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Note to Clients - Summer Reading
July 1, 2024

A selection of primarily digital asset focused regulatory and case law developments for the trading and markets industry (approx. 10 pages)

Digital Asset Regulatory and Litigation Developments

SEC Enforcement Letter, re: Closing its Ethereum 2.0 Investigation of Consensys

On June 18, 2024, the SEC Division of Enforcement sent a letter to Conesnsys informing it that it was closing its investigation into whether Ethereum 2.0 (the ETH network following the move to a proof-of-stake consensus mechanism) was a security. Consensys had previously sued the SEC on April 25, 2024, seeking a court order that would halt the SEC's investigation into Consensys and Etheruem on the grounds that ETH is a commodity and therefore the SEC lacks jurisdiction to investigate or regulate it. In early June, Consensys had also sent, via its counsel, a letter to the SEC requesting the SEC to lift the subpoenas to Consensys on this topic given the SEC's recent ETH ETF rule change approvals predicated on ETH being a commodity. While the SEC letter stops short of declaring: "ETH is a commodity and not a security," it certainly stands as nearly definitive support - particularly given the context around which the letter was issued - for that conclusion.

SEC Complaint Against Consensys, re: MetaMask offering unregistered securities (through Lido and Rocketpool) and acting as unregistered broker dealer

Notwithstanding its June 18, 2024 letter to Consensys concluding its Ethereum investigation, on June 28, 2024, the SEC filed a complaint against Consensys charging it with engaging in the unregistered offer and sale of securities through its MetaMask Staking service and with operating as an unregistered broker through MetaMask Staking and its MetaMask Swaps service. (SEC Press Release; updated Release). The complaint was filed in the Eastern District of New York (Brooklyn). The SEC Complaint is here.

In a statement on its website, Consensys said: "*We are confident in our position that the SEC has not been granted authority to regulate software interfaces like MetaMask. We will continue to vigorously pursue our case in Texas* [*See* Consensys statement on their April 25,

2024 complaint against the SEC] *for ruling on these issues because it matters not only for our company but the future success of web3*."

For reference, copying here a few excerpts from the SEC complaint on the subject of staking:

- "Consensys has offered and sold tens of thousands of securities for two issuers: Lido and Rocket Pool. By this conduct, Consensys acts as an underwriter of those securities and participates in the key points of their distribution."
- "Lido and Rocket Pool each offer what are commonly referred to as 'liquid staking' programs. 'Staking,' in the context of a blockchain network, refers to the commitment of the native crypto asset of the blockchain (in the case of the Ethereum blockchain, for example, ether or "ETH") in order to act as a 'validator' of transactions recorded on that network. Blockchain validators perform certain functions to earn rewards in the form of additional tokens and, when selected, proposing new blocks to the blockchain. Lido and Rocket Pool offer an investment program known as a 'staking program,' centered around this feature of the Ethereum blockchain. In essence, Lido and Rocket Pool each pool ETH contributed by investors and stakes it on the blockchain, using their technological expertise to earn returns that the typical investor would not be able to earn on their own. Upon receipt of an investor's ETH, Lido and Rocket Pool issue the investor a new crypto asset in return—stETH or rETH, respectively—representing the investor's pro-rata interest in the staking pool and its rewards. Lido and Rocket Pool refer to their staking programs as 'liquid' because investors' interests in the programs—represented by the stETH and rETH tokens—are tradable on the secondary market, thereby providing investors a mechanism to exit their investment position, whereas tokens staked directly on the blockchain cannot be easily accessed while they are staked."
- "Consensys, for its part, brokers and also offers and sells these securities in unregistered transactions through its 'MetaMask Staking' platform. By soliciting investors to participate in the Lido and Rocket Pool staking programs and by acting as an intermediary between Lido and Rocket Pool, on one hand, and investors in their respective staking programs on the other, Consensys was an integral part of the distribution of these securities. Indeed, Consensys developed and deployed MetaMask Staking for the specific purpose of offering and selling the Lido and Rocket Pool staking program investment contracts."

