UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON AT SEATTLE

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. BITTREX INC., BITTREX GLOBAL GMBH, and WILLIAM HIROAKI SHIHARA, Defendants.	NO. 2:23-cv-00580-RSM AMICUS CURIAE BRIEF OF PARADIGM OPERATIONS LP

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TABLE OF CONTENTS

GORDON TILDEN THOMAS CORDELL
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TABLE OF AUTHORITIES

CASES

GORDON TILDEN THOMAS CORDELL
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STATUTES

LEGISLATIVE MATERIALS

OTHER AUTHORITIES

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INTERESTS OF AMICUS CURIAE

Paradigm Operations LP ("Paradigm") is an investment firm that backs entrepreneurs building innovative crypto companies and protocols. To help these entrepreneurs achieve their full potential, Paradigm offers them a range of services, from the technical to the operational. Issues placed before this Court have the potential to impact the operation and viability of crypto companies. Paradigm seeks leave to participate in this case because it is concerned that the novel position advocated by the Securities and Exchange Commission ("SEC") could have sweeping effects on Paradigm and many others who seek to utilize new technology.

SUMMARY OF ARGUMENT

This case is one of several in which the SEC asks federal courts to expand its authority to encompass secondary-market transactions in blockchain-based "crypto assets," which are not "securities" within the SEC's purview. As recently as two years ago, the current SEC Chair acknowledged before Congress that the SEC lacked authority to regulate secondary markets in crypto assets, noting that "the exchanges trading in these crypto assets do not have a regulatory framework." *Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide, Part III: Virtual Hearing Before the H. Comm. on Fin. Servs.*, 117th Cong. 12 (May 6, 2021) (statement of SEC Chair Gary Gensler), https://tinyurl.com/mtrnkbn2 ("SEC Chair Statement"). Nothing has changed since the Chair's testimony except the boundaries of the SEC's regulatory ambition.

This case against Bittrex, based on secondary-market transactions, is fundamentally different than the SEC's many prior cases based on token financings. In the last six years, the SEC has pursued dozens of enforcement actions against persons who have sold crypto assets as part of their fundraising efforts, and courts have agreed that some of those sales were "investment contract" offerings under the *Howey* test. The few courts to have grappled with the distinction between the offering and the token itself, however, have recognized that the *Howey* analysis does

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not attach to the token, nor apply to transactions between unrelated third parties in a secondary market. Consistent with the many investment contract cases that preceded the advent of crypto assets, the "investment contract" security has been the fundraising scheme itself—not whatever crypto asset is being offered.

In contrast, here, the SEC oversteps its authority by looking past the fundraising transactions to grasp authority over downstream secondary-market sales of the crypto assets themselves—assets that generally create no legal or business relationship between the asset owner and the initial fundraising seller (or any other entity). Even if a crypto asset was first sold in a fundraising transaction, existing law provides no basis for the SEC to graft its view of those initial facts and circumstances onto subsequent sales of the underlying asset itself.

A comprehensive review of every federal appellate case to substantially address *Howey* reveals that no such court has held that an asset that is the "object" of an investment contract transaction is itself a security, nor that a subsequent transfer of that asset in a secondary market is a securities transaction by virtue of the circumstances of its initial offering. *See* Lewis Cohen *et al.*, *The Ineluctable Modality of Securities Law: Why Fungible Crypto Assets Are Not Securities* (Nov. 10, 2022) ("*Why Fungible Crypto Assets Are Not Securities*"), https://tinyurl.com/y6sfurf6. Rather, in every application of *Howey* where an investment contract was found, the common enterprise involved an identifiable *legal or business relationship* between an ostensible "issuer" and the "investor" providing investment capital.

In contrast, the SEC's "investment contract" allegations in the Complaint are remarkably thin. The Complaint briefly recounts how each of six different crypto assets were offered and sold, then bolts on a few allegations seeking to bridge the gap between the initial offerings and the secondary market. To make that leap, the SEC distorts the "common *enterprise*" element of *Howey*, to allege that secondary market purchasers of those tokens have a common *interest* with the promoters and may rely on their efforts. But a mere common interest in the price of a fungible

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asset, without any legal rights or obligations binding the interested parties, is the hallmark of a commodity and not a security, even if purchasers might reasonably expect some interested parties to undertake more efforts than others to support the price.

