

# A New Approach to the Application of Securities Laws to Digital Assets: The Need for Regulators to Adapt

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The evolution of technology over time has resulted in astounding advances for modern society. The Internet is a singular example of such evolutionary technology that brought both tremendous commercial opportunity and legitimate regulatory uncertainty.<sup>1</sup> In the securities law arena, hardly any other technological advancement has been more heavily scrutinized and debated than that of “digital assets.”<sup>2</sup> The issue presented by digital assets is ostensibly simple, whether or not a digital asset is a “security” under federal law. Despite the apparent simplicity of the question, the answer is in fact substantively complex, and after considerable scrutiny by industry and regulators, when a digital asset is a security remains unclear.

As a result, one can argue it is essential to provide clarity to the regulatory cloud overshadowing the digital asset arena so that the technology supporting the development of these assets can continue to thrive and grow without fear of being hampered by legal liability. Here, however, to provide clarity means to create new law. And in creating new law, it is imperative to leave intact the regulatory landscape that has proven effective in modern times.<sup>3</sup>

As discussed in this article, the above can be achieved through the creation of a hybrid version of the well-established “Howey” test,<sup>4</sup> whether it be through common law or legislation, with a tailored third prong that is triggered in the context of digital asset technology—an “evolved” Howey test.

## The Origins of the “Howey Test”

To understand the need for *Howey’s* evolution is to understand the origins of the *Howey* test itself.

In fact, *Howey*, in its most fundamental nature, was brought about by the development of (in my mind) new technology. Technology can be defined as “a manner of accomplishing a task especially using technical processes, methods, or knowledge.”<sup>5</sup> In *Howey*, the issue at hand explores the contours of a developed concept in real estate investment that, one can argue, was in many ways novel and, therefore, helped advanced technology of that time—1946.

Importantly, however, one must have an understanding of the definition of “security” before fully appreciating the holding in *Howey* itself. As it relates to the analysis of *Howey* and the focus of this article, the statutory definition of security is found within the Securities Act of 1933 (the Securities Act) and the Securities Exchange Act of 1934 (the Exchange Act) [with the Securities Act and the Exchange Act, collectively, referred to hereinafter as the Acts].<sup>6</sup> By and large, the definition of security within the Securities Act and the Exchange Act is the same.<sup>7</sup> Congress intended these definitions to be drafted in a manner that would effectively protect investors for any type of instrument that, ultimately, would serve, operate, and function as an investment.<sup>8</sup> In that vein, Congress defined “security” broadly enough to encapsulate “virtually any instrument that might be sold as an investment.”<sup>9</sup> This, in turn, resulted in the Acts leaving an apparent “catch-all” provision in that, outside of the Acts’ enumeration of various instruments that constitute a security, any instrument that is an “investment contract” is also deemed to be a security. The term “investment contract,” while seemingly straightforward, has been the subject of litigation throughout modern history.

Initially, the Supreme Court of the United States held that the definition of “investment contract” should be interpreted in the context of commerce.<sup>10</sup> In *Joinder*, the Court assessed whether or not certain offers to sell assignments of oil leases that were, in and of themselves, widely disseminated constituted “investment contracts” and, therefore, were subject to federal securities laws. There, in holding that the latter did in fact equate to investment contracts, the Court focused on whether the assignments of oil leases were “widely offered or dealt in under terms of courses of dealing which established their character in commerce as ‘investment contracts,’ or as ‘any interest of instrument commonly known as a security’.”<sup>11</sup> The Court in *Joinder* articulated that the test of what is deemed an investment contract is “what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect.”<sup>12</sup> While, as you will see, the Court in *Howey* revises this test, it is imperative to fully understand that the origins of the investment contract analysis stem from an economic based assessment of a particular contract because this tie to economic perception is the key to determining how and if new technology is subject to federal securities laws.

