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A False Sense of Security: How Congress and the SEC are Dropping the Ball on Cryptocurrency

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ABSTRACT

Today, companies use blockchain technology and digital assets for a variety of purposes. This Comment analyzes the digital token. If the Securities and Exchange Commission (SEC) views a digital token as a security, then the issuer of the digital token must comply with the registration and extensive disclosure requirements of federal securities laws.

To determine whether a digital asset is a security, the SEC relies on the test that the Supreme Court established in *SEC v. W.J. Howey Co*. Rather than enforcing a statute or agency rule, the SEC enforces securities laws by applying the *Howey* test on a fact-intensive case-by-case basis. This Comment takes the position that policymaking by enforcement is harmful to the financial technology industry and perpetuates the lack of clarity surrounding regulation of digital assets.

This Comment proposes a solution in which both Congress and the SEC play an integral role: 1) Congress should amend the Securities Act of 1933 and the Securities Exchange Act of 1934 to exclude "digital token" from the definition of "security"; and 2) the SEC should issue an agency rule that creates a grace period for digital tokens to become fully decentralized before the SEC may evaluate whether they are securities.

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* J.D. Candidate, Pennsylvania State University Dickinson Law, 2021. Thank you to my dear family for your unwavering love and support, and thank you to my friends who cheered me on and understood my vision before even I did.

I. INTRODUCTION

The more money we come across

The more problems we see[1]

Since the rise of cryptocurrency in 2009, entrepreneurs have used blockchain technology for a host of purposes including executing contracts, raising capital, and performing secure business transactions.[2] The problem is that the traditional structure of federal securities laws forces the otherwise rapidly developing financial

1. NOTORIOUS B.I.G., *Mo Money Mo Problems*, *on* LIFE AFTER DEATH (Bad Boy Records 1997).

2. MOHSEN ATTARAN & ANGAPPA GUNASEKARAN, APPLICATIONS OF BLOCKCHAIN TECHNOLOGY IN BUSINESS 19 (Suresh P. Sethi ed., 2019).

technology industry to a standstill.[3] Congress and the SEC have failed to provide the financial technology industry with clarity on how the federal securities laws apply to the sale of digital tokens.[4] Consequently, the SEC places sellers of digital tokens in a precarious position of uncertainty as to whether they are in violation of federal securities laws because the SEC sometimes views a modern token sale as an illegal sale of unregistered securities.[5] The distinction between a digital token and a security is significant because a company that issues a security must comply with costly federal registration and reporting requirements.[6] The SEC often pursues enforcement actions against such companies, and it justifies these actions with: (1) the traditional definition of "security"; (2) a legal test unequipped to account for the dynamic characteristics of digital tokens; (3) nonbinding agency-issued guidance; and (4) the SEC's purpose to protect investors.[7] However, these justifications are unclear together and lead to inconsistent enforcement and uncertainty in the digital token space.

Today's widespread use of digital assets presents regulators with a fresh opportunity to protect investors and facilitate innovation.[8] This Comment takes the position that Congress should legis-

3. *See* Part II.C.2 (describing the effects of unclear regulation in the U.S. by comparing different outcomes for different companies).

4. *See* Report of Investigation, Exchange Act Release No. 81207, 117 SEC Docket 745 (July 25, 2017), 2017 WL 7184670, at 17–18 [hereinafter DAO Report]; *Framework for "Investment Contract" Analysis of Digital Assets*, SEC, http://bit.ly/2TpScJI [https://perma.cc/YZC3-T6P7] (last visited Sept. 18, 2020) [hereinafter Framework]; SEC. v. W.J. Howey Co., 328 U.S. 293 (1946).

5. *See* Part III.A. (discussing the downfalls of the SEC's current regulatory enforcement procedure for digital tokens).

6. THERESA A. GABALDON & CHRISTOPHER L. SAGERS, BUSINESS ORGANIZATIONS 909 (2d. ed. 2019) ("Exchange Act compliance costs a company at least a few tens of thousands of dollars annually in legal, accounting, and printing costs. Beyond those expenses, a publicly held company has the annual fees of a transfer agent and registrar and the costs involved with continued dealings with securities analysts and shareholders.").

7. *See* Part II.B (reviewing the Securities Act of 1933, Securities Exchange Act of 1934, *Howey* test, and recent enforcement actions that cite the *Howey* test—a common law test established well before digital assets were even possible).

8. *See* Financial Services Committee, *Oversight of the Securities and Exchange Commission: Wall Street's Cop on the Beat*, YOUTUBE (Sept. 24, 2019), https://bit.ly/3gFY23U [https://perma.cc/RYM8-ACKD] (explaining that the United States's lack of regulatory clarity harms both companies and investors).

> This company-by-company approach prevents regulatory clarity . . . . For this reason, although innovators are in America, and innovation is still occurring in America, capital is fleeing—not to avoid our regulations but to find efficient regulatory clarity—and they are finding it elsewhere. We need a simple set of rules that apply equally and clearly to all. . . . Where is the capital going? Places like Singapore, the U.K., Switzerland have laid out clear frameworks for digital assets. Meanwhile, in the United

late and federal regulators should initiate rulemaking to remedy the regulatory uncertainty, rather than stand aside while the SEC regulates digital assets through enforcement using a legal test and other ineffectual justifications that were built for the analog age.[9]

Part II of this Comment will explain the technological platform on which digital assets function and the characteristics and potential uses for such a platform.[10] It will then transition to the governing law by reviewing the relevant provisions of the two major federal statutes governing securities and the leading Supreme Court opinion that establishes how to determine whether an instrument falls within the statutory definition of a security.[11] Finally, this Comment connects digital assets to the law by demonstrating how federal securities laws apply to digital tokens and illustrating the unintended consequences of regulation by enforcement.[12] This Comment ultimately urges Congress and the SEC to adopt a new regulatory framework for digital tokens that would equally protect token purchasers and issuers while allowing the industry to thrive.[13]

II. BACKGROUND

A. How Cryptocurrency Works

1. Blockchain

Blockchain is a distributed ledger technology that operates on a "peer-to-peer" network[14] to which computers connect ("the network").[15] The "peer-to-peer" terminology refers to the equality of the nodes—the computers connected to the network.[16] Nodes are all equal peers to each other in that they all have equal access to the data stored on the server and equally share the burden of providing

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> States, hundreds of companies await no-action letters, with only two having been issued thus far by the SEC. . . . Consumers and investors are harmed by that status quo.

Id.

9. *See* Part III.B.

10. *See* Part II.A.

11. *See* Part II.B.1–2.

12. *See* Part II.B.3–III.A.1.b.

13. *See* Part II.B–C; Part III.

14. A peer-to-peer network is one that connects two users directly without the need for a third-party intermediary. Ameer Rosic, *What is Blockchain Technology? A Step-by-Step Guide for Beginners*, BLOCKGEEKS, http://bit.ly/2ruWeWJ [https://perma.cc/G6EE-ZKR8] (last visited Sept. 18, 2020) [hereinafter Rosic, *What is Blockchain*].

15. *Id.* at 8.

16. Rosic, *What is Blockchain*, *supra* note 14.

essential network services such as verifying transactions.[17] Blockchain is analogous to a "global spreadsheet" as blockchain globally stores data on the network and allows anyone on the network to view a time-stamped record of network activity.[18] Real-time changes and modifications are visible to those who are connected to the network.[19]

2. Cryptocurrency Exchange

Before one actor can send cryptocurrency to another, the network must verify the transaction to ensure that no one modified or tampered with the file.[20] The network likewise must verify an actor's identity to prevent fraudulent use of another's payment information.[21] Verifying a transaction requires algorithms to solve a series of extraordinarily complex mathematical problems.[22] Any

17. *Id.* In an open blockchain, access to the internet is the only requirement for a node to view the network data. ANDREAS M. ANTONOPOULOS, MASTERING BITCOIN 139 (Mike Loukides & Allyson MacDonald eds., 1st ed. 2014).

18. MINGXING XU, YING TIAN, & JIYUE LI, BLOCKCHAIN: AN ILLUSTRATED GUIDEBOOK TO UNDERSTANDING BLOCKCHAIN 41 (Jie Liu trans., 2018). *See also* ETHERSCAN, http://bit.ly/2CBtCxA [https://perma.cc/3S35-WX3S] (last visited Sept. 18, 2020) (providing an example of blockchain).

19. XU, *supra* note 18, at 18 ("Once the ledger is altered, the modification of all replica data will be completed in minutes or even seconds. Every transaction in distributed ledgers has a unique timestamp to avoid duplicate payment.").

20. *See* haseebrabbani, *What is Hashing & Digital Signature in the Blockchain?*, BLOCKGEEKS (Oct. 12, 2017, 12:24 PM), http://bit.ly/2q2JxlM [https://perma.cc/PM9B-F7Z2]. Every new block must obtain a unique hash (signature), which is created by a cryptographic hash function, a formula that transforms input data into a "unique 64-digit string of output." Jimi S., *How Does Blockchain Work in 7 Steps — A Clear and Simple Explanation*, GOOD AUDIENCE BLOG (May 6, 2018), http://bit.ly/2CArBS4 [https://perma.cc/8B3X-95DT]. Each signature must comply with the blockchain's requirements. *Id.* For example, a blockchain could require each new signature to begin with ten consecutive zeroes. *Id.* Miners use their computer power to verify transactions by running software that uses trial and error to find a valid signature for a new block. IMRAN BASHIR, MASTERING BLOCKCHAIN: DISTRIBUTED LEDGER TECHNOLOGY, DECENTRALIZATION, AND SMART CONTRACTS EXPLAINED 167–68 (2d. ed. 2018). As the quantity of zeroes that a signature requires increases, the amount of computer power necessary to validate the transaction also increases; thus, a signature that requires a greater quantity of zeroes is very difficult to verify. *Id.* at 167–172. For a simple example of the effects of increasing difficulty, see Kiran Vaidya, *Decoding the Enigma of Bitcoin Mining—Part I: Mechanism*, MEDIUM BLOG (Dec. 14, 2016), https://bit.ly/3g19nLs [https://perma.cc/964C-CUN7].

