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A QUESTION TO THE SEC AFTER THE BLOCK.ONE SETTLEMENT: HAS THE SEC DECIDED TO BE LESS AGGRESSIVE IN SANCTIONING VIOLATIONS BY CRYPTO ISSUERS?

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Until September 30, 2019, Securities and Exchange Commission ("**SEC**") enforcement actions in the crypto industry conveyed a consistent message: most crypto is a security, and if a token issuer does not follow the registration requirements of the Securities Act of 1933 ("**1933 Act**"), the issuer would face significant consequences in the form of substantial penalties, a mandated rescission offer to US investors, a requirement to register the tokens under Section 12(g) of the Securities Exchange Act of 1934 (the "**1934 Act**"), and bad actor disqualifications preventing the issuer from future Regulation A and Regulation D offerings.[ii]

On September 30, the SEC announced a settlement with Block.one that did none of these things.[iii] Despite finding that Block.one issued tokens that were securities in the United States without complying with registration requirements of the 1933 Act, the SEC: imposed a financial penalty on Block.one that was minor in the context of the total size of Block.one's capital raise; did not require Block.one to make a rescission offer to investors; did not require Block.one to register its tokens under the 1934 Act; and did not impose bad actor disqualifications under Regulation A and Regulation D. And, as discussed below, the Block.one Settlement Order omitted any mention of key factual information necessary to support the SEC's conclusion that the tokens were in fact securities. Equally surprising, the SEC did not address, in any respect, whether new tokens issued being used on a blockchain supported by Block.one are securities, and the SEC took no action (and offered no discussion) with respect to the issuance of those tokens.

Block.one is by far the largest crypto issuer (measured by proceeds from the size of the token offering and by the market capitalization of tokens) sued by the SEC to date.[iv] In light of the size and prominence of Block.one, and the significantly more lenient treatment the SEC afforded to Block.one than it has afforded to other crypto issuers it has sued, the markets reasonably expected a detailed explanation from the SEC of its thinking and the bases for the various novel approaches it took in the Block.one Settlement Order. In fact, the SEC was silent on these issues.

Despite the surface appearance of a significant settlement amount of $24 million, the totality of the SEC's settlement with Block.one has confused crypto issuers, it has confused the crypto markets, and it has confused crypto lawyers and other crypto gatekeepers. It is important for the SEC and its staff (the "**Staff**") to explain, promptly, publicly and comprehensively, why the SEC took such a different and lenient approach in the Block.one Settlement Order, and what this suggests for the SEC's future approach to regulation of the crypto industry. This article discusses a number of questions and considerations arising from the Block.one Settlement Order that the SEC should address.

The SEC often declines to say more about its views of a case than is in the settlement papers. The SEC should not take that path here. First, following the Block.one Settlement Order, the information the crypto markets need from the SEC goes well beyond the four corners of that Order. The SEC previously had plainly signaled to the crypto markets what it viewed as the sanctions and remedies for an illegal public crypto offering. The SEC found Block.one engaged in an illegal public crypto offering, and then did not impose those sanctions and remedies. This appears to amount to a change in SEC enforcement policy that goes well beyond the Block.one Settlement Order, and the SEC should explain the reasons for and future contours of this change in policy.

Second, settled enforcement actions are perhaps the principal means that the crypto community has to learn about the SEC's views on the regulation of the industry. The SEC itself, and the Divisions of Corporation Finance, Trading and Markets, and Investment Management, have given the markets almost no affirmative guidance as to how to comply with the federal securities laws; the main thrust of their comments has been to say in essence that many or most tokens are securities, and that therefore the federal securities laws apply.[v] Since settled enforcement actions have become a (and probably the) principal method of communicating the SEC's views to the crypto community, it is important for the SEC to use those actions to inform, not confuse, the crypto markets. The Block.one Settlement Order has deeply confused the crypto markets, and the SEC should not, and in good faith cannot, attempt to address that confusion by insisting that the markets look for explanation to the very settlement papers that created the confusion in the first place.

The Block.one Settlement Order

According to the Block.one Settlement Order, from June 2017 through June 2018, Block.one sold approximately $4 billion of tokens that were distributed on the Ethereum blockchain using the ERC-20 protocol (the "**ERC-20 Tokens**"). Block.one said that it would use the proceeds to, among other things, build its EOSIO software, which was designed to support public or private blockchains, and to increase speed, reduce transaction costs, and improve scalability on those blockchains. Block.one sold some of the ERC-20 Tokens to US persons, and they did not register those transactions or comply with a registration exemption.