In *Howey*, the concept of analyzing whether or not an investment contract is a security through an economic lens is further solidified. There, the Court was faced with determining whether or not “an offering of units of a citrus grove development coupled with a contract for cultivating, marketing and remitting the net proceeds to the investor” constituted a security.<sup>13</sup> At the time, this type of investment structure was a newly developed concept to the Court. In essence, the offering of plots in a citrus grove development concurrently with contracts to maintain and develop the plot for a return was a new process and, one can argue, new technology, that needed to be addressed by the Court. In doing so, the Court would need to ensure that individual investors would be afforded the adequate and full protection of the federal securities laws if appropriate. Therefore, the

Court in *Howey* understood that to unveil the “economic reality” of the overall offering of citrus grove plots to determine whether or not this type of offering would constitute an investment contract and, thus, a security, it would need to develop a cohesive test.<sup>14</sup>

The *Howey* test in its very nature was created to address how a court should assess whether or not newly developed investment schemes through technological developments are securities. The test consists of three main prongs: (1) an investment; (2) in a common enterprise; and (3) with a reasonable expectation for profits to be derived solely from the efforts of others.<sup>15</sup> Over time, courts have broadened the scope of the third prong so that efforts do not need to derive solely from others.<sup>16</sup> Remember, however, that this test is meant to be viewed from an economic perspective so that the appearance of an investment scheme or instrument is not determinative. Rather, the economic reality of the investment scheme or instrument is the ingrained theme to consider when applying this analysis. “If [this] test be satisfied, it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value.”<sup>17</sup> The reasoning for or potential value to be gained by an investment scheme or instrument does not impact the *Howey* analysis. In the alternative, the economic nature of how the investment scheme or instrument is structured determines the applicability of the federal securities laws.

## Applying *Howey* to Digital Assets

The courts today are facing the same challenge that the Court faced in *Howey*: How does one apply current federal securities laws analysis to new technology. One can argue that the only way to sufficiently do so is to develop a new test inherent with the idea of determining the “economic reality” of an investment scheme or instrument as the Court did in *Howey*.<sup>18</sup>

Digital assets have become a commonplace product in modern day society. Yet, US

regulators, including the US Securities and Exchange Commission (SEC), the US Commodity Futures Trading Commission (CFTC) and the Financial Crimes Enforcement Network (FinCEN), have been unable to determine what type of digital asset does or does not constitute a security that is subject to federal securities laws. In general, the SEC, in an attempt to provide some clarity, narrowed its view of what falls under the umbrella of the term “digital asset.” The SEC states that a digital asset is “an asset that issued and transferred using distributed ledger or blockchain technology, including, but not limited to, so-called ‘virtual currencies,’ ‘coins,’ and tokens.”<sup>19</sup> Moreover, SEC Chairman, Jay Clayton, has indicated that tokens that are used to finance projects are likely securities.<sup>20</sup> Chairman Clayton further suggested that when a digital currency becomes a pure medium of exchange (citing Bitcoin for an example), it is not likely to constitute a security.<sup>21</sup>

The issue, therefore, lies in the multifaceted nature of the value that can be derived from a digital asset. A digital asset, in general and as Chairman Clayton has touched on, can drive value through two particular uses: (1) a digital asset can be used to raise capital; or (2) a digital asset can be used as a medium of exchange.<sup>22</sup> The fact that such an asset can, in practice, be used as a medium of exchange while also enabling, depending on the circumstances, its issuer to raise capital creates a complex regulatory overlap in that it may be construed to be a security in one case and not a security in the other. This concept of “regulatory overlap” is novel and has resulted in case of first impression for courts and regulators.

The clarity brought forth by the SEC and Chairman Clayton, however, is stunted when considering digital assets in the broader context. In fact, the SEC’s Director of Corporation Finance, Director Hinman, has made clear that the SEC acknowledges that certain digital assets can initially be deemed securities, only to evolve into non-security assets over time.<sup>23</sup> In the latter context, Director Hinman places an emphasis on a digital asset’s decentralized

network. He argues that “[a]s a network becomes truly decentralized, the ability to identify an issuer or promoter to make the requisite disclosures becomes difficult, and less meaningful.” Meaning, that as a digital asset’s network becomes effectively decentralized, the purchaser of the digital asset would no longer “reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts.”<sup>24</sup> Thus, the *Howey* test would fail and the digital asset would not be deemed a security.<sup>25</sup>

But, as noted previously, this approach makes it almost impossible to determine, at the outset, whether or not a digital asset is a security and, therefore, whether or not purchasers are afforded the protection of the federal securities laws. Even Director Hinman himself acknowledges that a digital asset’s characterizations can change over time by stating Bitcoin and Ethereum are now deemed not to be securities, suggesting that each may have been securities at one point in time.<sup>26</sup> So, how does a court determine whether or not a digital asset is a security at the outset? Does a court simply state, we will wait and see what happens? Well, then how is a purchaser protected from fraudulent offerings that may, in economic reality, be a security?