IRS Finalizes Crypto Broker Reporting Rules; Limits Rules to Custodial Brokers (Reserving the right to expand rules to so-called decentralized and non-custodial brokers)

On June 28, 2024, Treasury and the IRS issued final regulations requiring custodial brokers to report sales and exchanges of digital assets, including cryptocurrency. The rules require brokers to report certain sale and exchange transactions that take place beginning in calendar year 2025 and will be reported on the soon-to-be released Form 1099-DA. From the Treasury/IRS press release:

- The final regulations require reporting by brokers who take possession of the digital assets being sold by their customers. These brokers include operators of custodial digital asset trading platforms, certain digital asset hosted wallet providers, digital asset kiosks, and certain processors of digital asset payments (PDAPs). The majority of digital asset transactions today occur using these brokers. By focusing first on this group, the IRS intends these regulations to cover the greatest number of taxpayers while allowing the IRS and U.S. Treasury Department more time to consider the nuances of transactions involving non-custodial and decentralized brokers.
- The final regulations do not include reporting requirements for brokers that do not take possession of the digital assets being sold or exchanged. These brokers are commonly called decentralized or non-custodial brokers. The U.S. Treasury Department and the IRS intend to provide rules for these brokers in a different set of final regulations.

For an excellent summary (27 X/tweet thread) and analysis by tax partner Jason Schwartz of Fried Frank, see here: https://x.com/CryptoTaxGuyETH/status/1807575569162256567.

Interim Decision in *SEC v. Binance* Dismisses Charges Asserting that BNB Secondary Market Sales are Securities Transactions; Several Other Claims Remain Pending; Refers to SEC Crypto Litigation Strategy as "*probably not an efficient way to proceed*"

In a June 28, 2024 ruling on a Motion to Dismiss, over 89-pages, Judge Amy Berman Jackson (for the U.S. District Court for the District of Columbia) specified that SEC claims concerning Binance's staking program, the initial coin offering of BNB, anti-fraud violations, and the SEC's assertion that former CEO Changpeng "CZ" Zhao acted as a "control person" will proceed. However, Judge Jackson dismissed the SEC's claims charging that secondary market sales of BNB and, separately, that sales of the Binance USD (BUSD) stablecoin were securities

transactions. The decision to dismiss the BNB secondary market sales claim echoed a similar ruling by Judge Analisa Torres in a previous ruling in an ongoing SEC case against Ripple.

For reference here, copying some excerpts from the opinion:

- "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."
- "Obviously, orange groves are not securities, yet the seminal case on this point found the set of contracts and expectations surrounding their sale to be an investment contract for purposes of the Act. *See Howey*, 328 U.S. 293."
- "In the Court's view, then, the SEC's suggestion that the token is 'the embodiment of the investment contract,' . . . as opposed to the subject of the investment contract, muddied the issues before the Court, ignored the Supreme Court's directive that the analysis is supposed to be based on the entire set of understandings and expectations surrounding the offering, and unnecessarily invited the defendants' argument that a decision in the government's favor here would somehow encroach on the jurisdiction of the Commodities Futures Trading Commission."
- "[T]this Court will undertake the task it has been assigned: to apply all of the principles set forth above to the allegations in the complaint, resolving any inferences in favor of the plaintiff. But that being said, it is worth noting that intangible digital assets do not fit neatly into the rubric set forth in the mere seven pages that comprise the Howey opinion. Also, ***the agency's decision to oversee this billion dollar industry through litigation – case by case, coin by coin, court after court – is probably not an efficient way to proceed, and it risks inconsistent results that may leave the relevant parties and their potential customers without clear guidance***." (*emphasis added*)
- "Insisting that an asset that was the subject of an alleged investment contract is itself a 'security' 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 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. . . .[T]he Court . . . finds that the complaint does not include sufficient facts to support a plausible inference that any particular secondary sales satisfy the *Howey* test for an investment contract."