On June 1, 2018, the ERC-20 Tokens became fixed and non-transferable on the Ethereum blockchain at the close of the sale of those ERC-20 Tokens, and the holders of those ERC-20 Tokens (the "**Final ERC-20 Token Holders**") as of that date are identifiable. A blockchain developer who uses the EOSIO software to configure and launch a blockchain could issue that blockchain's "native" tokens to the Final ERC-20 Token Holders.

On June 14, 2018, the EOS blockchain, the first EOSIO-based blockchain, was launched.

This is essentially where the SEC's recitation of the facts ends. Among the many things the SEC does not discuss in the Block.one Settlement Order are:

- What the profit opportunity and profit expectation of the ERC-20 Tokens was. If there was no expectation of profit, the ERC-20 Tokens should not be securities.
- Whether and why there was a common enterprise among the ERC-20 Token holders (e.g., did they all profit equally from the tokens), or between an ERC-20 Token holder and Block.one (e.g., did a token holder profit only if Block.one also profited). If there was no common enterprise, the ERC-20 Tokens should again not be securities.
- Whether Block.one was and/or remains involved with the EOS blockchain.[vi] The EOS blockchain uses a native token called EOS. The SEC does not address the EOS tokens at all, and therefore does not discuss their status as securities or non-securities.

It is possible that the SEC agreed to the comparatively minor sanctions against Block.one because it was not confident of its ability to convince a court that ERC-20 Token holders had a reasonable expectation of profit or that there was a common enterprise. If this is the case, perhaps the SEC should have not brought the action against Block.one.

Questions the SEC Should Address

1. *Why was the Block.one monetary penalty so low, at least on a relative basis?*

Block.one reportedly raised over $4 billion in its token offerings.[vii] While not all of that was raised in the US (in fact, the SEC did not discuss how much was raised in the US), the SEC imposed only a $24 million penalty, which is less than 0.6% of the total amount Block.one raised. By contrast, in prior proceedings against token issuers that illegally sold unregistered tokens, the SEC imposed penalties of 1.67% and 2.07% of total amounts raised and/or agreed to additional undertakings that, in the aggregate, imposed more significant consequences on the issuer.[viii]

The SEC did not discuss why and how it determined this settlement amount, and why that amount is proportionately so much lower than the amounts it imposed in prior orders, particularly in light of the absence of additional penalties or undertakings seen in these other orders. In fact, the SEC's order did not even mention those prior orders.

2. *Why was Block.one the only crypto issuer that illegally sold unregistered tokens to not have to make a rescission offer and not have to register its tokens under the Securities Exchange Act of 1934?*

Prior to the Block.one Settlement Order, the SEC had settled actions with three crypto issuers whose sole alleged violation was illegally offering unregistered tokens.[ix] In each of those cases, the SEC required the issuer to, among other things, make a rescission offer to US investors, and register the tokens under the 1934 Act (this caused the issuer to provide significant public information so that, among other things, token holders could make an informed decision as to whether to accept the rescission offer).

The Block.one Settlement Order was the first time the SEC did not impose these sanctions on a crypto issuer that had illegally sold unregistered tokens in the US. The SEC did not explain why it decided not to impose these sanctions against Block.one. As noted above, the Block.one Settlement Order did not even mention or refer to the prior orders imposing these sanctions.

Once the SEC decided not to require Block.one to conduct a rescission offer, its decision not to require 1934 Act registration is to some extent understandable, because ERC-20 Token holders would not need the public information to make an informed rescission decision. This still begs the question, however, as to why the SEC decided not to require a rescission offer. One potential reason is that the SEC might have thought that US investors could sell their ERC-20 Tokens, at least until they were immobilized on the Ethereum blockchain, at or near the price they paid for those Tokens. This rationale would suffer from a number of defects, including that the sales would have to be made through illegally unregistered exchanges on which US persons should not be able to trade (unless and until those exchanges register with the Financial Industry Regulatory Authority ("**FINRA**"), which to date has not happened). And, in any event, holders of the ERC-20 Tokens would not have been able to trade those Tokens after those Tokens had been immobilized on the Ethereum blockchain. In addition, the SEC has suggested, in the context of denying applications for Bitcoin ETFs and otherwise, that it has doubts about the validity of the liquidity and pricing posted by many unregistered crypto exchanges, which calls into question whether investors really could get all or most of their money back by selling the ERC-20 Tokens on the illegal exchanges. Finally, the fact that some investors may not have lost money is an unconvincing argument for the SEC to use as a grounds for denying rescission rights to all investors.[x]