In comes *Howey*. The SEC, in an attempt to apply the *Howey* test to new technology, created a “Framework for ‘Investment Contract’ Analysis of Digital Assets” (the Framework).<sup>27</sup> The Framework attempts to conceptualize the prongs of the *Howey* test by providing a multitude of factors, or characteristics, to consider when applying each prong of the *Howey* test to a particular digital asset. In many instances, these factors include sub-factors. Then, the Framework, as it relates to assessing whether or not there is a reliance on the efforts of others, for example, will carve out that each factor is considered and weighted independently: “[a]lthough no one of the following characteristics is necessarily determinative, the stronger their presence, the more likely it is that a purchaser of a digital asset is relying on the ‘efforts of others’...”<sup>28</sup> Even more so, the Framework addresses the concept of having to

continuously assess digital assets to determine if they have in fact evolved out of being a security: “[i]n evaluating whether a digital asset previously sold as a security should be reevaluated at the time of later offers or sales, there would be additional considerations as they relate to the efforts of others . . .”<sup>29</sup> It is evident that the Framework, while well intended, only further complicates the application of *Howey* to digital assets by providing more fact-based factors to consider in assessing whether the prongs of the *Howey* test are met.<sup>30</sup>

## New Technology Necessitates New Law

The ability to regulate is inherently tied with the ability to amend, revise, or promulgate law to adapt to modern times. The development of new technology may require the adoption of new legislation mandating novel regulations to sufficiently protect citizens from fraud and harm. To do this, Congress must delegate the proper authority to the SEC so that the SEC can adopt and implement new regulations relating to digital assets.<sup>31</sup> While attempting to create a cohesive method for applying the current law to a new technology is an agreeable attempt at providing regulatory clarity, a more appropriate method would be to develop a new test that adequately and succinctly addresses the economic nature of the new technology. Just as the Court in *Howey* did so, we must look to the economic reality of the technology and develop a sound test that captures the key characteristics of that technology’s economic nature and helps one determine whether or not those characteristics, when considered as a whole, result in the technology being subject to the federal securities laws.

SEC Commissioner Hester Pierce has argued as much in advocating for a new “safe harbor” for initial coin offerings. Commissioner Pierce has acknowledged the inadequacies of utilizing the *Howey* test for determining whether or not a digital asset is in fact a security. “People are pretty frustrated with having to apply the *Howey* test in this particular

context.”<sup>32</sup> In an attempt to address the issue, she has proposed a “safe harbor” (the Safe Harbor) that, in essence, would allow the network surrounding and supporting the digital asset to develop for a period of three years before a determination would need to be made on whether or not the digital asset is a security and the offering needs to be fully registered with the SEC.<sup>33</sup> However, this Safe Harbor would still require certain disclosures to the SEC due to the fact that the Safe Harbor, by its very nature, indicates that no determination has been made as to whether or not the digital asset is a security.<sup>34</sup> Meaning, to protect investors from potential fraud, information will need to be provided by private parties to ensure the nature of development of the digital asset is well-intended.

The Safe Harbor falls short, however, in providing adequate regulation to digital assets because it defers any determination until three years later. While the Safe Harbor does allow time for a digital asset to evolve into its ultimate form, the economic reality of that digital asset, one could argue, is no different in three years from what it was when the digital asset was first created.<sup>35</sup> Similar to Director Hinman, Commissioner Pierce appears to be focused on the impact of developing a decentralized network around the digital asset.<sup>36</sup> This, in turn, means that the Director and the Commissioner are focusing on the second part of the third prong of the *Howey* test, *reliance on the efforts of others*.<sup>37</sup> While one may not disagree with the analysis relating to the latter part of the *Howey* test, one can disagree with application of this part of the *Howey* test, in general, because one can argue that it relates to assessing the economic reality of a digital asset.