Put another way, the SEC's effort to construe secondary market sales of crypto assets as securities transactions—even though those assets carry with them no legal relationship to any issuer—invents a new form of "issuer-independent security" unlike any other type of security known to our securities laws, and which instead resembles a commodity. That power to expand the scope of the securities laws is reserved for Congress, not the SEC or this Court, so the Complaint should be dismissed.

ARGUMENT

I. THE SIX CRYPTO ASSETS IDENTIFIED IN THE COMPLAINT ARE NOT, THEMSELVES, SECURITIES.

The Complaint asserts that six specific crypto assets constitute "crypto asset securities" (Compl. ¶ 1), based primarily on allegations that those assets were initially sold in "investment contract" transactions (Compl. ¶¶ 1, 4, 67, 98, 99, 101, 110). Those allegations, even if true, do not support attaching a "securities" label to the crypto assets under the test set forth in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) ("*Howey*"), and its progeny.

A. The *Howey* Test Evaluates Investment *Transactions* or *Schemes*, Not Underlying *Assets*.

The *Howey* test evaluates whether a "contract, transaction[,] or scheme"—not an asset—is an investment contract, considering whether the circumstances as a whole involve: (1) an investment of money (2) in a common enterprise (3) with an expectation of profits to come (4) solely from the efforts of the promoter or a third party. 328 U.S. at 298–99.

The *Howey* test does not—and cannot—support a determination that an asset that is the object of an investment contract is itself a security. This conclusion is supported by the language

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of *Howey* itself and a review of 253 federal appellate court decisions and 13 U.S. Supreme Court decisions, which represent all relevant appellate cases identified as applying the *Howey* test, either with reference to *Howey* or to *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975). *See Why Fungible Crypto Assets Are Not Securities* at 116-56, Schedules 1–3.

Since 1946, federal courts have found all manner of arrangements involving ostensibly commercial transactions to nevertheless be investment contracts. *See Why Fungible Crypto Assets Are Not Securities* at 116–29, Schedule 1 (collecting examples of orange groves, cattle embryos, whiskey warehouse receipts, among others). While many of these cases apply *Howey* to the purported *sale* of an underlying asset, that sale is almost always accompanied by the seller or an affiliated entity performing post-purchase functions, "such as picking, bundling and selling oranges; husbanding cattle and their embryos; or maturing whiskey in casks." *Id.* at 57–58; *see also id.* at 55–58 (collecting cases).[1] These cases therefore uniformly highlight the critical distinction between the investment package (*i.e.*, the set of formal or informal agreements or understandings between the seller and the purchaser) and the object of the scheme itself (*i.e.*, the orange groves, cattle, or whiskey).

Prior to this year, the SEC's litigated cases involving crypto assets hewed more closely to precedent by focusing on claims against fundraising parties and the circumstances of the

[1] *E.g.*, *Bailey v. J.W.K. Props., Inc.*, 904 F.2d 918 (4th Cir. 1990) (a cattle breeding program); *Glen-Arden Commodities, Inc. v. Costantino*, 493 F.2d 1027 (2d Cir. 1974) (warehouse receipts for whiskey were coupled with additional services, including storing the whisky and assisting purchasers in selling the whiskey when it matured); *Kemmerer v. Weaver*, 445 F.2d 76 (7th Cir. 1971) (sales of beavers coupled with service agreements to house, feed, and otherwise care for the beavers); *Miller v. Cent. Chinchilla Grp., Inc*., 494 F.2d 414 (8th Cir. 1974) (sale and management agreements with respect to chinchillas); *SEC v. ETS Payphones, Inc*., 408 F.3d 727 (11th Cir. 2005) (sale and leaseback of payphones); *Smith v. Gross*, 604 F.2d 639 (9th Cir. 1979) (earthworms); *Newmyer v. Philatelic Leasing, Ltd*., 888 F.2d 385 (6th Cir. 1989) (printing plates for foreign postage stamps); *see also Rodriguez v. Banco Cent. Corp*., 990 F.2d 7, 10–11 (1st Cir. 1993) (finding that "[a] security *might* exist if the defendants had promised, along with the land sales, to develop [a thriving residential] community themselves," but that "[a] simple sale of land, whether for investment or use, is not a 'security'"); *Bamert v. Pulte Home Corp*., 445 F. App'x 256 (11th Cir. 2011) (rejecting the argument that purchase agreements for a condominium unit were investment contracts because the plaintiffs were under no contractual obligation to join an offered rental pool or otherwise contract with the defendant's proposed rental agent, but finding that the plaintiff had sufficiently alleged the possible existence of an investment contract in considering exclusive rental agreements, if the rental agents were affiliates of the condominium seller).