SEC Settlement with Terraform and Do Kwon for $4.5B, with Most Becoming an Unsecured Claim in Terraform's Bankruptcy Liquidation Proceeding

On June 13, 2024, the SEC announced a settlement with Terraform Labs and Do Kwon for $4.5 billion. The SEC had charged Terraform and Kwon in the U.S. District Court for the Southern District of New York on February 16, 2023, with securities fraud and for offering and selling securities in unregistered transactions – in connection with the TerraUSD algorithmic stablecoin and related tokens, including Luna. Much of the settled amount is unlikely to be paid because Terraform filed for bankruptcy in January 2024. The settlement amount (or the overwhelming majority of it) is likely to be treated as an unsecured claim in the Terraform bankruptcy liquidation.

Other Litigation Developments

Supreme Court Issues Decision Overturning *Chevron Deference* Doctrine

In a widely reported on case, the Supreme Court issued a decision, dated June 28, 2024, holding that: "The Administrative Procedure Act requires courts to exercise their independent judgment in deciding whether an agency has acted within its statutory authority, and courts may not defer to an agency interpretation of the law simply because a statute is ambiguous; *Chevron* is overruled." The *Loper Bright Enterprises* Decision is available here. As relevant to financial services practitioners, the major implication of the holding is that agencies such as the SEC and CFTC (particularly in the context of rulemakings and in supporting enforcement allegations) will not be able to assert that their interpretation of their governing statutes, when those statutes are ambiguous, must prevail. Instead, questions related to interpreting ambiguous statutory provisions must be decided by courts.

Supreme Court Issues Decision that Defendants are Entitled to Jury Trials when the SEC is Seeking Civil Monetary Penalties

The Supreme Court issued a decision in SEC v. Jarkesy, dated June 27, 2024, holding that "when the SEC seeks civil penalties against a defendant for securities fraud, the Seventh Amendment entitles the defendant to a jury trial." Sometime after the passage of the Dodd-Frank legislation, the SEC brought an enforcement action alleging anti-fraud violations against George Jarkesy, Jr. and his firm, Patriot38 LLC before an in-house administrative law judge. As a result a civil penalty was ordered against Jarkesy and Patriot38. Respondents appealed and the Fifth Circuit vacated the SEC order stating that the defendants' Seventh Amendment rights to a jury trial had been violated. The Supreme Court agreed. The Supreme Court's *Jarkesy* opinion is here. This decision could dramatically impact proceedings currently pending before agency in-house administrative law judges and future agency enforcement decisions.

Fifth Circuit Vacates SEC's Private Fund Adviser Rule in Challenge Brought by Several Trade Associations for the Private Funds Industry

In a June 5, 2024 decision, the Fifth Circuit vacated a SEC rulemaking for private fund advisors. The plaintiffs had asserted a series of Administrative Procedure Act ("APA") and related claims, including that (1) the SEC exceeded its statutory authority, (2) the Final Rule was not a logical outgrowth of the proposed rule the preceded it, (3) that the Final Rule is arbitrary and capricious under the APA, and (4) that the SEC failed to adequately consider the Final Rule's impact on efficiency, competition, and capital formation. For the purposes of this Summer Reading note, the important takeaway is that the Court concluded that the SEC did exceed its statutory authority and thus the Court vacated the rulemaking.

Digital Asset Market Observations

Moody's Provides "A" Rating to Open Eden Fund that Issues Tokenized US T Bills

OnJune 19, 2024, OpenEden published a Medium post indicating that: "The global credit rating agency, Moody's Ratings, has awarded an "A" rating to Hill Lights International Limited — the regulated mutual fund that issues OpenEden's tokenized U.S. T-bills ('TBILL'). The rating places OpenEden's TBILL tokens within the 'investment-grade' quality category."