21. *See Why Has My ID Submission Been Rejected?*, BLOCKCHAIN SUPPORT, http://bit.ly/2O2K0MH [https://perma.cc/Y2RZ-4KQB] (last visited Sept. 18, 2020).

22. *See* Eric Rykwalder, *The Math Behind Bitcoin*, COINDESK (Oct. 19, 2014, 1:08 PM), http://bit.ly/2pTbTPv [https://perma.cc/Z6XN-F67Y] (explaining private and public keys, the formulas involved in each, and how they secure cryptocurrency). The odds of solving one of these problems on the Bitcoin network were

node with enough processing power can verify a transaction.[23] Miners[24] attempt to verify transactions and earn a small transaction fee for successfully doing so.[25] Further, public-private key encryption allows a sender of cryptocurrency to ensure that only the intended recipient can decrypt messages.[26]

Once the network validates the transaction and the actor's identity, the network groups the verified transaction with other verified transactions to create a "block."[27] The network then attaches the block to the existing "chain" in the network, hence the title "blockchain."[28] At a minimum, a blockchain will record and add to

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about 1 in 17.6 trillion in September 2020. *Difficulty*, BTC.COM, https://bit.ly/2BDyipq [https://perma.cc/TM83-QPV7] (last visited Sept. 18, 2020) (graphing the current height of the Bitcoin blockchain and the measure of how difficult it is to mine a Bitcoin block, among other statistics).

23. BASHIR, *supra* note 20, at 167, 173–74. Verification does not require the efforts of every computer on the network. *See id.* at 167–68 (describing the mining process). Such a requirement would heavily burden the verification process and destroy blockchain's efficiency. Instead, once the mining nodes successfully verify a transaction and add a new block to the chain, all computers on the network can view the new addition and all transaction history in real time. XU, *supra* note 18, at 39. The opportunity to earn transaction fees is the reason miners purchased unprecedented quantities of graphics cards and customized hardware in 2018—to multiply their computer processing power and consequently increase their computers' capacities to verify transactions. Tom Warren, *Bitcoin Mania is Hurting PC Gamers by Pushing Up GPU Prices*, THE VERGE (Jan. 30, 2018, 7:42 AM), https://bit.ly/3d93daX. Increase in demand and product shortages caused graphics card prices to nearly double. *Id.* ("[P]ricing for Nvidia's GeForce GTX 1070 should be around $380 . . . but . . . some cards are now being sold for more than $700 due to the stock shortages—an increase of more than 80 percent.").

24. Miners are network participants who solve mathematical problems to create the next "block" on the ledger of transactions. ISHAN ROY, BLOCKCHAIN DEVELOPMENT FOR FINANCE PROJECTS loc. Sec. 1, Chapter 4 (Packt Publishing 2020) (ebook). *See also* Jimi S., *supra* note 20 and accompanying text (explaining how miners verify transactions).

25. BASHIR, *supra* note 20, at 168; *see, e.g.*, *Predicting Bitcoin Fees for Transactions*, EARN, http://bit.ly/2p8kSf3 [https://perma.cc/8ZYX-W4Q3] (last visited Sept. 18, 2020) (explaining that, in September 2020, "the fastest and cheapest transaction fee [for Bitcoin] . . . [was] 120 satoshis/byte"). A satoshi is the smallest unit of Bitcoin and is equivalent to a 100 millionth of a bitcoin. Jake Frankenfield, *Satoshi*, INVESTOPEDIA (June 27, 2020), http://bit.ly/33PCPOs [https://perma.cc/CZ5Y-GM65].

26. PRIMAVERA DE FILIPPI & AARON WRIGHT, BLOCKCHAIN AND THE LAW: THE RULE OF CODE (2018) 14–16.

27. *Id.* at 22. Verified transactions are grouped together to form a single block ("Bundles of . . . transactions are grouped together into separate 'blocks,' which Bitcoin's protocol links together to form a sequential, timestamped 'chain.'").

28. *See* SATOSHI NAKAMOTO, BITCOIN: A PEER-TO-PEER ELECTRONIC CASH SYSTEM 7 (2008), http://bit.ly/2QadxVL [https://perma.cc/RG7E-NNHX] (referring to the distributed ledger as "a chain of blocks").

the "digital spreadsheet" the hash[29] and size of a newly created block, the amount of currency involved in an exchange, the miner who successfully verified a transaction,[30] and the blockchain's new total height.[31]

a. Digital Tokens versus Digital Coins

Though Bitcoin was the first and most widely-known digital coin, thousands of different cryptocurrencies exist on the market, and more cryptocurrenices are introduced to the market nearly every day.[32] In the span of only ten months between October 2019 and September 2020, the quantity of cryptocurrencies on the market more than tripled, averaging 15 new cryptocurrencies per day.[33]

In ordinary language, the words "token" and "coin" both describe a valuable object that is exchangeable for a good or service.[34] However, in the context of digital assets, these two terms are not interchangeable.[35] A digital coin is an asset that is native to its own blockchain and resembles cash in that users can use digital coins to make payments.[36] However, developers can contrive digital assets to function more complexly than typical payment methods.[37] De-

29. A hash is a block's unique identifier or "digital signature." ARVIND MATHARU, UNDERSTANDING CRYPTOCURRENCIES 12 (2019). *See also* Jimi S., *supra* note 20.

30. *See* Jimi S., *supra* note 20.

31. *See* ETHERSCAN, *supra* note 18. Blockchain increases in "height" as the network adds new blocks. *Id.* To view an example of a block height, see *Block #10616540*, ETHERSCAN, https://bit.ly/2DH5b5E [https://perma.cc/B429-ZUNT] (last visited Sept. 18, 2020).

32. *See Top 100 Cryptocurrencies by Market Capitalization*, COINMARKETCAP, http://bit.ly/32BL0g0 [https://perma.cc/LUH4-634G] (last visited Sept. 18, 2020) (listing Bitcoin as the number one cryptocurrency by market capitalization); Ameer Rosic, *What Is Cryptocurrency? [Everything You Need to Know!]*, BLOCKGEEKS, http://bit.ly/2CENQq0 [https://perma.cc/SRT4-ER86] (last visited Sept. 18, 2020).

33. *See* COINMARKETCAP, *supra* note 32 (listing 7,106 cryptocurrencies as of September 18, 2020). In October 2019, CoinMarketCap listed 2,069 cryptocurrencies. *Id.*

34. *Token*, LEXICO, http://bit.ly/2RsQI1j [https://perma.cc/93GP-B2RS] (last visited Sept. 18, 2020); *Coin*, LEXICO, http://bit.ly/2GssVbz [https://perma.cc/AR74-B34N] (last visited Sept. 18, 2020).

35. Citowise, *The Basics: Coin vs. Token. What Is the Difference?*, MEDIUM BLOG (Jan. 22, 2018), http://bit.ly/2Kbi0W9 [https://perma.cc/M8T7-HHME].

36. *Id.* Bitcoin was the first digital coin. *Id.* Bitcoin owners can pay others and accept payment from others in Bitcoin. *Id.* AT&T became the first mobile carrier to accept online phone bill payments in cryptocurrency. Kathleen Joyce, *AT&T Says It Will Accept Payments in Cryptocurrency*, FOXBUSINESS (May 24, 2019), https://fxn.ws/2NAVOH5 [https://perma.cc/TVD8-KQA7]. Microsoft, Overstock.com, Nordstrom, Whole Foods, and GameStop also accept payments in cryptocurrency. *Id.*

37. ATTARAN, *supra* note 2, at 17–19 (2019).

velopers can attach any sort of value to a digital token, including access to a gaming license or document, voting rights, or the ability to partake in an activity.[38]

3. Characteristics of Blockchain

Three unique characteristics of blockchain make it particularly attractive to users: 1) decentralization, 2) security, and 3) efficiency.[39]

a. Decentralization

In a centralized system, users depend on a single authority to fully control and manage all data on the network.[40] If a centralized server crashes, users will be unable to access the data, and if a hacker breaches the centralized server, all data is compromised. Most online service providers use centralized servers, including Amazon, eBay, Facebook, Google, and YouTube, which is why each of these providers adopts a privacy policy to explain to users how the central authority manages users' data.[41] On the contrary, blockchain is a decentralized system.[42] The adjective "decentralized" describes the independent nature of the peer-to-peer network.[43] Unlike the network in a centralized system, a blockchain has no central authority that single-handedly owns, controls, and manages network data.[44] A blockchain also does not store its data in a single location. Instead, it distributes its data and provides equal access to network data to all computers on the network.[45] For these reasons, blockchain is a true "democratized system."[46]

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38. Tim Falk, *The Difference Between Cryptocurrency Coins and Tokens*, FINDER (Mar. 14, 2019), http://bit.ly/32yPHY9 [https://perma.cc/DC69-RMA8].