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offerings.[2] Through all of its crypto enforcement actions and litigation, however, the SEC has cited no authority to support treating the object sold in an investment contract transaction as a security in itself. This is because no such authority exists.

The few courts to have directly considered the distinction between offerings and the tokens sold in those offerings have taken pains to clarify that any conclusion about the offerings should *not* be read as a conclusion about the token itself. For example, in *SEC v. Telegram Group Inc.*, 448 F. Supp. 3d 352 (S.D.N.Y. 2020) ("*Telegram*"), the court *twice rejected* the position that the Gram token itself was the security at issue:

> 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. *Howey* requires an examination of the entirety of the parties' understandings and expectations.

448 F. Supp. 3d at 379. On a motion for clarification, the court sharpened the point:

> But focusing upon the Initial Purchasers and their Gram Purchase Agreements misses <u>one of the central points</u> of the Court's Opinion and Order, specifically, that the "security" was neither the Gram Purchase Agreement <u>nor the Gram</u> but the entire scheme that comprised the Gram Purchase Agreements and the accompanying understandings and undertakings made by Telegram, including the expectation and intention that the Initial Purchasers would distribute Grams into a secondary public market.

[2] *See, e.g.*, *SEC v. Kik Interactive Inc.*, 492 F. Supp. 3d 169, 177–82 (S.D.N.Y. 2020); *SEC v. LBRY, Inc.*, No. 21-cv-00260, 2022 WL 16744741, *3 (D.N.H. Nov. 7, 2022); *Munchee Inc.*, Release No. 33-10445, 2017 WL 10605969 (Dec. 11, 2017); *Bloom Protocol, LLC*, Release No. 33-11089, 2022 WL 3273493 (Aug. 9, 2022); Compl., *SEC v. PlexCorps*, No. 17-cv-7007 (E.D.N.Y. Dec. 1, 2017), 2017 WL 5988934 (alleging misrepresentations about the size and scale of PlexCorps' operations, the use of funds raised in an ICO, and the amount of funds raised in the ICO); Compl., *SEC v. AriseBank*, No. 18-cv-186 (N.D. Tex. Jan. 25, 2018), 2018 WL 623772 (alleging "many" materially false statements and omissions in connection with an ICO transaction). The SEC also previously asserted claims premised on tokens being securities in actions that were settled before its assertions were tested. *See, e.g.*, *Zachary Coburn*, Release No. 34-84553 ¶ 26, 2018 WL 5840155, at *6 (Nov. 8, 2018) (claiming that EtherDelta "operated as a market place for bringing together orders of multiple buyers and sellers in [digital assets] that included securities"); Compl., *SEC v. Wahi*, No. 22-cv-1009 (W.D. Wash. July 21, 2022), ECF No. 1 (alleging that secondary transactions constituted insider trading under the securities laws).