The economic reality of a digital asset is found in the *purpose* of its transferability. Indeed, the ability to transfer a digital asset is largely dependent on the network developed around it and the value of a digital asset is also dependent on its transferability. But, as the Court in *Howey* has noted and as stated above, “it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value”<sup>38</sup>

To the contrary, the economic purpose of the digital asset is fully derived from the benefits of its transferability.<sup>39</sup> The purpose of transferability of any digital asset is unique. In practice, a digital asset could be transferred for the following reasons: (1) to represent ownership in a company; (2) to represent a participation in a revenue stream; or (3) to represent a medium of exchange.<sup>40</sup> The nature of a digital asset's transferability conveys that it has a unique economic reality because the economic value derived from each of the mentioned transferring purposes is, in fact, different; respectively, the economic values are: (1) equity in a company; (2) the right to cash flow derived from performance; and (3) transfer of property/assets or purchase of property or services. Thus, a new test needs to be developed to more closely focus on the digital assets function rather than the network that supports that function.

The State of California recently has proposed legislation that aims at limiting the second part of the third prong of the *Howey* test—*derived from the efforts of others*.<sup>41</sup> The California bill carves out digital assets with the following characteristics from being deemed a security: “[a]ny changes to the software code underlying that asset may be made by network participants. Voting rights over the functioning of the network are conferred to each holder of the asset.” It is clear that California is attempting to shift the focus from the digital asset's supporting infrastructure to the digital asset's actual function. But more than a carve-out of a state bill will be needed to properly address this issue. Both companies and investors across the United States need to be provided federal regulatory clarity so that they can address the costs and risks associated with either developing or purchasing a digital asset, as well as to determine the regulatory protections to be afforded to that digital asset.

The mistake is in focusing on the decentralized network. One can argue that this parts ways from the fundamental economic analysis engrained in the *Howey* test. Focus, instead, on the overall function and purpose of the digital asset.

## The Hybrid of *Howey*

The creation of a new hybrid *Howey* test will not only enable regulators to provide clarity as to what type of digital asset will be deemed a security but will make clear to US citizens the costs and risks associated with developing or investing in certain digital asset technology. Similar to the proposed bill in California, one could focus on the third prong of the *Howey* test in creating a hybrid *Howey* test.<sup>42</sup> However, instead of creating a carve-out as the proposed California bill does,<sup>43</sup> one can recommend the creation of a new hybrid test to be applied in the context of digital assets only. In that respect, once it has been determined that a digital asset is at issue, the following rule would apply, where, similar to *Howey*, each prong would have to be satisfied for the digital asset to be deemed a security:

1. an investment;
2. where the reasonable buyer's and reasonable seller's primary motivations for entering into the investment are to receive profits and raise money, respectively; and
3. where the reasonable expectation of profits is to be derived directly from an asset's transferability regardless of the efforts of others.<sup>44</sup>

The last prong to be addressed, one can argue, sufficiently avoids the need to analyze a digital asset's decentralized network as it will ensure courts, regulators, and practitioners do not take into consideration the continued research and development of a digital asset's supporting technological infrastructure even if that continued research and development directly impacts the market value or price of the digital asset.<sup>45</sup> In the alternative, the third prong focuses on the economic reality of a digital asset because it narrows the scope of a court's assessment to that economic gain incurred through a digital asset's transferability.

The application of this new rule will result in certain digital assets falling outside the scope of federal securities laws. It is a concern for the courts that

instruments that are not subject to federal securities laws are regulated in some other manner so that the instrument's risk can be reduced.<sup>46</sup> Here, when a digital asset is deemed not to be a security under the new test, that digital asset likely will be deemed a virtual currency and, thus, subject to oversight by either the CFTC<sup>47</sup> or the Department of Treasury's FinCEN.<sup>48</sup>

The ability to create a new test to assess the economic reality of a new technology is imperative to the evolution of not only regulations, but of the development of technology. If we are unable to revise regulations to be adequately applicable to modern technological advancements, then private parties will be burdened by costs associated with their attempting to identify what regulations their newly created assets fall under. As the Court in *Howey* recognized, to protect the advancement of modern technology is to tailor the law surrounding the current society accordingly.<sup>49</sup>