39. BASHIR, *supra* note 20, at 24–25.

40. DE FILIPPI, *supra* note 26, at 55–56 ("Today, algorithms are centrally controlled, deployed[,] and stewarded by online intermediaries, which . . . retain control over these algorithms and the power to tweak them or shut them off if necessary.").

41. BASHIR, *supra* note 20, at 44.

42. ARVIND MATHARU, UNDERSTANDING CRYPTOCURRENCIES 17 (2019). The "decentralized" characteristic of blockchain is significant to this Comment's proposed regulatory scheme. *See infra* note 193 and accompanying text.

43. *See* BASHIR, *supra* note 20, at 44 ("A decentralized system is a type of network where nodes are not dependent on a single master node; instead, control is distributed among many nodes.").

44. *Id.*

45. *Id.*

46. Rosic, *What is Blockchain*, *supra* note 14.

b. Security

Blockchain transactions are highly secure because no single person or entity owns a blockchain, and a blockchain has no central control room from which a person can alter or control the ledger.[47] Unlike a centralized network,[48] the decentralized network distributes to each computer a real-time copy of the chain as it expands and transforms.[49] Further, once the network verifies a transaction, creates a block, and adds the block to the chain, the network assigns a "hash" to the block.[50] The hash is comparable to a digital fingerprint in that no two hashes are identical.[51] The new block records both its own hash and the previous block's hash to which the new block attaches, thus creating an unbreakable chain of entirely unique blocks.[52] Even a slight alteration to a single block's hash will alter each of the connected blocks' hashes.[53] When a user alters a block, the altered block detaches from the chain and immediately notifies the network of the modification, causing the network to automatically reject the alteration.[54] To hack or otherwise alter a blockchain, a hacker would have to obtain enough computing power to outnumber all other network participants.[55] The inability to alter a block is referred to as "immutability."[56]

c. Efficiency

Finally, cryptocurrency transactions on the blockchain can be far more efficient than alternatives such as wire transfers and credit card transactions.[57] Wire transfers that involve more than one type

47. *See* Jimi S., *supra* note 20.

48. *Supra* Part II.A.3.a ("[I]f a hacker breaches the [centralized] server, all data is compromised.").

49. XU, *supra* note 18, at 39; Jimi S., *supra* note 20. To successfully alter one block, a hacker would have to keep the block attached to the chain by rapidly assigning new hashes to each block on the chain. Jimi S., *supra* note 20. This task would be possible only if the hacker possessed more computing power than the aggregate of the other computers on the network. *Id.*

50. Jimi S., *supra* note 20.

51. *Id.*

52. *Id.*

53. XU, *supra* note 18, at 29; *accord* Rosic, *What is Blockchain*, *supra* note 14. This consequence is fittingly called the "Avalanche Effect." Rosic, *What is Blockchain*, *supra* note 14.

54. *See* Jimi S., *supra* note 20.

55. *See* DE FILIPPI, *supra* note 26, at 113 (reporting the cost of performing a 51% attack as more than $1 billion in 2018). Recall there can be thousands of computers in the network. Jimi S., *supra* note 20.

56. ATTARAN, *supra* note 2, at 13.

57. Lori Tripoli, *Regulators Wary of Crypto as Digital Assets Go Mainstream*, COMPLIANCE WEEK (Nov. 20, 2019, 3:57 PM), http://bit.ly/34L7mwQ [https://perma.cc/68ML-G779].

of currency illustrate the benefits to utilizing blockchain.[58] In such transactions, parties often must use banks to convert one currency to another currency and thus must complete transactions within normal banking hours.[59] Working within business hours can be particularly problematic when parties transfer money from one time zone to another.[60] On the contrary, a transfer of cryptocurrency does not require any conversions and will transfer instantaneously without time-of-day restrictions.[61]

4. Other Applications of Blockchain

The financial technology industry is just one of the countless industries that uses blockchain technology.[62] Blockchain's decentralization, security, and efficiency attract a variety of markets to utilize blockchain for purposes such as smart contracts[63], supply chain management[64], and voting.[65]

Ethereum is a "programmable blockchain" that allows developers to write code to control the exchange of their cryptocurrency.[66] Users can create "smart contracts": contracts which "self-execute the stipulations of an agreement when predetermined conditions are triggered."[67] The parties to the contract agree on the terms and conditions that will trigger execution of the contract and write them into the code, and the network records the details of the smart contract on the blockchain.[68] For example, the French airline AXA began using smart contracts in 2018 to distribute flight-delay

58. *Id.*

59. *Id.*

60. *Id.*

61. *Id.*

62. *See* Scott D. Hughes, *Cryptocurrency Regulations and Enforcement in the U.S.*, 45 W. ST. L. REV. 1, 4 (2017); *see also* Speech, Bill Hinman, Dir. of Div. of Corp. Fin., SEC, Digital Asset Transactions: When Howey Met Gary (Plastic) (June 14, 2018), https://bit.ly/3fF6OOc [https://perma.cc/4Q3F-TWEM] [hereinafter Hinman Speech].

63. XU, *supra* note 18, at 55–57.

64. Id. at 82.

65. Id. at 73; *see also* FOLLOW MY VOTE, http://bit.ly/34PAR0J [https://perma.cc/C6EC-B5H5] (last visited Sept. 18, 2020) ("Using the unparalleled security of blockchain technology, we are poised to disrupt the established voting industry by offering a more cost-effective and technologically superior solution.").

66. *See generally* ETHEREUM, http://bit.ly/2Q9SVyO [https://perma.cc/34MH-KSWT] (last visited Sept. 18, 2020).

67. *See id.*; Reggie O'Shields, *Smart Contracts: Legal Agreements for the Blockchain*, 21 N.C. BANKING INST. 177, 179 (2017).

68. Ameer Rosic, *Smart Contracts: The Blockchain Technology That Will Replace Lawyers*, BLOCKGEEKS, http://bit.ly/2Kb5fuL [https://perma.cc/VLW8-Q8DV] (last visited Sept. 18, 2020).

insurance payouts to flight insureds.[69] For AXA, a flight delay of two hours or more is the predetermined condition that triggers execution of the smart contract.[70] The smart contract receives information from global air traffic databases and automatically initiates payment to insureds once the blockchain registers a two-hour delay.[71]

In light of recent food-borne illnesses and contamination outbreaks, Walmart now uses blockchain technology to trace the origin and processing steps of food inventory, including fresh meat and vegetables.[72] Farmers and food suppliers enter data about the food into the blockchain database so Walmart can, in a matter of seconds, precisely pinpoint when food will spoil or which food is at risk of contamination during a food-borne illness outbreak.[73] Walmart estimates that its new ability to better manage the shelf life of its products will save it billions of dollars.[74]

Finally, Follow My Vote utilizes blockchain technology and cryptography to create an anonymous, fraud-proof, and transparent online voting platform where voters can "independently audit the ballot box."[75] Each vote is a transaction on the blockchain that requires verification by the network.[76]

B. Transformation of U.S. Securities Laws

Understanding all intricacies of federal securities laws is beyond the scope of this Comment. However, an overview of the first major securities laws, the controlling Supreme Court case, and a few recent SEC actions illustrate the process by which regulators apply traditional securities laws to cryptocurrency.

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69. Maria Terekhova, *AXA Turns to Smart Contracts for Flight-Delay Insurance*, BUS. INSIDER (Sept. 15, 2017, 9:48 AM), http://bit.ly/2QjldXJ [https://perma.cc/5R64-BS2Z].

70. *Id.*

71. *Id.*

72. Michael Corkery & Nathaniel Popper, *From Farm to Blockchain: Walmart Tracks Its Lettuce*, N.Y. TIMES (Sept. 24, 2018), https://nyti.ms/2X8XBGC [https://perma.cc/F5RL-8Z9B] (raising questions about the necessity of a distributed database when Walmart already stores all of its blockchain records on IBM's cloud). A major benefit of blockchain technology is that it removes the need for a third-party intermediary, but IBM is serving as such by hosting the data on its cloud. *Id.*

73. *See id.*

74. XU, *supra* note 18, at 82.

75. FOLLOW MY VOTE, http://bit.ly/34PAR0J [https://perma.cc/C6EC-B5H5] (last visited Sept. 18, 2020).

76. *Blockchain Technology in Online Voting*, FOLLOW MY VOTE, http://bit.ly/32CHfqL [https://perma.cc/VVL7-XF6H] (last visited Sept. 18, 2020).

1. The Securities Act of 1933 and the Securities Exchange Act of 1934

Congress enacted the Securities Act of 1933 ("the Securities Act")[77] and its sister statute, the Securities and Exchange Act of 1934 ("the Exchange Act"),[78] to protect investors.[79] The Securities Act, often referred to as the "Truth in Securities Act," regulates the issuance of securities while the Exchange Act regulates the trading of securities on the secondary market.[80] The Securities Act defines the term "security" broadly to include stocks, bonds, profit-sharing interests, and the ambiguous catch-all term, "investment contracts."[81] Companies that sell securities to the public must register their securities with the SEC.[82] These registration requirements oblige the issuing company to publish information about the company and the securities it offers for sale to allow investors to make informed investment decisions.[83] A company that sells unregistered securities violates the Securities Act, but notably, only the offering of a *security* will trigger the registration requirements.[84] Because of the serious legal implications of selling unregistered securities, parties wishing to issue digital tokens frequently contend with whether a digital token is a security.