GORDON TILDEN THOMAS CORDELL
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SEC v. Telegram Grp. Inc., No. 19-cv-9439, 2020 WL 1547383, at *1 (S.D.N.Y. Apr. 1, 2020) (emphasis added). Similarly, a federal court in New Hampshire recently ruled that sales of the crypto asset known as LBRY were investment contract transactions. *See SEC v. LBRY, Inc.*, No. 21-cv-00260, 2022 WL 16744741, at *8 (D.N.H. Nov. 7, 2022). At the remedy phase, the court addressed the distinction between the offering and the token at length, making clear that it had not concluded that the token itself was a security, and that it was not restricting token holders from making subsequent sales of their tokens. *See* Tr. of Mot. Hr'g, *SEC v. LBRY, Inc.*, No. 21-cv-260 (D.N.H. Jan. 30, 2023), ECF No. 105 at 36:1–37:18; *see also id.* at 25:7–13 (Court: "What I was focused on is what the parties were litigating, was whether these particular offerings of the token were securities offerings, and I said that they were. That does not necessarily mean that every offering of the—every resale of the token violates the Securities Act because it's a restricted security."). The court remarked that the SEC attorneys were "trying as hard as they possibly can not to put [the status of the token in secondary markets] as an issue for whatever reason in front of me." *Id.* at 29:21–22; *see also id.* at 31:14–18 ("I don't fully understand the SEC's ultimate position on that at this point."). The SEC Chairman further muddied the water in his testimony before the House Financial Services Committee in April 2023, refusing to answer direct questions as to whether Ether—the second-largest crypto asset after Bitcoin—was or was not a security. *See* Press Release, Patrick McHenry, Chairman, House Fin. Servs. Comm., *Committee Republicans Grill SEC Chair Gensler Regarding His Disastrous Agenda* (Apr. 19, 2023), https://tinyurl.com/3dh7fv2t.

Most recently, at oral argument in *SEC v. Terraform Labs PTE Ltd.*, No. 23 CV 1346 (S.D.N.Y June 15, 2023), the SEC conceded that a crypto asset token at issue in that case, known

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as LUNA, was *not* itself an investment contract, and that without a promise or expectation of profit, the token is just a piece of code. *See* Tr. Oral Arg. at 55:17–24, *Terraform Labs*, No. 23 CV 1346. The relevant question, according to the SEC, was how LUNA was offered, marketed, promoted, and sold, and the economic realities surrounding the offer of the asset. *Id.* at 34:10–12, 35:4–7; *see also id.* at 35 ("the investment contract analysis has been applied to a range of assets. In every situation, the asset itself is virtually irrelevant.")

In short, when courts have considered the distinction between an offering and an underlying token, they have limited their *Howey* analysis to the initial offerings. Meanwhile, when the SEC has been pressed to explain its approach to labelling tokens as securities, it has either dodged the issue or conceded that the token itself is not a security. There is no basis in existing law to reach a contrary result.

II. THE SEC CANNOT SUPPORT EXTENDING *HOWEY* TO DETERMINE THAT SECONDARY MARKET SALES ARE INVESTMENT CONTRACT TRANSACTIONS.

The SEC's efforts to transpose its *Howey* analysis of initial offerings onto secondary market transactions is both unprecedented and unworkable.[3] Of the hundreds of federal appellate and Supreme Court decisions applying the *Howey* analysis, *none* directly deals with secondary transactions in those assets. Moreover, there is no suggestion in any of the appellate cases that the transfer of the underlying object to another "investor," *without an assignment or transfer of the surrounding promises or rights that originally gave rise to the "investment contract,"* would result in another securities transaction. This is not a historical accident, but a reflection of the fact that the *Howey* test is fundamentally ill-suited to evaluating the status of assets in a secondary market under current securities laws.

[3] Until recently, the SEC recognized that crypto secondary markets fell outside their regulatory purview. In 2021, SEC Chair Gensler testified that "only Congress" could address the regulatory gap, "because right now the exchanges trading in these crypto assets do not have a regulatory framework." SEC Chair Statement.

GORDON TILDEN THOMAS CORDELL
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Since 1946, only one federal appellate decision applied *Howey* to a transaction that did not directly involve as a party the entity that would purportedly be the "issuer" of the alleged investment scheme. In that one case, *Hocking v. Dubois*, 885 F.2d 1449, 1462 (9th Cir. 1989) (*en banc*) ("*Hocking II*"), the Court made clear that the secondary transaction—a resale of a condominium in a development for which there was a rental pool—was not automatically a securities transaction, and the court remanded for consideration of whether the circumstances of a particular secondary transaction provided independent grounds for conducting an investment contract analysis.[4]

The full court held that just because the purchase of an asset *could* have been based on an expectation of profit did not support a holding that all transactions were *automatically* securities transactions. On rehearing *en banc*, the *Hocking* majority reasoned:

> We agree with defendants and *amici* that the three-judge panel may have written too broadly its conclusion that so long as a rental pool 'option' exists, all secondary market sales necessarily involve a security. Such a *per se* rule would be ill-suited to the *examination of the economic reality of each transaction required by Howey*.