In any event, the effect of the SEC's decision was to give no relief at all to the US investors who purchased in the illegal offering, combined with an almost negligible monetary penalty (in light of the total amount raised) against the token issuer. It is difficult to understand how this settlement protects or assists aggrieved investors. Of course, investors can sue Block.one, but the SEC permitted Block.one to neither admit nor deny the factual allegations in the Settlement Order, so even the Settlement Order and the allegations set forth in that Order may be of limited value to aggrieved investors in litigation.

3. Does the SEC have a "too-big-to-fail" policy for crypto issuers?

The SEC has expressly or implicitly identified only three tokens that it unconditionally views as not securities:[xi] Bitcoin, Ether and EOS. Those three tokens are numbers 1, 2 and 7 by market capitalization.[xii] There are valid reasons under the *Howey* test to think that Bitcoin is not a security,[xiii] although the SEC apparently has never publicly explained its analysis.

It appears the Staff believes that Ether initially was a security, but has now reached a sufficient state of decentralization so that it may no longer be a security.[xiv] The SEC has not meaningfully explained why it has determined that Ether is sufficiently decentralized to no longer be a security.[xv] The SEC also has not explained why it determined not to bring an action against the creators of Ether for potentially illegally offering unregistered securities in the United States.[xvi]

As discussed earlier, the Block.one Settlement Order concluded that the ERC-20 Tokens issued by Block.one were securities, but the SEC's complete silence on the regulatory status of the EOS Tokens, which appear to be held by US persons, implies that the SEC thinks they are not securities. In the absence of a full (or any) explanation by the SEC of its thinking, there has been speculation that the SEC thinks the EOS Tokens are sufficiently widely held and the EOS platform sufficiently decentralized so that the EOS Tokens are not securities.[xvii] If this is the SEC's view, it is important for the SEC to explain why it reached that determination, and why it omitted the relevant facts on that issue from the Block.one Settlement Order.

The significant market capitalization and widely dispersed holding of Bitcoin, Ether and the EOS Tokens may well help support a conclusion that those tokens are sufficiently decentralized to no longer be securities. But even assuming each of those tokens is not currently a security, the SEC has not explained why these three token issuers – uniquely among token issuers -- have been subject to no or limited penalties for any illegal unregistered offerings of their tokens while they still were securities. (Again, the SEC's position may be that Bitcoin was never a security.) The SEC also has not explained why it would permit illegal sales of tokens that are securities to be used to help justify the argument that the tokens are now so widely held that they should not be deemed to be securities; typically the SEC does not permit a company to obtain a regulatory benefit from the company's illegal activities.

Finally, the SEC may have decided that, in the interest of fostering the crypto industry, it will not take significant enforcement action against the most widely used tokens. While there is perhaps some logic to this position, it is extremely difficult to find a regulatory basis to justify a decision by the SEC to be more lenient with large companies whose illegal activities arguably affected a larger number of US investors, and stricter with small companies whose illegal activities arguably affected a smaller number of US investors. Nonetheless, based on the available evidence, this seems to largely describe the SEC's current approach.[xviii]

4. Has the SEC changed its approach to token regulation?

Perhaps the focus in this article on prior SEC enforcement actions against crypto issuers is misguided, and the Block.one Settlement Order reflects that the SEC is taking a new, more permissive attitude to the regulation of tokens and token offerings.[xix] There has been significant and consistent industry pressure on the SEC to exempt all or many token offerings from the scope of the federal securities laws, because tokens are new instruments that were not envisioned when the federal securities laws were drafted.[xx] Public statements by some high-ranking SEC officials seem to at least tacitly support this argument.[xxi]

If the Block.one Settlement Order does reflect a new "kinder and gentler" SEC approach to token offerings, the SEC should promptly and publicly clarify its new thinking. The Block.one Settlement Order is a significant departure from prior SEC enforcement actions, and from its highly publicized ongoing litigation with Kik over the Kin token;[xxii] the Order has left the crypto industry – as well as lawyers and other gatekeepers – mystified about what new standards the SEC is setting.