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77. Securities Act of 1933, 15 U.S.C. §§ 77a–mm (2018).

78. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–qq.

79. *See* Securities Act of 1933, 15 U.S.C. § 77b(b) ("[T]he Commission shall . . . consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.").

80. 15 U.S.C. §§ 77a–mm, 78a–qq (2018). This Comment discusses SEC enforcement actions against companies for perceived violations of the Securities Act rather than the Exchange Act but ultimately recommends Congress amend the definition of "security" in both the Securities Act and the Exchange Act. *See* 15 U.S.C. § 77b(a)(1) (defining "security" in the Securities Act); 15 U.S.C. § 78c(a)(10) (defining "security" in the Exchange Act).

81. 15 U.S.C. § 77b(a)(1) ("The term 'security' means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, . . . investment contract, ...").

82. *See* 15 U.S.C. § 77e (2018).

83. *See id.* §§ 77f–g. Registration forms require the company to disclose relevant information including a description of the security to be offered for sale and the company's business, ownership, capital structure, and financial health. *Id.*; *see also* SEC, RELEASE NO. 81207, REPORT OF INVESTIGATION PURSUANT TO SECTION 21(A) OF THE SECURITIES EXCHANGE ACT OF 1934: THE DAO 10 (2017).

84. *See* 15 U.S.C. § 77f(a) (2018).

2. The Howey *Test*

In *SEC v. W.J. Howey Co.*,[85] the U.S. Supreme Court established a test to interpret "investment contract," the ambiguous, catch-all term in the Securities Act.[86]

In *Howey*, two Florida corporations were in the business of selling, servicing, and managing orange groves.[87] The corporations offered to sell two types of contracts: land and service.[88] Under the land contract, a purchaser would pay a price per acre in exchange for conveyance of the land.[89] However, under the service contract, a purchaser would not pay for the land itself but rather the right to the profits generated by the orange groves on the land.[90] A purchaser would have no right to market the oranges—rather, the corporation would have "full discretion and authority over the cultivation of the groves and the harvest and marketing of the crops."[91] The Court defined an investment contract as "a contract, transaction[,] or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party . . . ."[92] Applying this "*Howey* test," the Court found the service contract to be an investment contract because the sellers offered the service contract to purchasers who lacked both the knowledge and means to, themselves, care for and make money off of the orange crops.[93] The purchasers were "attracted solely by the prospects of a return on their investment," and to obtain such a profit, they relied on the efforts of others.[94]

Though the *Howey* test is over 70 years old, courts today apply the *Howey* test to determine whether a digital token is a security.[95] This analysis is complex because a digital token *itself* is not necessarily an investment contract, and the court must analyze the totality of the circumstances surrounding the transaction.[96] For example, a court would likely consider a token to be an investment contract if a

85. SEC v. W.J. Howey Co., 328 U.S. 293 (1946).
86. *Id.* at 296–97.
87. *Id.* at 294–95.
88. *Id.* at 295.
89. *Id.*
90. *Id.* at 296–97. Investment contracts are securities under the Securities Act. 15 U.S.C. § 77a(1) (2018).
91. *Id.* at 296.
92. *Id.* at 298–99.
93. *Id.* at 296, 299.
94. *Id.* at 300.
95. SEC v. Telegram Grp. Inc., No. 19-civ-9439, 2020 WL 1430035, at *9–18 (S.D.N.Y. 2020); *see also* DAO Report, *supra* note 4, at *8.
96. Hinman Speech, *supra* note 62.

person purchased the token with the expectation of profiting off of the token's increase in value.[97]

3. The DAO Report

In July 2017, the SEC applied the *Howey* test to a digital token and, in its infamous "DAO Report," it announced that the token was a security.[98]

The Decentralized Autonomous Organization[99] ("DAO") built a smart contract on the Ethereum blockchain[100] to form a crowdfund that allowed people to pitch project ideas to the DAO community and potentially receive funding.[101] Any person could exchange Ether[102] for DAO tokens that allowed token-holders to vote on project plans and receive rewards from profitable projects.[103] In July 2017, the SEC issued the DAO Report announcing that the DAO tokens were securities and those who issued them were therefore in violation of federal securities laws.[104] Such a finding shocked the cryptocurrency industry because the industry did not view coin offerings as securities prior to publication of the DAO Report.[105]

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97. DAO Report, *supra* note 4, at 11–12; *see also id.*

98. DAO Report, *supra* note 4, at 1.

99. While "The DAO" is the name of a particular company, the term "DAO" refers to a company that encodes a set of rules as a smart contract and fundraises so that it can function on its own without the "hierarchical management" of a traditional company. *What is DAO*, COINTELEGRAPH, https://bit.ly/2UAi9Zm [https://perma.cc/4X45-E37X] (last visited Sept. 18, 2020). The DAO, as referred to in this Comment, is the name of one of such decentralized organizations. *Id.*

100. Ethereum is a "programmable blockchain" that allows developers to write code to control the exchange of their cryptocurrency. *See generally* ETHEREUM, http://bit.ly/2Q9SVyO [https://perma.cc/TZZ5-QY8C] (last visited Sept. 18, 2020) (describing the ability of Ethereum users to write code on the Ethereum blockchain, which users can access from anywhere in the world, that controls digital value and runs exactly as programmed).

101. Brian Ray, *Article: Blockchain Symposium Introduction: Overview and Historical Introduction*, 67 CLEV. ST. L. REV. 1, 8 (2019); *see also* Samuel Falkon, *The Story of the DAO — Its History and Consequences*, MEDIUM BLOG (Dec. 24, 2017), http://bit.ly/2PM253N [https://perma.cc/M6YT-FRLU].

102. Ether is the digital coin native to the Ethereum blockchain. *What Is Ethereum?*, ETHEREUM, https://bit.ly/2Vj7f9D [https://perma.cc/UV2Y-6FDR] (last visited Sept. 18, 2020). For a description of the Ethereum blockchain, see *supra* text accompanying note 100.

103. DAO Report, *supra* note 4, at *2. Ether is a cryptocurrency that users can purchase and exchange like money. *Id.*

104. *Id.* at *1.

105. Ray, *supra* note 101, at 7. For a simplified explanation of the SEC's findings, see also Jon Buck, *Forewarned Is Forearmed: Key Takeaways from SEC DAO Report*, COINTELEGRAPH (Jul. 30, 2017), http://bit.ly/390VsSF [https://perma.cc/N25R-N8TB].

The SEC did not file charges against The DAO, but the DAO Report rapidly spread throughout the cryptocurrency industry and served as notice that a digital tokens may be an investment contract and therefore trigger the Securities Act's registration requirements.[106] This new distinction was significant because it meant that any issuer of digital tokens was potentially in violation of federal securities laws, and it forced companies pursuing future digital token projects to reconsider doing so.[107]

While the DAO Report was the SEC's first step toward creating a regulatory scheme for digital tokens, the SEC carefully noted that it had not adopted a bright-line rule for analyzing whether a digital asset is a security.[108] Commissioner Hester Peirce explained that "the application of *Howey* to one particular ICO [(initial coin offering)] does not answer every question."[109] In fact, the scope of the DAO Report was strictly limited to The DAO tokens.[110] Despite its limited reach, the DAO Report had a widespread impact on the industry: it clarified that the SEC will evaluate the facts, circumstances, and economic realities of digital tokens on a fact-specific, case-by-case basis.[111] The SEC cautioned companies planning to issue digital tokens against making decisions based solely on the DAO Report and advised them to seek the advice of attorneys with expertise in federal securities laws.[112]

4. Framework for Analyzing Digital Assets and the TurnKey Jet No-Action Letter

Three years later, the SEC published agency guidance entitled "Framework for 'Investment Contract' Analysis of Digital Assets."[113] The Framework is expansive and provides an exhausting

106. DAO Report, *supra* note 4, at *12–14.

107. *Id.* at 16.

108. *Statement by the Divisions of Corporation Finance and Enforcement on the Report of Investigation on the DAO*, SEC (July 25, 2017), http://bit.ly/35KOgIm [https://perma.cc/ML5B-6Z94] ("[T]he issue of whether a particular investment opportunity involves the offer or sale of a security . . . depends on the facts and circumstances, including the economic realities and structure of the enterprise.").

109. Hester M. Peirce, *Wolves and Wolverines: Remarks at the University of Michigan Law School*, SEC (Sep. 24, 2018), http://bit.ly/2Miif2v [https://perma.cc/MRY2-KJH3].

110. *See* DAO Report, *supra* note 4, at *1.

111. *Id.* at 17–18.

112. Jay Clayton, Chairman, SEC, Statement on Cryptocurrencies and Initial Coin Offerings (Dec. 11, 2017), http://bit.ly/2Q6M2fS [http://bit.ly/2Q6M2fS]; *see also infra* Part III.A.1 (describing the challenges a company faces when applying SEC agency guidance to understand how the SEC will view a digital token offering under federal securities laws).