885 F.2d at 1462 (emphasis added).

A. A Common Enterprise Requires a Legal Relationship, Not Just a Common *Interest.*

The SEC has offered various articulations of its approach to extending *Howey* to reach crypto secondary markets, but each fails for the same reason. The SEC cannot overcome the absence of any legal relationship binding the purchaser to a "common enterprise."[5]

[4] Hocking, an individual investor, purchased a rentable condominium unit in a secondary transaction through the encouragement of his real estate broker, then entered into a rental pool agreement with a company acting as the rental pool operator for the resort. Hocking later brought a lawsuit against the real estate broker, claiming that the combination of the condominium purchase and the rental pool agreement constituted an unregistered securities transaction. *See Hocking II*, 885 F.2d at 1452–53.

[5] Outside of court, the SEC is unwilling to concede that the common enterprise element of *Howey* exists at all. Diverging from federal courts, the SEC's Framework for "Investment Contract" Analysis of Digital Assets states that "[t]he Commission, on the other hand, does not require vertical or horizontal commonality *per se*, nor does it

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Rather, the SEC seeks to replace the common enterprise requirement with a pleading of a transitory "common interest" among unrelated parties. In the Complaint before this Court, for example, the SEC commences with allegations that proceeds received by the promoters in the initial sales of the six identified tokens would be pooled and used to support the projects. (*See, e.g.*, Compl. ¶ 200 ("proceeds from the TKN sale would be pooled to develop TokenCard's business"), *id.* ¶ 212 ("NAGA described to investors that it would pool the funds it raised in the token sales to build and promote the NAGA ecosystem")). To bridge these allegations from the initial offering to the secondary market, the SEC relies on statements suggesting that subsequent purchasers' fortunes remain tied to the initial promoters. (*See, e.g.*, Compl. ¶ 148 ("Even after the ICO, and through changes in management, the promoters of OMG continued to tout the connected fortunes of OMG token holders and the promoters"); *id.* ¶ 163 (for DASH "the fortunes of the investors (*i.e.*, the non-Masternode token holders) are tied to the fortunes of the Masternodes and DCG.")).

The common *interest* shared among third parties who have exposure to a fungible asset, however, does not place all holders of the asset in a common *enterprise* for purposes of *Howey*. There are many examples where non-security assets are purchased partially or entirely for their profit potential and derive their value significantly from the purchaser's reasonable expectations of the actions of "others," such as:

- A speculative buyer that made a secondary purchase of a parcel of real estate that was part of a larger development may reasonably expect the developer that owns many of the other nearby parcels to add features to the development that would increase the value of all of these parcels based on statements made in advertising brochures concerning the development published by the developer;

view a 'common enterprise' as a distinct element of the term 'investment contract.'" U.S. SEC, *Framework for "Investment Contract" Analysis of Digital Assets* n.10, https://tinyurl.com/2p9ny2a2 (last visited July 7, 2023).

GORDON TILDEN THOMAS CORDELL
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- A fund acquiring certain cartel-supported commodities (like diamonds or crude oil) for investment purposes may reasonably expect the relevant cartel (e.g., De Beers or OPEC) to maintain production levels that support publicly announced unit price targets that would benefit both the buyer and the cartel members; and
- A hobbyist collector/investor in children's limited-edition plush dolls may see a social media post by the dolls' manufacturer and reasonably expect a particular line of dolls to be discontinued by the manufacturer after a run of a certain volume, increasing scarcity and therefore price of the dolls, providing profit to the buyer and enhancing demand for future toys to be sold by the manufacturer.

In none of these cases would a court in the Ninth Circuit have judicial precedent to find that the third-party asset buyer is in a "common enterprise" within the meaning of *Howey*. A common interest among purchasers, without a legal relationship to bind them, is the hallmark of fungible commodities markets.