DRW Cumberland Entity Receives NY DFS BitLicense; NY DFS List of Virtual Currency Business "Regulated Entities" Now Lists 33 Companies (Link)

On June 17, 2024, Cumberland New York LLC, a subsidiary of the DRW Cumberland family of entities, announced that it had received its BitLicense from the New York Department of Financial Services. See https://x.com/CumberlandSays/status/1802727346824253442.

Circle Receives EU Stablecoin License under MiCA

On July 1, 2024, on X/twitter, Circle's CEO Jeremy Allarie posted: "Circle announces that USDC and EURC are now available under new EU stablecoin laws; Circle is the first global stablecoin issuer to be compliant with MiCA. Circle is now natively issuing both USDC and EURC to European customers effective July 1st."

Dapper Labs Settlement with Civil Lawsuit Plaintiffs, re: TopShot NBA NFTs

Pursuant to a June 2, 2024 Stipulation of Settlement court filing, Dapper Labs has settled a putative class action lawsuit brought by customers alleging that the NBA TopShots NFTs were sold as unregistered securities. The settlement amount was reported as $4 million. In the settlement, Dapper Labs denies any wrongdoing and continues to assert that NBA Top Shot Moments are collectibles and not securities.

Other Selected Takeaways from Various Crypto Cases:

SEC v. Coinbase:

- June 6, 2023: The SEC sued Coinbase for operating as an unregistered securities exchange, broker, and clearing agency. (LINK)
- March 27, 2024: Judge Failla issues decision on a Motion to Dismiss, largely preserving the SEC's complaint (including allegations that a range of cryptocurrencies, including Solana / SOL and Chiliz / CHZ, are securities). One quote from the decision reads: "whether a particular transaction in a crypto-asset amounts to an investment contract does not necessarily turn on whether an investor bought tokens directly from an issuer or, instead, in a secondary market transaction."
- "[T]he Court finds that the SEC has ***adequately alleged*** that the Staking Program constitutes an investment contract under Howey, given, among other things: (i) the risk of loss associated with participation in the Staking Program, (ii) Coinbase's significant technical efforts in implementing and maintaining the Program, and (iii) Coinbase's promotional efforts to drive customer participation in the Program." (emphasis added)
- However, the decision did dismiss the SEC's claims that alleged that Coinbase's Base wallet (the "Wallet") was an unregistered broker dealer. "[T]he SEC's allegations do not implicate many of the factors courts use in identifying a 'broker.' Notably, the SEC does not allege that the Wallet application negotiates terms for the transaction, makes investment recommendations, arranges financing, holds customer funds, processes trade documentation, or conducts independent asset valuations." And ". . . the SEC does not allege that Coinbase performs any key trading functions on behalf of its users in connection with those activities. As the Complaint acknowledges, Coinbase has no control over a user's crypto-assets or transactions via Wallet, which product simply provides the technical infrastructure for users to arrange transactions on other DEXs in the market. . . . control over her own assets, and the user is the sole decision-maker when it comes to transactions." Concluding: "the Complaint does not plausibly allege that Coinbase is a broker with respect to its Wallet service."
- The case remains ongoing.

SEC v. Ripple:

- Dec. 22, 2020: The SEC sued Ripple Labs Inc. and two of its executives alleging that they raised over $1.3 billion through an unregistered, ongoing digital asset securities offering. (LINK)
- July 13, 2023: Judge Torres (SDNY) issues a decision on competing Motions for Summary Judgement. In notable part, the Judge Torres decision concluded that while Ripple's own institutional sales of XRP to sophisticated investors under written contracts did constitute securities transactions, programmatic sales of XRP by Ripple, on exchange, were not securities transactions because those buyers could not reasonably expect that Ripple would use the capital it received from its sales to improve the XRP ecosystem and thereby increase the price of XRP.
- The case remains ongoing.