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## NOTES

<sup>1</sup> Through the development of the Internet came the creation of web-based portals that provided immediate access to market information and news (Portals). In time, registered broker-dealers found it lucrative to pay these Portals to display a hyperlink on their

webpage that provides direct access to online brokerage services. This allowed individuals interested in certain stocks to only have to click the hyperlink to effect a transaction. However, Section 3(a)(4) of the Securities Exchange Act of 1934 includes in the definition of "broker" any person that is engaged in the business of effecting transactions for the accounts of others and, in general, courts have broadly interpreted this definition to mean *participating in meaningful ways at key points in securities transactions*. *Massachusetts Financial Services Inc. v. SIPC*, 411 F. Supp. 411, 415 (D. Mass.), *aff'd*, 545 F.2d 754 (1st Cir. 1976), *cert. denied*, 431 U.S. 904 (1977). So, the practice of broker-dealers compensating Portals to display their hyperlinks could result in the Portals being deemed to be "engaged in the business of effecting transactions for the accounts of others" and, therefore, necessitate Portals having to register as broker-dealers under the Securities Exchange Act of 1934. Thus, the US Securities Exchange Commission was tasked with the challenge of applying existing federal securities laws to new technology in a manner that would not prohibit innovation but foster technological development that could benefit the very investors it vows to protect. *See* Laura S. Unger, Commissioner, US Securities and Exchange Commission, *Online Brokerage: Keeping Apace of Cyberspace* (1999) [the *Unger Report*] ("The growing relationship between portals and broker-dealers is beginning to create pressure for the Commission to relax its historical prohibition against receipt of transaction-based compensation by non-broker-dealers").

<sup>2</sup> *See* SEC Release No. 81207, *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO* (July 25, 2017), <https://www.sec.gov/litigation/investreport/34-81207.pdf> ("Digital assets may be referred to in the industry by labels such as 'virtual assets,' 'crypto-assets,' 'digital tokens,' 'digital coins,' 'digital currencies,' 'cryptocurrencies,' and 'convertible virtual currencies.'"; "Financial activities involving digital assets may also be referred to as 'initial coin offerings' or 'ICOs.'").

Moreover, the Financial Action Task Force has defined “virtual currency” as:

a digital representation of value that can be digitally traded and functions as: (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status (*i.e.*, when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is not issued or guaranteed by any jurisdiction, and fulfils the above functions only by agreement within the community of users of the virtual currency. Virtual currency is distinguished from fiat currency (a.k.a. “real currency,” “real money,” or “national currency”), which is the coin and paper money of a country that is designated as its legal tender; circulates; and is customarily used and accepted as a medium of exchange in the issuing country. It is distinct from e-money, which is a digital representation of fiat currency used to electronically transfer value denominated in fiat currency.

FATF Report, “Virtual Currencies, Key Definitions and Potential AM/CFT Risks,” *Financial Action Task Force* (June 2014), <http://www.fatf-gafi.org/media/fatf/documents/reports/Virtual-currency-key-definitions-and-potentialaml-cft-risks.pdf>.

<sup>3</sup> In *Reves v. Ernst & Young*, the Court—in deciding what type of analysis would be most appropriate in assessing whether or not a “note” was deemed a security subject to the federal securities laws—determined that it would not rely on the *Howey* test when, in fact, the federal securities laws themselves provided other means of regulating the asset at issue. *Reves v. Ernst & Young*, 494 U.S. 56 at 64 (1990) (“*Howey* provides a mechanism for determining whether an instrument is an ‘investment contract.’ The demand notes here may well not be ‘investment contracts,’ but that does not mean they are not ‘notes.’ To hold that a ‘note’ is not a ‘security’ unless it meets a test designed for an entirely different variety of instrument ‘would make the [Securities Act of 1933 and

the Securities Exchange Act of 1934] enumeration of many types of instruments superfluous”). Applying similar reasoning to that of the Court in *Reves*, any to be enacted law should serve to regulate only such assets that current federal securities laws do not relate to as to do otherwise would prove to make certain aspects of the current regulatory framework superfluous.

<sup>4</sup> *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946).

<sup>5</sup> Definition of Technology, June 1, 2020, <https://www.merriam-webster.com/dictionary/technology>.

<sup>6</sup> Securities Act of 1933, codified as amended at 15 U.S.C. § 77a et seq.; Securities Exchange Act of 1934, codified as amended at 15 U.S.C. § 78a et seq.

<sup>7</sup> See 15 U.S.C. § 77b, (a)(1); See, 15 U.S.C. § 78c, (a) (10).

