customers’ transactions.

The court further found that the SEC adequately pleaded that CGI is liable as a control person of Coinbase for the purposes of Exchange Act Section 20(a).

Offer and sale of securities. In a merger of functions that are typically separate in traditional securities infrastructure, the court found that the SEC plausibly alleged that Coinbase itself is the promoter of a crypto-asset investment contract via its staking program.

Here, the court found that the staking program plausibly involved an investment of money and that participants reasonably expect to profit based on Coinbase’s managerial efforts. Accordingly, the court found the SEC plausibly alleged that Coinbase, through its staking program, engages in the unregistered offer and sale of securities in violation of section 5 of the Securities Act

Coinbase not a broker. The court did hand a win to Coinbase on one issue, dismissing the SEC’s claim that Coinbase acts as an unregistered broker through its Wallet service in violation of Section 15(a) of the Exchange Act.

The SEC’s allegations did not implicate many of the factors courts use in identifying a “broker.” In particular, the SEC did little to suggest that Wallet undertakes routing activities in a manner recognized by courts to have been traditionally carried out by brokers.

Major Questions Doctrine and process rights. The court found that the SEC’s enforcement action does not implicate the Major Questions Doctrine, noting the doctrine is reserved for the most “extraordinary cases” and is therefore rarely invoked.

First, while certainly sizable and important, the cryptocurrency industry “falls far short” of being a “portion of the American economy” bearing “vast economic and political significance.” The cryptocurrency industry cannot compare with those other industries the Supreme Court has found to trigger the major questions doctrine, the court said.

Second, the SEC is not asserting “transformative expansion in its regulatory authority” or a “highly consequential power beyond what Congress could reasonably be understood to have granted” it. Here, the court stated that Congressional consideration of new legislation implicating cryptocurrency, on its own, alter the SEC’s mandate to enforce existing law.

“Until the law changes, the SEC must enforce, and the judiciary must interpret, the law as it is,” the court wrote.

The court also found that the SEC has not violated Coinbase’s rights under the Due Process Clause. Contrary to its argument that it was deprived of “fair notice,” Coinbase repeatedly touted to the investing public its familiarity with the relevant legal standards governing the offer and sale of securities, as well as its awareness of the risk it would create if it facilitated transactions in crypto-assets that were found to be securities.

Finally, the court found that the SEC has not violated Coinbase’s rights under the APA. The court concluded that the SEC is not announcing a new regulatory policy, but rather is simply engaging in a fact-intensive application of an existing standard—an application that Coinbase also conducted—to determine whether certain transactions involving crypto-assets meet the characteristics of an “investment contract.”

This is case [No. 23 Civ. 4738 \(KPF\)](#).

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Companies: Coinbase, Inc.; Coinbase Global, Inc.

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