113. Framework, *supra* note 4.

but "not intended to be an exhaustive" list of over 30 factors that a court will consider to decide whether a digital token is a security under *Howey*.[114] For example, the ability of token holders to trade or transfer a token on the secondary market favors the conclusion that users have a reasonable expectation of profit under *Howey*.[115] A token whose holder can immediately use the token for its intended functionality or whose issuers market the token by emphasizing the token's functionality, rather than the token's potential for appreciation in value, is less likely to meet the *Howey* test.[116]

The Framework is problematic because its contents are not legally binding on the SEC.[117] The SEC merely intended the Framework as "[s]taff guidance"—an "analytical tool" to evaluate digital assets.[118] While the SEC's intention for the Framework was to guide digital asset creators in determining if federal securities laws apply to their digital assets,[119] the Framework seems to confuse market participants. Instead, the Framework may more realistically function as a guide for judges to navigate litigation[120] as the Framework describes the *Howey* test as an objective test with a focus on the "transaction itself and the manner in which the digital asset is offered and sold."[121]

Alongside the Framework, the SEC issued its first no-action letter regarding digital tokens to TurnKey Jet, Inc. ("TKJ").[122] A

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114. *Id.*
115. *Id.*
116. *Id.*
117. Hinman Speech, *supra* note 62.
118. *Id.*
119. Framework, *supra* note 4.
120. RECENT GUIDANCE: SECURITIES REGULATION—FINANCIAL TECHNOLOGY—SEC PROVIDES ANALYTICAL TOOLS FOR ASSESSING DIGITAL ASSETS.—SEC, FRAMEWORK FOR "INVESTMENT CONTRACT" ANALYSIS OF DIGITAL ASSETS, 132 HARV. L. REV. 2418, 2422 (2019).
121. *Id.* In *SEC v. Blockvest, LLC*, the court denied the SEC's motion for injunction and found that the Commission failed to show that investors purchased the digital assets with an expectation of making profits from the efforts of others. SEC v. Blockvest, LLC, No. 18-cv-2287, 2018 WL 6181408, at *7 (S.D. Cal. Nov. 27, 2018). Upon reversal, the court agreed with the SEC that the *Howey* test is "unquestionably an objective one" but disagreed that the court had previously applied a subjective test. SEC v. Blockvest, LLC, No. 18CV2287-GPB(BLM), 2019 WL 625163 at *5 (S.D. Cal. Feb. 14, 2019). The Framework's emphasis on the objectivity of the *Howey* test seems to directly reference the SEC's disagreement between the courts in *Blockvest*.
122. Letter from Jonathan A. Ingram, Chief Legal Advisor, Finhub, Division of Corporate Fanance, SEC to TurnKey Jet, Inc., 2019 WL 1471132, at *1 (April 3, 2019) [hereinafter TurnKey Letter]. As of January 2020, TurnKey Jet, Inc. was the first of only two companies to receive a no-action letter from the SEC. *Id.* Pocketful of Quarters was the second company to receive a no-action letter. Letter from Jonathan A. Ingram, Chief Legal Advisor, FinHub, Division of Corporate

no-action letter is a non-binding pledge to not pursue enforcement action.[123] A company that is unsure whether its digital token is a security can request a no-action letter from the SEC.[124]

In its letter, the SEC noted particularly influential characteristics of the TKJ token that aligned with the characteristics the SEC identified in the DAO Report.[125] Particular characteristics of the TKJ tokens that favored the SEC's conclusion that the tokens were not securities included the following: the tokens would be immediately usable for their intended function; TKJ would market the token's functionality rather than potential for appreciation of value; TKJ would sell the tokens for one dollar each; and the tokens would represent an obligation to provide airline services.[126] Contingent upon TKJ retaining such characteristics, the SEC permitted TKJ to sell its tokens.[127]

C. The SEC Today: A Case Comparison

1. Telegram

In 2018, a messaging app called Telegram utilized a Simple Agreement for Future Tokens ("SAFT") to sell to 175 original purchasers mere *rights* to "Grams," digital tokens that were not yet existent or functional.[128] Telegram planned to use the $1.7 billion funds from the SAFT to finance its own blockchain, the Telegram Open Network ("TON"), that would create a decentralized economy within the messaging app, on which users could use Grams as a

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Finance, SEC, to Pocketful of Quarters, Inc. (July 25, 2019), http://bit.ly/39dcgpp [https://perma.cc/94VR-KUML] [hereinafter Pocketful of Quarters Letter] (informing Pocketful of Quarters that the Division will not recommend the SEC take enforcement action). Notably, George Weiksner, the owner of Pocketful of Quarters, was only 11 years old when he developed the company. Zoë Bernard, *This Cryptocurrency Startup with a 12-Year-Old CEO is Trying to Solve a Common Frustration Among Gamers*, BUSINESS INSIDER (Apr. 14, 2018, 8:45 AM), http://bit.ly/2GnK9qv [https://perma.cc/2TWB-3B6N].

123. *No Action Letters*, SEC, http://bit.ly/2uG2WLA [https://perma.cc/BXU9-9VW4] (last visited Sept. 18, 2020).

124. *Id.*; see also Part III.A.1.b for more details about no-action letters.

125. TurnKey Letter, *supra* note 122, at *1 (noting that TKJ did not create the expectation that purchasers would profit from the tokens); DAO Report, *supra* note 4, at *9–10 (explaining that DAO tokens resembled investment contracts because DAO token purchasers reasonably expected to profit after The DAO launched).

126. TurnKey Letter, *supra* note 122, at *1.

127. *Id.*

128. SEC v. Telegram Grp. Inc., No. 19-civ-9439, 2020 WL 1430035, at *1 (S.D.N.Y. 2020). Telegram asserts that "[t]he Grams themselves, as distinct from the purchase contracts, will merely be a currency or commodity . . . ." Answer at 3, SEC v. Telegram Grp. Inc., No. 19-civ-9439 (S.D.N.Y. filed Oct. 16, 2019).

medium of exchange.[129] But, to prevent Grams from implicating federal securities laws, Telegram would wait to distribute the Grams to purchasers until after the launch of the TON Blockchain.[130] After the launch of the TON Blockchain, Grams would constitute a utility token rather than a security because Grams would be fully functional on the TON Blockchain.[131]

Between February 2, 2018, and October 11, 2019, Telegram cooperated with SEC investigations.[132] Telegram produced thousands of documents, submitted a legal analysis of Grams under the *Howey* test, made presentations to the SEC, and communicated with SEC attorneys through phone and email.[133] When the SEC expressed concern for a particular function of the tokens, Telegram modified its plans.[134]

However, on October 11, 2019, the SEC filed a complaint against Telegram, moved for a preliminary injunction, and obtained a temporary restraining order to prevent Telegram from delivering Grams to purchasers as scheduled on October 31, 2019.[135] Telegram agreed to delay delivering Grams to purchasers until April 30, 2020.[136] Focusing on one element of the *Howey* test, the SEC al-

129. Complaint at 2, SEC v. Telegram Grp. Inc., No. 19-civ-9439 (S.D.N.Y. filed Oct. 11, 2019) [hereinafter Telegram Complaint].

130. The Telegram Team, *A Public Notice About the TON Blockchain and Grams*, TELEGRAM BLOG (Jan. 6, 2020), http://bit.ly/2TVNt4a [https://perma.cc/YEJ3-WTTG] ("Only once the TON Blockchain launches will Grams be created and available to purchase [to ensure that the TON Blockchain and Grams can operate in a way that is compliant with all relevant laws and regulations].").

131. JUAN BATIZ-BENET, MARCO SANTORI, & JESSE CLAYBURGH, THE SAFT PROJECT: TOWARD A COMPLIANT TOKEN SALE FRAMEWORK 9 (2017) (explaining that purchasers of fully functional tokens purchase the tokens either to use the tokens themselves for in-app consumptive purposes or sell the tokens on the secondary market). The latter would likely not satisfy *Howey* because selling tokens on the secondary market is unlikely an expectation of profits from the efforts of *others*. *Id.*

132. Defendant's Memorandum of Law in Opposition to Plaintiff's Motion to Strike Telegram's First Affirmative Defense 12–13, SEC v. Telegram Grp. Inc., No. 19 Civ. 9439 (PKC) (S.D.N.Y. 2020), 2020 WL 4282371 (describing Telegram's efforts to cooperate with SEC investigations)*; but see* Plaintiff SEC's Memorandum of Law in Support of its Motion to Strike Telegram's First Affirmative Defense 4–5, SEC v. Telegram Grp. Inc., No. 19 Civ. 9439 (S.D.N.Y. 2020), 2020 WL 4282376 (asserting that Telegram began communicating with the SEC only after it informed Telegram that it was investigating Telegram's sale of Grams).

133. Answer at 2, SEC v. Telegram Grp. Inc., No. 19 Civ. 9439 (S.D.N.Y. 2020); *but see* Plaintiff SEC's Memorandum of Law in Support of its Motion to Strike Telegram's First Affirmative Defense, *supra* note 132, at 4–5.