<sup>8</sup> As the Court explained in *Reves*:

The fundamental purpose undergirding the [Securities Act of 1933 and the Securities Exchange Act of 1934] is “to eliminate serious abuses in a largely unregulated securities market.” *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 849, 95 S.Ct. 2051, 2059, 44 L.Ed.2d 621 (1975). In defining the scope of the market that it wished to regulate, Congress painted with a broad brush. It recognized the virtually limitless scope of human ingenuity, especially in the creation of “countless and variable schemes devised by those who seek the use of the money of others on the promise of profits,” *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299, 66 S.Ct. 1100, 1103, 90 L.Ed. 1244 (1946), and determined that the best way to achieve its goal of protecting investors was “to define the ‘term “security” in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security.’”

*Reves*, at 60-61 (1990).

<sup>9</sup> *Id.* at 61 (“Congress therefore did not attempt precisely to cabin the scope of the [Securities Act of 1933

and the Securities Exchange Act of 1934]. Rather, it enacted a definition of ‘security’ sufficiently broad to encompass virtually any instrument that might be sold as an investment.”).

<sup>10</sup> SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 64 S.Ct. 120, 88 L.Ed. 88 (1943).

<sup>11</sup> *Id.* at 351, 634 S.Ct. at 124.

<sup>12</sup> *Id.* 352–353, 634 S.Ct. at 124–25 (quoted in *Marine Bank v. Weaver*, 455 U.S. 551 at 556, 102 S.Ct. at 1223 (1982)).

<sup>13</sup> *Howey*, 328 U.S. at 294.

<sup>14</sup> SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1946) (“Form was disregarded for substance and emphasis was placed upon economic reality.”)

<sup>15</sup> *Id.* at 301.

<sup>16</sup> See, e.g., SEC v. Merchant Capital, LLC, 483 F.3d 747 (11th Cir. 2007); *Long v. Schultz Cattle Co.*, 881 F.2d 129 (5th Cir. 1989); *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981); SEC v. Glenn W. Turner Enter., Inc., 474 F.2d 476 (9th Cir. 1973); *Continental Marketing Corp. v. SEC*, 387 F.2d 466 (10th Cir. 1967).

<sup>17</sup> *Howey*, at 301.

<sup>18</sup> See generally, *Id.*

<sup>19</sup> “Framework for ‘Investment Contract’ Analysis of Digital Assets,” Securities and Exchange Commission, Division of Corporation Finance, available at <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets>.

<sup>20</sup> See Agrawal, Neeraj. “SEC Chairman Clayton: Bitcoin is not a security,” *Coin Center*, April 27, 2018, <https://coincenter.org/link/sec-chairman-clayton-bitcoin-is-not-a-security>.

<sup>21</sup> *Id.*

<sup>22</sup> See *Id.*

<sup>23</sup> See Shieber, Johnathan, “SEC says Ether isn’t a security, but tokens based on Ether can be,” *TechCrunch*, <https://techcrunch.com/2018/06/14/sec-says-ether-isnt-a-security-but-tokens-based-on-ether-can-bel>.

<sup>24</sup> *Id.*

<sup>25</sup> Acting in compliance with the Administrative Procedure Act (APA), codified as amended at 5 U.S.C. § 551 et seq., federal agencies, in sum, are

limited to: (i) rulemaking; and (ii) conducting adjudications. It is important to note that statements of Staff members are neither the latter nor the former. Unless the SEC’s Commissioners carry-out a vote pursuant to the applicable administrative procedures, statements by either the SEC’s Chairman or SEC Directors are isolated Staff statements and not statements of the SEC itself.

<sup>26</sup> *Id.*

<sup>27</sup> Framework for ‘Investment Contract’ Analysis of Digital Assets, *supra* n.19.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> The difficulty in assessing whether or not a digital asset is a security does not stem in the ambiguity of the *Howey* test itself, but rather in the reality that a digital asset can have two practical uses simultaneously. In fact, one can argue, *Howey* has over time proven to provide a means of clarity in regulating instruments that otherwise are not addressed by federal securities laws. However, as it applies to digital assets, creating a more robust set of factors to facilitate the application of *Howey* will still not address the issue of whether or not a digital asset’s economic reality resembles that of a traditional security. Instead, the provided Framework may in fact complicate practitioners’ ability to conduct analysis on what digital assets may be deemed securities.