In contrast to commodities, every item on the enumerated list of instruments that comprise the definition of a security under federal securities laws reflects the presence of a *legal relationship* established between an identifiable *issuer* of the security and the *owners* of that security. *See Why Fungible Crypto Assets Are Not Securities* at 62–63 (addressing each of the enumerated list of instruments in the definition of "security" to show they each involve a legal relationship with an issuer). The inclusion of the term "investment contract" is no exception. Every federal appellate court finding an "investment contract" to exist under *Howey* is consistent with this trend, and no such case has suggested that an investment contract can exist in the absence of any legal relationship. *See id.* at 116–56, Schedules 1–3.

Under current law, there is simply no such thing as an "issuer-independent security"—a security that exists independently of any legal relationship to an identifiable entity considered its "issuer." Throughout the federal securities laws it is assumed that all securities will have an

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"issuer"—an identifiable person or entity against whom a securityholder's rights can be exercised. When a security has been issued, many different obligations and potential liabilities are imposed on the issuer of that security, including the responsibility for filing periodic reports where the security or issuer has registered with the SEC. 15 U.S.C. § 78m.

The survey of appellate jurisprudence presented in Annex A to *Why Fungible Crypto Assets Are Not Securities* demonstrates that a traditional written contract is present in virtually every instance where an investment contract has been found by an appellate court. In those few appellate cases in which an investment contract was found without a written instrument between the parties, however, the elements necessary to find an implied-in-fact contract were present.

No appellate decision holds or suggests that the ownership of an ordinary asset, without some ongoing business relationship to the issuer of the investment contract, would suffice to establish a "common enterprise" required for an investment contract. Of the 266 decisions surveyed, approximately 62 had more than a cursory reference to the concept of "common enterprise." *Why Fungible Crypto Assets Are Not Securities* at 48. Of those, 37 decisions either found that an investment contract transaction or scheme was present or remanded for further fact finding. *Id.* In each of these decisions, the one constant was that commonality was based on a direct business relationship between the issuer and the participant.[6]

B. Relying on *Howey* to Classify Transferrable Crypto Assets as Securities Is Inherently Unstable, Transitory, and Impossible to Implement.

Relying on *Howey*'s transaction test to brand assets as securities would be not only unprecedented, but impossible to implement. Under federal securities laws, it is essential that all parties, including intermediaries like clearing agencies, broker-dealers, exchanges, and self-regulatory organizations, are able to determine with reasonable certainty whether and when they

[6] A good example of this is *Shaw v. Hiawatha Inc.*, 884 F.2d 582, 1989 WL 102013 (9th Cir. 1989) (unpublished table decision), in which the plaintiffs alleged that the defendants' agents told them that they "would be in business together" coupled with a letter from an officer of the defendant stating that he was looking forward to a "long and profitable relationship" with the defendants. *Id.* at *4 .

GORDON TILDEN THOMAS CORDELL
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are dealing with a security, who the issuer of that security is, and what rights or duties that issuer may have in respect of those securities. This is particularly important because the federal securities laws can impose strict liability on those who violate them (for example, operating an unregistered exchange for the transfer of securities or acting as an unregistered "broker" or "dealer" in securities). *See* 15 U.S.C. § 78o.

If the court were to graft the *Howey* analysis onto the token itself, however, third parties dealing in such crypto assets might face significant consequences and penalties without ever having notice of the facts, circumstances, promises, and expectations giving rise to a determination that a particular asset or arrangement is in hindsight deemed to be a security at any point in time.