The SEC also should discuss its views on many of the "collateral consequences" of the Block.one Settlement Order. For example:

- How should token issuers that have done Regulation A offerings, or that are thinking about doing Regulation A or registered offerings, think about the Block.one Settlement Order? Among other things, those companies go through a significant review process; they disclose significant information to the public, including audited financial statements; and they become subject to significant ongoing reporting requirements. They often give up or substantially defer fundraising opportunities due to the time involved in obtaining the SEC's approval, and they sometimes are shunned by (often vocal) investors and others in the market who believe regulation is inappropriate. Are these issuers better served by not registering or qualifying their tokens, and taking the risk of paying only a minor financial penalty (and that's assuming they are one of the very small number of crypto issuers the SEC even sues)? To experienced securities lawyers, this question sounds preposterous; to crypto issuers who read the Block.one Settlement Order, this question is unavoidable.

- What lessons should lawyers and other gatekeepers who advise crypto clients take from the Block.one Settlement Order? Responsible lawyers and other gatekeepers advised crypto clients from an early stage about the applicability of the federal securities laws. Many token issuers abided by these restrictions; many others did not. While responsible lawyers and gatekeepers will continue to advise clients to follow the requirements of the federal securities laws, they are faced with the question of how to convince clients and prospective clients to adopt that approach after the Block.one Settlement Order. It is likely that many rational clients will conclude that these gatekeepers are overly cautious and conservative, and will potentially turn to and rely on advisers who are more willing to suggest skirting the securities (and perhaps other) laws.
- What are the lessons from the Block.one Settlement Order for lawyers and other gatekeepers who advise clients that in the future develop novel, non-crypto financial products? The financial markets are endlessly creative, and they will continue to develop new products and services and that implicate the federal securities laws. Without further SEC guidance about the rationale for the Block.one Settlement Order, lawyers and other gatekeepers may be – and likely will be -- less likely to be able to convince some clients who in the future develop novel products to comply with the federal securities laws, even when those laws are clearly applicable. And in any event, the Block.one Settlement Order means that at least some of those clients likely will be less willing to comply with the federal securities laws, and more inclined to seek out and rely on advisers who advise them that lack of compliance is in effect a cost of doing business.

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The Block.one Settlement Order is a significant aberration from prior SEC orders against crypto companies, and the Settlement Order itself lacks much of the factual and legal discussion that is present in most of the other orders against crypto companies. Combined with the high visibility of Block.one and EOS, the Block.one Settlement Order has created significant uncertainty and a large number of questions in the crypto community. The SEC should promptly and publicly clarify its thinking on why it entered into the settlement, including by addressing the various issues raised in this article.

[i] This article was prepared by Robert Rosenblum, Amy Caiazza, Taylor Evenson, and Katherine Mann. Mr. Rosenblum is a shareholder, Ms. Caiazza and Mr. Evenson are associates, and Ms. Mann is a law clerk, in the Washington, DC office of Wilson Sonsini Goodrich & Rosati ("**WSGR**"). The views expressed in this article do not necessarily represent the views of the WSGR, the authors' colleagues at WSGR or the clients of WSGR.

[ii] In the Matter of CarrierEQ, Inc., d/b/a AirFox, Securities Act Release No. 10575 (Nov. 16, 2018), https://www.sec.gov/litigation/admin/2018/33-10575.pdf; In the Matter of Paragon Coin, Inc., Securities Act Release No. 10574 (Nov. 16, 2018), https://www.sec.gov/litigation/admin/2018/33-10574.pdf; In the Matter of Gladius Network LLC, Securities Act Release No. 10608 (Feb. 12, 2019), https://www.sec.gov/litigation/admin/2019/33-10608.pdf.

[iii] In the Matter of Block.one, Securities Act Release No. 10714 (Sept. 30, 2019), https://www.sec.gov/litigation/admin/2019/33-10714.pdf (Order imposing a cease and desist order and fining Block.one $24 million) (the "**C&D Order**"), and In The Matter of Block.one, Securities Act Release No. 10717 (Sept. 30, 2019) (Granting a waiver of Regulation A and Regulation D disqualification provisions) (the "**Waiver Order**" and together with the C&D Order, the "**Block.one Settlement Order**").