134. Durov Dep. 161:10–19, SEC v. Telegram Grp. Inc., No. 19 Civ. 9439 (S.D.N.Y. 2020).

135. Telegram Complaint, *supra* note 129, at 4.

136. SEC v. Telegram Grp. Inc., No. 19 Civ. 9439, 2020 WL 1430035, at *11 (S.D.N.Y. 2020); *see also* Anna Baydakova, *Telegram Looks to Cut Deal with TON*

leged that Grams were securities because Grams purchasers invested money into a common enterprise and expected to profit from the managerial efforts of others.[137] Notably, the SEC did not provide a full analysis of Grams under the *Howey* test until it filed its brief in support of motion for summary judgment.[138]

On March 24, 2020, the court granted the SEC's motion for a preliminary injunction, which prevented Telegram from distributing Grams until litigation concluded.[139] "[Having examined] the totality of the evidence and consider[ed] the economic realities . . . ," the court found that the SEC met its burden of showing a substantial likelihood of success in proving that the transaction between Telegram and the initial purchasers constituted a sale of securities.[140] The court disregarded the form of the exchange and determined that the substance of the exchange was a security sale—despite the delayed Grams distribution under the SAFT and the warranties in the Purchase Agreements that consumers were "purchasing the tokens for [their] own account and not with a view towards, or for resale in connection with, the sale or distribution."[141] In light of the court's decision, Telegram notified its purchasers on April 30, 2020 that it would not issue Grams, and it provided purchasers with repayment options.[142] Telegram appealed the District Court's decision to the Second Circuit, which is significant because a circuit court has never decided an issue regarding an ICO, but then later withdrew its appeal.[143]

Two months later, Telegram announced that it had abandoned the blockchain platform.[144] A mere two and a half weeks after that, a Chinese company announced it would launch its own version of

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Blockchain Investors After SEC Order, COINDESK (Oct. 16, 2019, 10:22 PM), https://bit.ly/2U7vmYu [https://perma.cc/VD34-78L5] (quoting Telegram's letter to Gram purchasers).

137. Telegram Complaint, *supra* note 129, at 15–25.

138. Plaintiff SEC's Memorandum of Law in Support of its Motion for Summary Judgment at 22–26, SEC v. Telegram Grp. Inc., No. 19 Civ. 9439 (S.D.N.Y. 2020), ECF 70, 2020 WL 863548.

139. SEC v. Telegram Grp. Inc., No. 19 Civ. 9439, 2020 WL 1430035, at *1 (S.D.N.Y. 2020).

140. *Id.* at *18.

141. *Id.* at *20.

142. Андрей Колесников [Andrey Kolesnikov], *Письмо Telegram Open Network инвесторам. Предлагаются 2 опции* [*Letter to Telegram Open Network to investors. 2 options available*], SMART-LAB (April 30, 2020, 5:36 AM), https://bit.ly/2VmfhyQ [https://perma.cc/SCS7-QZUP].

143. Notice of Appeal, SEC v. Telegram Grp. Inc., No. 19-civ-9439 (S.D.N.Y. 2020).

144. Pavel Durov, *What Was TON and Why It Is Over*, https://bit.ly/3gILUiY [https://perma.cc/NG9F-P8LT] (May 12, 2020) ("I am writing this post to officially announce that Telegram's active involvement with TON is over.").

Telegram's blockchain on its own platform, independent from that of Telegram.[145] While Telegram advised Grams purchasers to not trust third-party sites that use Telegram's brand or blockchain, Telegram remains optimistic that the United States will one day obtain "decentralization, balance[,] and equality" as other countries have.[146]

2. *Block.one*

Block.one is a Cayman Islands-registered technology company that raised several billion dollars by selling 900 million digital tokens through an ICO.[147] Despite Block.one's efforts to not sell tokens to U.S. citizens,[148] U.S. citizens managed to purchase them.[149] The SEC commenced an enforcement action against Block.one and opined that the tokens were securities under the federal securities laws based on *Howey* and the DAO Report.[150]

Unlike Telegram, Block.one settled with the SEC.[151] The SEC imposed a civil penalty on Block.one amounting to only a small percentage of the total capital from its token sale[152] and did not require Block.one to admit or deny the SEC's findings that its tokens

145. Robert Stevens, *Chinese TON Community to Launch Telegram's Abandoned Crypto Project*, DECRYPT (May 29, 2020), https://bit.ly/2Mjsi78 [https://perma.cc/P38R-3BCM]; *see also infra* note 169 (expressing concern that the United States's lack of regulatory clarity will cause the United States to fall behind in the financial technology industry).

146. Durov, *supra* note 144.

147. Block.one, Securities Act Release No. 10714, 2019 WL 4793292, at *1–2 (Sept. 30, 2019) [hereinafter Block.one Settlement].

148. Block.one's exclusion of Americans from purchasing its tokens illustrates how U.S. securities laws encourage innovators to relocate outside of the United States. *See infra* note 169 (expressing concern that the United States's regulatory unclarity will cause it to fall behind in the financial technology industry).

149. Block.one Settlement, *supra* note 147, at *2.

150. *Id.* at *1. The SEC did not incorporate the "common enterprise" element of the *Howey* test into its analysis. *Id.*

151. *SEC Orders Blockchain Company to Pay $24 Million Penalty for Unregistered ICO*, SEC (Sept. 30, 2019), http://bit.ly/2TY33fK [https://perma.cc/595B-9LWH].

152. *See* Block.one Settlement, *supra* note 147, at *5 (ordering Block.one to pay a civil penalty of $24 million); *see also* Robert Rosenblum, Amy Caiazza, & Taylor Evenson, *Less Aggressive SEC Sanctions on Violations by Crypto Issuers*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE, https://bit.ly/3aaXMYd [https://perma.cc/BM8U-P5VG] (Oct. 26, 2019).

> [T]he 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.

Id.

were securities.[153] Moreover, the SEC did not impose bad actor disqualifications under Regulation A and Regulation D and did not require Block.one to make a rescission offer to U.S. investors or register the tokens under the Exchange Act.[154]

III. ANALYSIS

A. Issuing Digital Tokens: A Costly Gamble

1. The Perils of Regulation by Enforcement

Companies do not receive clear guidance from the SEC to understand the securities registration requirements as applied to digital tokens.[155] Rather than issuing a binding agency rule, the SEC creates digital token policies through enforcement actions on a case-by-case basis.[156] This method of policymaking makes it very difficult for a company to predict the SEC's response to a company's digital token sale.[157] Because of this regulatory uncertainty, companies choosing to issue digital tokens face a high-stakes decision between two risky choices: move forward and issue the digital token or petition the SEC for a no-action letter before issuing the token.[158] Both options yield significant risks that could severely im-

153. Block.one Settlement, *supra* note 147, at *1 (ordering Block.one to pay a civil penalty of $24 million).

154. *Id.* at *5. *See also* Rosenblum, *supra* note 152 (comparing the SEC's mild sanctions on Block.one to the SEC's more serious sanctions on other digital token issuers).

155. *See* DAO Report, *supra* note 4; Framework, *supra* note 4; SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

156. The perils of regulation through enforcement are perhaps best exemplified by the Consumer Financial Protection Bureau (CFPB). *See*, *e.g.*, Todd Zywicki, *The Consumer Financial Protection Bureau: Savior or Menace?*, 81 GEO. WASH. L. REV. 856, 921–23 (2018) (criticizing regulation by enforcement as lacking in due process protections); Matt Levine, *Rules Make for Better Rules Than Lawsuits Do*, BLOOMBERG OPINION (Jan 30, 2018, 2:00 am), https://bloom.bg/3ahq8yQ (same), *but see, e.g.*, Brief for Current and Former Members of Congress as Amici Curiae at 17–18, Seila Law v. Consumer Fin. Prot. Bureau, No. 19-7 (U.S. argued Mar. 3, 2020) (arguing that the CFPB's ability to act quickly through enforcement makes the agency better equipped to protect consumers); Kate Berry, *CFPB's Cordray Defends Agency's Enforcement Actions*, AM. BANKER (Mar. 31, 2017, 11:33 am), https://bit.ly/2VxToxe [https://perma.cc/EP8C-F7N9] ("[Former CFPB Director Richard] Cordray said that when a company is hit with an enforcement action, other companies in similar situations are put on notice that they could be violating the law if they are acting in the same way.").

157. *See supra* Part II.C (discussing the disparity between the SEC's response to two different companies' unregistered token sales).

158. *See*, *e.g.*, Letter from Lewis Rinaudo Cohen, Counsel for Pocketful of Quarters, Inc., to Off. of Chief Counsel, Division of Corporate Finance, SEC (July 25, 2019), http://bit.ly/32BPR2B [https://perma.cc/J7XM-4BAJ] [hereinafter Incoming Pocketful of Quarters Letter] (requesting a no-action letter from the SEC).

pact the company's financial health.[159] Uncertainty is a risk common to both options and will continue to be a problem until regulators and legislators change their approach to regulating digital assets.[160]

a. Option One: Issue the Digital Token[161]

If a company feels confident enough that its token is not a security under *Howey*, then the company will not register its tokens before selling them.[162] Doing so allows the company to proceed with new technology projects without immediately drawing the SEC's attention to the token sale,[163] but it creates uncertainty regarding the company's future.[164] A company in this position can be sure of only one thing: if the SEC perceives the company to have issued an unregistered security, then the SEC will commence enforcement action.[165]

The SEC "appropriately tailor[s]"[166] its enforcement sanctions to further its goals of deterrence and protection of market partici-

159. *See, e.g.*, Block.one Settlement, *supra* note 147, at *5 (ordering Block.one to pay a civil penalty of $24 million). *See also* Robert Stevens, *The SEC Killed Telegram's $1.7B Crypto Project. Who's Next?*, DECRYPT (May 13, 2020), https://bit.ly/2WUdAcn [https://perma.cc/T6K9-YZM8] (describing ongoing litigation between Kik and the SEC in which the SEC alleges that Kik's ICO cryptocurrency project, Kin, amounted to a sale of unregistered securities). "[T]he court case has crippled [Kik], costing over $6 million so far and forcing Kik to split from Kin and sell off its chat app." *Id.*

160. See Part III.B (suggesting an alternative to the current securities laws that would minimize the potentially detrimental effects of uncertainty).