Judge Rakoff (SDNY) Decision in SEC v. Terraform Labs Pte. Ltd.:

- July 21, 2023: Judge Rakoff issued an opinion in the SEC's favor in its securities claims against Terraform and Do Kwon, which the SEC brought following the collapse of Terraform, its algorithmic stablecoin, and its related coin Luna.
- *Speaking on the major questions doctrine*: "the crypto-currency industry – though certainly important – falls far short of being a 'portion of the American economy' bearing 'vast economic and political significance.' . . .it would ignore reality to place the crypto-currency industry and the American energy and tobacco industries – the subjects of *West Virginia* and *Brown & Williamson*, respectively – on the same plane of importance. If one were to do so, almost every large industry would qualify as one of 'vast economic and political significance' and the doctrine would frustrate the administrative state's ability to perform the function for which Congress established it: the regulation of the American economy."
- *Speaking on the securities law analysis of digital assets*: " . . . [T]he 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. Instead, it will evaluate -- as the Supreme Court did in Howey -- whether the crypto-assets and the 'full set of contracts, expectations, and understandings centered on the sales and distribution of [these tokens]' amounted to an 'investment contract' under federal securities laws."
- *Disagreeing with Judge Torres in the Ripple case, Rakoff writes*: "the Court declines to draw a distinction between these coins based on their manner of sale, such that coins sold directly to institutional investors are considered securities and those sold through secondary market transactions to retail investors are not. In

doing so, the Court rejects the approach recently adopted by another judge of this District in a similar case, *SEC v. Ripple Labs Inc.*, 2023 WL 4507900 (S.D.N.Y. July 13, 2023)."

Other Digital Asset Industry Lawsuits Regarding the SEC:

- Feb. 21, 2024: Fort Worth-based crypto company Lejilex and lobbying group Crypto Freedom Alliance of Texas (CFAT) sued the SEC arguing the crypto assetstrade don an exchange are not securities and arguing that the SEC has overstepped its statutory authorities in its enforcement efforts that seek to conclude otherwise. The docket is here. The case is ongoing.
- Mar. 26, 2024: Texas apparel company Beba and the DeFi Education Fund sued the SEC with a complaint challenging the SEC's crypto policies and asserting that airdrops are not securities. The docket is here. The case is ongoing.
- Coinbase continues to pursue various lawsuits against the SEC and other regulators, related to crypto policies, the refusal of the SEC to adopt a rulemaking for digital assets, and various Freedom of Information Act claims, amongst others.

Other SEC Crypto Cases and Wells Notices (Publicly Disclosed):

- May 6, 2024: Robinhood announced that it had received a Wells Notice form the SEC in connection with its crypto token trading platform.
- Uniswap has also received a Wells Notice form the SEC related to security slaw allegations that the SEC would bring against its crypto trading software. On May 21, 2024, Uniswap and its counsel submitted a 43-page response to the Wells Notice (which they have made public).
- Nov. 20, 2023: The SEC sued Payward Ventures (Kraken) with charges similar to those it has brought against Coinbase. The docket is here, and the case remains ongoing.

One More Noteworthy Development

FinCEN Issues Proposed Rule to "Strengthen and Modernize AML/CFT."

On Friday, June 28, 2024, the Financial Crimes Enforcement Network (FinCEN) issued a proposed rule "to strengthen and modernize financial institutions' anti-money laundering and countering the financing of terrorism (AML/CFT) programs. It seeks comments in 60 days. See: https://www.federalregister.gov/public-inspection/2024-14414/anti-money-laundering-and-countering-the-financing-of-terrorism-programs.

Through this proposed rule FinCEN seeks to:

- amend existing rules to explicitly require effective, risk-based, and reasonably designed AML/CFT programs with certain minimum components, including a mandatory risk assessment process;
- require financial institutions to review government-wide AML/CFT priorities and incorporate them, as appropriate, into risk-based programs; and
- promote clarity and consistency across FinCEN's program rules for different types of financial institutions.

About us:

Miller Strategic Partners LLP is a law firm headquartered in New York City. We advise clients on trading and markets regulatory and commercial matters, investigations, and crisis management scenarios.

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