First, *Howey* relies on evidence that would be impractical or impossible for secondary-market participants to obtain and evaluate. Unlike instruments where all relevant legal characteristics can be examined by a buyer or seller through the review of definitive written documentation, the "facts and circumstances" test is not capable of being determined with certainty on an ongoing basis by persons not part of the original scheme. Many relevant "facts and circumstances" may be private matters between the original parties and not capable of discovery by third parties who lack the SEC's subpoena power. The two recent cases in which the SEC has proceeded to summary judgment are instructive, as in both instances the SEC relied on facts that would not be readily ascertainable or predictable by participants in a secondary market, such as private deal terms, emails, and other informal statements.[7]

Second, the *Howey* test is difficult to apply even with an identified set of facts. Of the hundreds of cases applying *Howey* on appeal, a significant majority (57%) end either in a

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[7] In the *Ripple* case, for example, the SEC relied on evidence that Ripple Labs targeted "venture capital firms and other types of 'accredited investors' who were 'purchasing XRP for speculative purposes'" (Pl. SEC's Mem. of Law in Supp. of its Mot. for Summ. J., *SEC v. Ripple Labs, Inc.*, No. 20 Civ. 10832 (S.D.N.Y. Sept. 17, 2022), ECF No. 640 at 56), and that Ripple once required purchasers to "agree[] to lock-ups or resale restrictions based on XRP's trading volume" (*id.* at 58). Last year's *LBRY* decision relies on somewhat different sources, further highlighting the problem. *See LBRY*, 2022 WL 16744741, at *4-6 (pointing to various blog posts, an email to a potential investor, a communication on Reddit, an interview, an essay, and an information business plan).

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conclusion by courts that no investment contract was present (43%) or remand the dispute for further fact finding (14%). More specifically, the Ninth Circuit, which has thus far been responsible for 27% of all federal appellate investment contract cases, has found that an investment contract was not present, or remanded for further proceedings, in 53% of all of its decisions, thus highlighting that a *Howey* analysis is particularly challenging to get right.[8]

Third, the problems are compounded by the inherently transitory nature of any *Howey* analysis. The outcome today may be different tomorrow. The SEC staff sought to address this transitory problem in a 2018 speech by Director Hinman, which gave rise to the concept that a token once classified as a security might later morph into a non-security.[9] But this novel morphing concept cannot reasonably be implemented in secondary markets. For example, if a token can morph from a security to a non-security based on extrinsic factors (such as the disappearance of the founding team), then it can just as easily morph back into a security (upon their return, or the ascendance of a new leader, or some other set of promises or assurances).

The securities laws drafted by Congress cannot accommodate crypto assets morphing in and out of transitory "security" status, untethered from any legal relationship to any issuer. In a similar context, the Supreme Court rejected an analogous "morphing" concept, because:

> coverage by the Acts would in most cases be unknown and unknowable to the parties at the time the stock was sold. These uncertainties attending the applicability of the Acts would hardly be in the best interests of either party to a transaction. *Cf. Marine Bank*

[8] The procedural history of the *Hocking* case demonstrates the difficulty of applying *Howey* to secondary market transactions even for experienced judges on an established factual record. The district court held that Hocking's arrangement did not constitute an investment contract. *See Hocking v. Dubois*, 839 F.2d 560, 562 (9th Cir.) (describing trial court opinion), *withdrawn*, 863 F.2d 654 (9th Cir. 1988). The Ninth Circuit reversed, finding that an "offering of a condominium with [a rental pool agreement] *automatically* makes the [transaction an investment contract]."' *Id.* at 565.

[9] *See* William Hinman, Director, Div. Corp. Fin., SEC, *Remarks at the Yahoo Finance All Markets Summit: Digital Asset Transactions: Crypto, When Howey Met Gary (Plastic)* (June 14, 2018), https://tinyurl.com/2p9dx557 ("And putting aside the fundraising that accompanied the creation of Ether, based on my understanding of the present state of Ether, the Ethereum network and its decentralized structure, current offers and sales of Ether are not securities transactions.").

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> *v. Weaver*, 455 U.S. [551,] 559, n. 9 [(1982)] (rejecting the argument that the certificate of deposit at issue there was transformed, chameleon-like, into a "security" once it was pledged).

Landreth Timber Co. v. Landreth, 471 U.S. 681, 696 (1985) (emphasis added). Under current law, the only rational approach is to regulate each *offering* according to its facts and circumstances, recognizing that the crypto asset underlying the offering is not itself a security.

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CONCLUSION

For the reasons discussed above, this Court should reject the SEC's unsupported allegations that secondary-market transactions in tokens are securities transactions on the basis of the *Howey* test and the facts alleged in the Complaint.

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