161. Alternatively, the company could attempt to issue the digital token pursuant to an exemption from registration—Regulation A or Regulation D. *See* 17 C.F.R. §§ 230.251–.263, .500–.508 (2019).

162. *C.f.* Brief for Defendant at 1, SEC v. Kik Interactive Inc., No. 1:19-cv-5244 (S.D.N.Y. Jan. 9, 2020) (alleging that Kik's tokens were not securities, and the SEC "twist[ed]" and mischaracterized the facts).

163. Even so, it is unrealistic to expect a company to be able to stay under the radar for long. Telegram began selling rights to Grams in January 2018, and the SEC contacted Telegram by February 2018. SEC v. Telegram Grp. Inc., No. 19 Civ. 9439, 2020 WL 1430035, at *3–4 (S.D.N.Y. Mar. 24, 2020).

164. For an example of a company getting blindsided by an enforcement action, see Complaint at 48–49, SEC v. Kik Interactive Inc., No. 1:19-cv-5244 (S.D.N.Y.) (seeking to "permanently restrain[ ] and enjoin[ ] . . . Kik . . . from . . . violating . . . the Securities Act").

165. *See, e.g.*, Order, Securities Act Release No. 33-10755, 2020 WL 821462 (Feb. 19, 2020) (entering a settlement between the SEC and Enigma MPC); Litigation Release, Securities Act Release No. 24723, 2020 WL 359633 (Jan. 21, 2020) (describing the SEC's enforcement action against Sergii "Sergey" Grybniak and his company, Opporty International, Inc., for an offering of unregistered digital tokens); Block.one, Securities Act Release No. 10714, 2019 WL 4793292 (Sept. 30, 2019) (settling with Block.one).

166. SEC DIV. OF ENF'T ANN. REP. 18 (2019).

pants from potential future misconduct.[167] However, the SEC's current trend of policymaking by enforcement actions is ineffective at deterring bad behavior and protecting investors.[168]

The SEC's unpredictable response to digital tokens unnecessarily deters potential token issuers and stifles innovation within the U.S.[169] Fear that the SEC will view a company's token as a security drives companies out of the U.S. and causes them to spearhead their digital token projects in other countries that have more sophisticated and predictable regulations.[170]

Inconsistent enforcement is another undesirable consequence of using enforcement actions to create policy.[171] For example, the SEC sanctioned two different companies for registration violations: Block.one and Telegram.[172] Despite similarities between the two cases, the SEC's penalty for Telegram was much more severe than that for Block.one.[173]

In what appears to be another attempt to encourage settlement, the SEC chose to not impose a civil penalty upon Gladius Network, LLC, which self-reported its unregistered token offering and cooperated with related investigations.[174] Despite Gladius Network, LLC's success in avoiding a civil penalty, a company, in gen-

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167. *Id.* at 5.

168. *See* Part III.B.

169. Hester M. Peirce, Commissioner, SEC, Renegade Pandas: Opportunities for Cross Border Cooperation in Regulation of Digital Assets (July 30, 2019) [hereinafter Commissioner Peirce, *Digital Assets*] (expressing "concern that the U.S. will fall behind other countries in attracting crypto-related businesses unless [the U.S. is] more forward-leaning in establishing a regulatory regime with discernible parameters").

170. *See id.*; *see also* Part II.C.2 (illustrating an example of a company that started its digital token project in another country and made efforts to prevent U.S. involvement).

171. *See, c.f.* Part II.C (distinguishing between the results of two different SEC enforcement actions).

172. *See* Part II.C.

173. *See* Part II.C; Block.one Settlement, *supra* note 147, at *1. The companies' differences in cooperation may explain such a contrast: Telegram forcefully committed to pushing back against the SEC in court; whereas, Block.one agreed to settle. *Id.*; Final Judgment as to Defendants Telegram Group Inc. and TON Issuer Inc., SEC v. Telegram Grp. Inc., No. 19 Civ. 9439, 3–4 (S.D.N.Y. 2020), ECF 70 (ordering Telegram to pay $1.2 billion back to investors and pay an $18.5 million dollar civil penalty to the SEC). However, even if this fully explained SEC's contrasting penalties, the SEC's enforcement procedure remains problematic. A policy of rewarding a company that displays willingness to settle and punishing a company that will take the SEC to court bullies companies into settling with the SEC, when they otherwise may have been successful, ensuring an empty field of caselaw surrounding digital token offerings. *Infra* Part III.A.1.a.

174. Gladius Network LLC, Securities Act Release No. 10608, 2019 WL 697993, at *5 (Feb. 20, 2019) [hereinafter Gladius Settlement].

eral, would be unwise to self-report a violation if it is uncertain that it has indeed broken the law.[175] Doing so would draw the SEC's attention to the company's potentially *legal* sale of digital tokens and affirmatively suggest that the company believes it violated registration requirements and that remedial action is warranted.[176] Through its favorable treatment of self-reporters, the SEC expresses its preference for cooperation and leaves companies with little choice but to enter into a settlement agreement with the SEC.[177] Consequently, the SEC may perceive issuing a digital token without first seeking a no-action letter as uncooperative and invoke more serious consequences for a company that chooses such an option.

While encouraging companies to forego litigation saves time and resources, settlement forecloses the opportunity to develop case law and perpetuates the lack of regulatory clarity within the industry.[178] Sparse case law,[179] in conjunction with high stakes, coerces companies to enter settlement agreements when a trial, while

175. Even if a company is certain of a violation, a company would be unwise to admit to facts that demonstrate a violation of federal securities laws as part of a settlement with the SEC because the Department of Justice may use this admission as evidence to prosecute the company in a parallel proceeding. FED. R. EVID. 801(d)(2) ("An Opposing Party's Statement. [A] statement [that] is offered against an opposing party . . . [is not hearsay]."). It may be more strategic to lose at trial than to admit facts in a settlement agreement because loss of a civil lawsuit will have no evidentiary use in a subsequent criminal trial. FED. R. EVID. 403 ("The court may exclude evidence if its probative value is substantially outweighed by a danger of one or more of the following: unfair prejudice, confusing the issues, misleading the jury . . . ."). While the prosecutor's burden of proof in a criminal prosecution is often "beyond a reasonable doubt," the burden of proof in a civil lawsuit is "preponderance of evidence." JACK H. FRIEDENTHAL, MARY KAY KANE, & ARTHUR R. MILLER, CIVIL PROCEDURE 658 (5th ed. 2015). Therefore, a Rule 403 objection would likely succeed if the Department of Justice sought to present evidence of a lost civil lawsuit to prove guilt in a criminal prosecution. *Id.* Similarly, while the court in a criminal proceeding cannot draw an adverse inference from a company's assertion of its Fifth Amendment privilege, the court is free to do so in a civil proceeding. 81 AM. JUR. 2D *Witnesses* § 118 (2020).

176. Gladius Settlement, *supra* note 174, at *2. A company that reports itself invites the SEC to begin its investigation with the understanding that the self-reporting company thinks it violated the law. The SEC's perspective going into the investigation may bias the outcome of its investigation and lead to a finding unfavorable to the self-reporting company. For this reason, self-reporting, though encouraged by the SEC, may be an unwise choice for a company.

177. *See, e.g.*, News Release, Exchange Act, 2019 WL 696830 (quoting Robert A. Cohen, Chief of the SEC's Cyber Unit: "'Today's case shows the benefit of self-reporting and taking proactive steps to remediate unregistered offerings'").

178. Very few companies against whom the SEC took enforcement action have taken the issue to court. *See, e.g.*, Status Report at 2, SEC v. Kik Interactive Inc., No. 1:19-cv-5244 (S.D.N.Y. Jan. 9, 2020), ECF 43 (requesting that the court set a trial date); *c.f. supra* note 173 (describing how the SEC may encourage settlement).

still risky, could ultimately be more beneficial to the company—a vicious cycle that will be broken only by legislative and agency intervention.[180]

b. Option Two: Petition the SEC for a No-Action Letter

Petitioning the SEC for a no-action letter shows the SEC that a company is acting in good faith and willing to disclose its company practices.[181] The SEC's response to a company's request for a no-action letter will provide valuable insight regarding the SEC's stance on its proposed token sale that the company would otherwise obtain only through litigation.[182] Receipt of a no-action letter is an ideal outcome for a company wishing to issue digital tokens because the company will be free to sell its digital tokens with low risk of an SEC enforcement action.[183] To persuade the SEC to issue a no-action letter, a company can analogize to other companies' token sales that have been granted—or not granted—no-action letters.[184] However, the probability of receiving a no-action letter is low given that the SEC has issued only two letters in the digital token space.[185] The SEC's' ability to change its position found in previous no-action letters further decreases a company's likelihood of success.[186]

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179. For example, the SEC had not provided a complete analysis of digital tokens under *Howey* until it motioned for summary judgment in *SEC v. Telegram Grp. Inc.* Brief for Plaintiff at 22–25, SEC v. Telegram Grp. Inc., No. 19 Civ. 9439 (PKC) (S.D.N.Y. Jan. 15, 2020), ECF 79 (discussing ambiguity among district courts with respect to analyzing *Howey*).