<sup>31</sup> See APA, codified as amended at 5 U.S.C. § 551 et seq.

<sup>32</sup> Post, Kollen, “SEC Commissioner CryptoMom Explains Planned ICO Safe Harbor to Cointelegraph,” Feb 11, 2020, <https://cointelegraph.com/news/sec-commissioner-cryptomom-explains-planned-safe-harbor-to-cointelegraph>.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> In fact, one can argue that it is the perception of the digital asset that changes in the eyes of the public rather than the economic reality of the digital asset itself. To realize its ultimate economic reality, a digital asset will need the appropriate technological infrastructure supporting its use. Prior to that

infrastructure being in place, the average consumer may find difficulty in perceiving what the instrument's economic reality actually may be. In contrast, once the digital asset's use can be realized through an established, well-functioning technological framework that has led to its wide-spread adoption and use, the average consumer's perception of the instrument's true economic reality will likely be changed.

<sup>36</sup> *Id.* (“Currently, Peirce is saying that such a network should make itself known to the SEC but have three years to establish itself as decentralized before having to worry about classification as a security”).

<sup>37</sup> *Howey*, 328 U.S. at 293.

<sup>38</sup> *Id.* at 301.

<sup>39</sup> When assessing a digital asset's transferability purpose, it is assumed that the holder of that digital asset owns no other rights that relate to the issuer of that asset (*e.g.*, dividend rights, voting rights, etc.).

<sup>40</sup> While the issuance of “tracking stock” is becoming more common in the marketplace, this form of capital raising will not be considered for the purposes of this article. In general, “tracking stock is a stock issued by a parent company that tracks the financial performance of a particular division. Tracking stocks trade in the open market separately from the parent company's stock. Tracking stocks are also known as targeted stocks.” Chen, James, “Tracking Stock,” *Investopedia*, May 8, 2019, <https://www.investopedia.com/terms/t/trackingstocks.asp>.

<sup>41</sup> Post, Kollen, “New Bill Would Presume That Digital Assets Are Not Securities in California,” May 6, 2020, <https://cointelegraph.com/news/new-bill-would-presume-digital-assets-not-to-be-securities-in-california>.

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> “Transferability,” in this instance, includes the buying or selling of the digital asset to represent: (i) equity in the issuer; or (ii) the right to cash flow derived from performance. The latter is further discussed, *supra*.

<sup>45</sup> Similarly, the Court in *Marine Bank* did not look to continuing efforts of the issuer in determining that

the certificates of deposits at issue were not securities. *See Marine Bank*, 455 U.S. 551; (*cf. Gary* where the Court included in its analysis the impact of Merrill Lynch's continued efforts on the underlying value of the certificate of deposits where in fact securities subject to federal securities laws).

<sup>46</sup> *See, e.g., Marine Bank*, 455 U.S., at 557-559, and n. 7, 102 S.Ct., at 1224-1225, and n. 7.

<sup>47</sup> Commodity Futures Trading Commission, *An Introduction to Virtual Currency* (2018) (“currencies have been determined to be commodities under the Commodity Exchange Act. While its regulatory oversight authority over commodity cash markets is limited, the US Commodity Futures Trading Commission [] maintains general anti-fraud and manipulation enforcement authority over virtual currency cash markets as a commodity in interstate commerce”).

<sup>48</sup> *See* Financial Crimes Enforcement Network, “Application of FinCEN's Regulations to Certain Business Models Involving Convertible Virtual Currencies” (2019) (“the label applied to any particular type of [convertible virtual currency (CVC)] (such as “digital currency,” “cryptocurrency,” “cryptoasset,” “digital asset,” etc.) is not dispositive of its regulatory treatment under the [Bank Secrecy Act]. Similarly, as money transmission involves the acceptance and transmission of value that substitutes for currency by any means, transactions denominated in CVC will be subject to FinCEN regulations regardless of whether the CVC is represented by a physical or digital token, whether the type of ledger used to record the transactions is centralized or distributed, or the type of technology utilized for the transmission of value.”)

<sup>49</sup> This article was completed but not yet published when Commissioner Pierce delivered her speech addressing the regulatory environment surrounding digital assets on July 21, 2020. *See* Pierce, Hester M., “Not Braking and Breaking,” <https://www.sec.gov/news/speech/peirce-not-braking-and-breaking-2020-07-21>.