[iv] As noted in the C&D Order at 2-3, Block.one raised "several billion dollars" of Ether through the sale of ERC-20 tokens. Further, as of October 7, 2019, EOS tokens are seventh in cryptocurrency market capitalization. See https://coinmarketcap.com/.

[v] See *Public Statement, Divisions of Corporation Finance, Investment Management, and Trading and Markets on Digital Asset Securities Issuance and Trading* (Nov. 16, 2018), https://www.sec.gov/news/public-statement/digital-asset-securites-issuuance-and-trading; *Public Statement, Division of Trading and Markets, SEC Office of General Counsel, Financial Industry Regulatory Authority on Broker-Dealer Custody of Digital Asset Securities (July 8, 2019),* https://www.sec.gov/news/public-statement/joint-staff-statement-broker-dealer-custody-digital-asset-securities; *Public Statement, Leaders of CFTC, FinCen, and SEC Issue Joint Statement on Activities Involving Digital Assets* (Oct. 11, 2019), https://www.sec.gov/news/public-statement/cftc-fincen-secjointstatementdigitalassets.

[vi] While not discussed by the SEC, it appears from publicly-available information that Block.one was and remains involved with the EOS blockchain. *See generally* Press Release, "EOSIO 1.0 Release," https://block.one/news/eosio-1-0-release/ (noting release of EOSIO blockchain software by Block.one); Press Release "Block.one Releases EOSIO 1.6.0, Sees Potential 35% Increase in Transaction Speeds," https://block.one/news/eosio-35-increase-in-transaction-speeds/ (noting release of update to EOSIO blockchain software code by Block.one).

[vii] C&D Order at 3 (noting sale of 900 million tokens sold at an average of $4.40 per token); Rooney, Kate, "A blockchain start-up just raised $4 billion without a live product," https://www.cnbc.com/2018/05/31/a-blockchain-start-up-just-raised-4-billion-without-a-live-product.html.

[viii] In the Matter of CarrierEQ, Inc., d/b/a AirFox, Securities Act Release No. 10575 (Nov. 16, 2018); In the Matter of Paragon Coin, Inc., Securities Act Release No. 10574 (Nov. 16, 2018). In In the Matter of Gladius Network LLC, Securities Act Release No. 10608 (Feb. 12, 2019), a case in which the issuer self-reported its unregistered offering of tokens, the SEC did not impose a civil penalty, but the issuer was subject to bad actor disqualifications preventing the issuer from future Regulation A and Regulation D offerings and undertook a rescission offer and registration of its tokens under the 1934 Act.

[ix] In the Matter of CarrierEQ, Inc., d/b/a AirFox, Securities Act Release No. 10575 (Nov. 16, 2018); In the Matter of Paragon Coin, Inc., Securities Act Release No. 10574 (Nov. 16, 2018); In the Matter of Gladius Network LLC, Securities Act Release No. 10608 (Feb. 12, 2019). In other cases, the SEC has entered cease and desist orders that did not impose the same panoply of conditions, for issuers who halted offerings after being contacted by the SEC. *See*, *e.g.*, In the Matter of CoinAlpha Advisors LLC, Securities Act Release No. 10582 (Dec. 7, 2018), https://www.sec.gov/litigation/admin/2018/33-10582.pdf.

[x] Another possible argument for not imposing significant sanctions and undertakings could be that, according to the Block.one Settlement Order, roughly 75% of the initial sale of the ERC-20 Tokens was held by only 100 wallets, which suggests that there was significant institutional participation in the offering. Problems with this argument include that at least 25% of the offering – which would amount to about $1 billion of the ERC-20 Tokens – would have been held by other wallets, which suggests a potentially substantial distribution to non-institutional and retail investors; non-institutional and retail investors may have purchased ERC-20 Tokens on illegal exchanges; and the SEC presumably should be concerned about protecting institutional investors as well as retail investors.

Yet another potential argument for not imposing significant sanctions and undertakings is that Block.one imposed some "geofencing", which in this case appears to mean that Block.one's offering materials said US persons could not participate and US-based IP addresses were blocked from the offering website (which generally may be bypassed with virtual private networks). There is no suggestion in the Block.one Settlement Order that Block.one took any other affirmative steps to actually preclude US investment. In fact, the Order talks about a number of significant marketing activities that Block.one took to market the ERC-20 Tokens in the US, and the Order states there was US participation (although the Order does not specify how much). It is difficult to believe that the SEC would give meaningful weight to these seemingly meager and ultimately ineffective efforts to purportedly exclude US investors.

[xi] Separately, the SEC has provided no-action relief to two issuers, with significant conditions. *See* TurnKey Jet, Inc., SEC No-Action Letter (Apr. 3, 2019), https://www.sec.gov/divisions/corpfin/cf-noaction/2019/turnkey-jet-040219-2a1.htm; Pocketful of Quarters, Inc., SEC No-Action Letter (July 25, 2019), https://www.sec.gov/corpfin/pocketful-quarters-inc-072519-2a1. As described in these two no-action letters, for a developer to rely on this relief, proceeds from the developer's token sales cannot be used to build the platform, the tokens need to be immediately functional upon sale, transfers can only be allowed to wallets on the platform, tokens can only be sold at a fixed price, repurchases could only be at a discount to the fixed price, and the token cannot be marketed in a manner to suggest potential increases in market value.

[xii] *See* Coinmarketcap, https://coinmarketcap.com (last visited Oct. 7, 2019).

[xiii] Under the four-prong test set forth in *Howey*, an instrument meets the definition of an "investment contract" and, therefore is a security, if it involves (1) an investment of money, (2) in a common enterprise, (3) with the expectation of profits (4) to be derived primarily from the efforts of others. Because

Bitcoin is created only through mining, not issued or controlled by an issuer or similar entity, arguably Bitcoin holders have never reasonably expected any profit from Bitcoin to be dependent on the efforts of any identifiable parties, as compared to any other network participants. As a result, arguably, Bitcoin was never an "investment contract" under the test set forth in *Howey*.

[xiv] *See* William Hinman, Director, Division of Corporate Finance, Securities and Exchange Comm'n, Remarks at the Yahoo Finance All Markets Summit: Crypto (June 14, 2018) (the "**June 2018 Remarks**").

[xv] In the June 2018 Remarks, Director Hinman did list several factors to consider when assessing whether a token network is so sufficiently decentralized that the token is no longer a security, but Director Hinman did not discuss how those factors applied to the specific facts of Ether, the Ethereum foundation, and the Ethereum network and its structure. Rather, Director Hinman addressed these facts only summarily. *See Id.* ("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."). Further, even to the extent that the June 2018 remarks do provide explanation, Director Hinman's views as expressed in the June 2018 Remarks with respect to Ether are "nonbinding and create no enforceable legal rights or obligations of the Commission or other parties" as was emphasized within a few months of Director Hinman's speech. Jay Clayton, Chairman, Securities and Exchange Commission, Statement Regarding SEC Staff Views (Sept. 13, 2018), https://www.sec.gov/news/public-statement/statement-clayton-091318 .

[xvi] To the extent an unregistered and non-exempt offering was undertaken, presumably these developers would be liable. Ethereum's development was an ongoing project for some time following the "genesis sale" of Ether, Ethereum's native token, with the primary efforts undertaken by a key group of contributors now commonly identified as the "Ethereum Foundation." See generally "Launching the Ether Sale," Jul. 22, 2014, https://blog.ethereum.org/2014/07/22/launching-the-ether-sale/ and "Ethereum Foundation Spring 2019 Update" https://blog.ethereum.org/2019/05/21/ethereum-foundation-spring-2019-update/.

[xvii] The SEC might, for example, have relied to some extent on the fact that (according to the Block.one Settlement Order) Block.one retained only 10% of the ERC-20 Tokens that it issued. This argument would suffer from several problems, including that 10% (equivalent to roughly $400 million of Tokens) is still a significant amount of Tokens; because 100 wallet holders held 75% of the ERC-20 Tokens, ownership of a controlling stake of Tokens may still be closely held among a small group of entities, potentially including Block.one; and Block.one might still be able to exercise significant control over the EOS blockchain through means other than Token ownership, although again the Order does not meaningfully address this possibility one way or the other.

[xviii] This observation is further supported by the SEC's odd approach to crypto exchanges. On the one hand, the SEC must be aware of a number of large crypto exchanges that permit US persons to trade crypto that is or likely is a security, even though none of those have registered with the FINRA as an exchange or an alternative trading system ("**ATS**"). Indeed, as discussed above, it is possible the SEC's settlement with Block.one on such favorable terms may have rested in part on the SEC's view that purchasers of the ERC-20 Tokens were able to sell those Tokens at favorable prices on some of these illegally unregistered exchanges. Moreover, the SEC has essentially already found that one such exchange, called EtherDelta, is an illegally unregistered exchange. In the Matter of Zachary Coburn, Exchange Act Release No. 84553 (Nov. 8, 2018), https://www.sec.gov/litigation/admin/2018/34-84553.pdf. Other than suing the developer who created the code for the platform, however, the SEC has taken no enforcement action against EtherDelta or any other significant crypto exchange.

On the other hand, the SEC has brought several enforcement actions against relatively small crypto brokers and crypto trading platforms. *See, e.g.*, Complaint, Sec. & Exch. Comm'n vs. ICOBox, et al., No. 2:19-cv-08066 (C.D. Cal. Sept. 18, 2019), https://www.sec.gov/litigation/complaints/2019/comp-pr2019-181.pdf; Complaint, Sec. & Exch. Comm'n v. 1pool Ltd. a.k.a. 1Broker and Patrick Brunner, No. 1:18-cv-02244 (D.D.C. Sept. 27, 2018), https://www.sec.gov/litigation/complaints/2018/comp-pr2018-218.pdf; In the Matter of TokenLot LLC, Lenny Kugel, and Eli Lewitt, Securities Act Release No. 10543, Exchange Act Release No. 84075, Investment Company Act Release No. 33221 (Sept. 11, 2018), https://www.sec.gov/litigation/admin/2018/33-10543.pdf.

One explanation for why the SEC may not have brought any enforcement actions against significant crypto exchanges is because FINRA (and realistically the SEC) has to date been unwilling to approve any crypto ATSs or exchanges. While there is little regulatory basis to justify it, the SEC's approach empirically seems to be to permit significant crypto exchanges to act illegally, at least until it and FINRA finally approve a crypto ATS, presumably to permit US persons to have some form of liquidity for their tokens. The SEC does not seem to offer the same leniency to smaller, less widely used crypto brokers and trading platforms.

[xix] Notably, the Block.one Settlement Order was issued on September 30, the last day of the SEC's 2019 fiscal year, a day when the SEC traditionally tries to close out as many enforcement cases as possible. This year, the SEC announced 28 SEC enforcement actions on September 30. By way of comparison, this year the SEC announced six enforcement actions on August 30, seven enforcement actions on July 31, and four enforcement actions on June 28. As a result, one possibility is that the SEC, in its eagerness

to close out enforcement actions by the end of its fiscal year, simply didn't pay close enough attention to the Block.one Settlement Order.

[xx] A response to this position is that the inclusion of the term "investment contract" in the definition of a security, and the Supreme Court's *Howey* test, were precisely intended to capture new instruments that, although not considered by the drafters of the federal securities laws, nonetheless have the types of characteristics and pose the risks the federal securities laws were intended to address. *See* Framework for "Investment Contract" Analysis of Digital Assets (Apr. 3, 2019), https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets. Under this line of analysis, the question is not whether tokens are a new instrument unforeseen by the drafters of the federal securities laws (which of course they are), but whether they share sufficient characteristics with other instruments that are deemed to be securities and pose the types of risks the federal securities laws are intended to address.

[xxi] *See* Hester M. Peirce, Commissioner, "Beaches and Bitcoin: Remarks before the Medici Conference," https://www.sec.gov/news/speech/speech-peirce-050218 ("For those ICOs and tokens that do come under the SEC's jurisdiction, it will fall to us to devise an appropriate regulatory structure for these new types of deals." and "The law deserves respect, but technological progress should not be bound by the limits of the regulator's lawyerly imagination."); Hester M. Peirce, Commissioner, "Spelling FinTech without the 'F' for Fear," https://www.sec.gov/news/public-statement/statement-peirce-053119 ("Keeping an open mind to innovation might mean untethering ourselves and the industry we regulate from tired paper-based requirements….More generally, it might mean reconsidering some of the technologically outdated assumptions underpinning our laws.").

[xxii] Complaint, Sec. & Exch. Comm'n v. Kik Interactive Inc, No. 19-cv-5244 (S.D.N.Y. June 4, 2019).