180. *See supra* note 175 and accompanying text (describing the evidentiary danger of admitting violation of securities laws).

181. Gladius Settlement, *supra* note 174, at *5 (explaining that the SEC did not impose civil penalties against Gladius because it was cooperative with investigations); see also *supra* note 123 and accompanying text for a definition of a no-action letter.

182. *See* TurnKey Letter, *supra* note 122; Pocketful of Quarters Letter, *supra* note 122; Brief in Support of Plaintiff's Motion for Summary Judgment at 22–25, SEC v. Telegram Grp. Inc., No. 19 Civ. 9439 (PKC) (S.D.N.Y. Jan. 15, 2020), ECF 79.

183. Such a token sale is not completely free from the risk of an enforcement action because a no-action letter does not create binding precedent as the SEC can later change its position after sending a no-action letter. *No Action Letters*, SEC, http://bit.ly/2uG2WLA [https://perma.cc/VE7Y-MWVH] (last visited Sept. 18, 2020).

184. Incoming Pocketful of Quarters Letter, *supra* note 158, at 13. Analogizing to the facts of other companies' token sales shows that the industry treats no-action letters the same as it would treat binding agency precedent.

185. TurnKey Letter, *supra* note 122; Incoming Pocketful of Quarters Letter, *supra* note 158.

186. *No Action Letters*, SEC, http://bit.ly/2uG2WLA [https://perma.cc/VE7Y-MWVH] (last visited Sept. 18, 2020). The agency may change or erase its no-

Further, creating policy through no-action letters prohibits public participation and sidesteps commitment and accountability.[187] Because cryptocurrency is a highly technical subject, the SEC would greatly benefit from receiving public comments and industry experts' contributions to the rulemaking process.[188] The Administrative Procedure Act (APA) requires agency notice and comment procedures for this very reason, which the SEC's backdoor method of rulemaking undermines.[189] This would not be so if the SEC were using its no-action letters merely to interpret the law or a previously adopted agency rule.[190] However, the SEC has previously gone beyond rule interpretation by creating new substantive rules and revising existing statutes through no-action letters.[191]

B. A Regulatory Framework that Removes Uncertainty, Encourages Innovation, and Protects Market Participants

1. Modify and Codify Howey

In the absence of statutory guidance that specifically addresses digital assets, the SEC takes *Howey*'s position: securities laws control any activity that involves an "investment of money in a common enterprise with profits to come solely from the efforts of *others*."[192] While the SEC has suggested that federal securities laws do not govern *decentralized* digital tokens,[193] one could reasonably interpret *Howey*'s ambiguous "efforts of others" language to en-

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action letter position at any time because no-action letters are not binding authority to the agency. *Id.* A company that analogizes to companies who have been granted or denied no-action letters will be unsuccessful if the SEC changes its position on such previously granted or denied no-action letters. *See id.*

187. *See id.* (explaining that the SEC may change its positions in no-action letters at any time); 5 U.S.C. § 553 (2018) (illustrating a rulemaking procedure that requires public participation and holds the agency accountable to the public).

188. Hester M. Peirce, Commissioner, SEC, Running on Empty: A Proposal to Fill the Gap Between Regulation and Decentralization, Appendix (Feb. 6, 2020) [hereinafter Peirce Proposal Appendix] (urging public participation and comment on Commissioner Peirce's digital token safe harbor proposal).

189. 5 U.S.C. § 553(b)–(c) (2018).

190. *Id.* § 553(b)(A).

191. Donna M. Nagy, *Judicial Reliance on Regulatory Interpretations in SEC No-Action Letters: Current Problems and a Proposed Framework*, 83 CORNELL L. REV. 921, 961–63 (1998) (describing that the SEC has announced binding substantive law "in the guise of regulatory interpretations in no-action letters").

192. SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946) (emphasis added).

193. Hinman Speech, *supra* note 62 ("If the network on which the token or coin is to function is sufficiently decentralized—where purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts—the assets may not represent an investment contract."); *see also* Part II.A.2. (describing a decentralized network as one that functions on its own without a central authority).

compass efforts of the decentralized network itself. In *Howey*, the "efforts of others" were the corporation's efforts to cultivate the orange crops.[194] Regarding digital assets, one could reasonably construe the "efforts of others" as the blockchain's efforts to manage purchasers' investments.

This view illustrates the critical need to distinguish between efforts of *others* under *Howey* and efforts of the *network*. If efforts of the decentralized network did indeed equal "efforts of others" under *Howey*, then a decentralized token would nonetheless be a security under *Howey*, contrary to the SEC's current stance.[195]

To achieve regulatory clarity and consistency, a necessary first step is for Congress or the SEC to codify the distinction between efforts of *others* and efforts of *the network*. Instead of policymaking via enforcement actions, no-action letters, and litigation,[196] the SEC or Congress should codify a version of the *Howey* test that draws the line between a decentralized network and a network that depends on the managerial efforts of others. One way that regulators and legislators could create this distinction is by narrowing the term "others" to include only persons and groups of persons.[197] A blockchain is not a person; it is impossible for a person to manage any blockchain, and there is no central access point to any blockchain.[198] This distinction is essential because if "others" includes only "persons, and "groups of persons," then a blockchain will never meet the *Howey* test as it does not depend on the managerial efforts of persons or groups of persons. The *Howey* test, without a distinction of this nature, is inadequate to evaluate whether a digital asset is an investment contract.[199]

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194. *Howey*, 328 U.S. at 300 ("A common enterprise managed by respondents or third parties with adequate personnel and equipment is therefore essential if the investors are to achieve their paramount aim of a return on their investments.").

195. *Id.* at 301 (1946).

196. *See* Part III.A.1.

197. Narrowing the term "others" to include only "persons" and "groups of persons" ensures that the term "others" includes corporations and unincorporated entities. Efforts of the blockchain must be distinguished from efforts of persons, corporations, and unincorporated entities, which are traditional categories of managers under *Howey*.

198. *See* Part II.A.3.a.

199. Notably, William Hinman, Director of the SEC Division of Corporation Finance, has distinguished between the following:

> [A] person or coordinated group (including 'any unincorporated organization') that is working actively to develop or guide the development of the infrastructure of the network . . . [and] multiple, independent actors work[ing] on the network but no individual actor's or coordinated group of actors' efforts are essential efforts that affect the failure or success of the enterprise.

Congress could more clearly create this distinction by amending and creating statutory definitions. It should: 1) amend the Securities Act and Exchange Act's definition of "security" to exclude digital tokens; and 2) define "digital token" in such a manner that incorporates decentralization.[200] The following is one example of an appropriate definition of "digital token." This definition incorporates the decentralization and immutability elements of blockchain as it requires the recording of transaction history on a decentralized, immutable ledger.[201] Additionally, it forecloses a digital token from representing a financial interest in a company, which is a traditional characteristic of a security:

> A token is a digital representation of value or rights
>
> (i) that has a transaction history that:
>
> (A) is recorded on a distributed ledger, blockchain, or other digital data structure;
>
> (B) has transactions confirmed through an independently verifiable process; and
>
> (C) resists modification or tampering of the transaction;
>
> (ii) that is capable of being transferred between persons without an intermediary party; and
>
> (iii) that does not represent a financial interest in a company, partnership, or fund, including an ownership or debt interest, revenue share, entitlement to any interest or dividend payment.[202]

2. Adopt a Grace Period

Only once regulators have codified the legal distinction between "efforts of others" and "efforts of the network" should regulators address a second challenge: the regulatory Catch 22.[203] At

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Hinman Speech, *supra* note 62, n.3. Director Hinman distinguishes between the extent of managerial efforts, while this Comment's author distinguishes between types of actors performing managerial efforts. *See id.* This Comment's author does not promote one method of distinction over the other but cites the Hinman Speech to illustrate a need to further clarify the *Howey* test.

200. *See* Token Taxonomy Act of 2019, H.B. 2144, 116th Cong. §2(a) (2019) (proposing to define "security" and "digital token" under the Securities Act of 1933).

201. *Id.*

202. Peirce Proposal Appendix, *supra* note 188. The Token Act includes a similar definition and would also appropriately codify the distinction between *Howey*'s "managerial efforts of others" and the efforts of the decentralized network. Token Taxonomy Act of 2019, H.B. 2144, 116th Cong. §2(a) (2019).

203. Commissioner Peirce, *Digital Assets*, *supra* note 169. The grace period policy centers around the issue of whether a digital token is fully decentralized. *See id.* Without codifying the "modified *Howey* test," there would still be a ques-

inception, digital tokens are almost never completely decentralized—it takes time for the network to be able to function on its own.[204] For this reason, the current law terminates a digital token project before it can even begin. In order for a digital token to mature to the point where the SEC will not view it as a security, token issuers must be able to sell the token to marketplace participants.[205]

The current law prohibits the sale and exchange of unregistered securities and strips digital tokens of any opportunity to mature to the point that they will not implicate securities laws.[206] Because digital tokens immediately resemble securities and, under current law, have no occasion to become fully decentralized—as they are designed to be—the financial technology industry has reached a deadlock. To simultaneously overcome this deadlock and protect token purchasers, the SEC should adopt a rule that grants digital token developers time for the digital tokens to reach complete decentralization, during which token issuers must publish key information to consumers. This policy would limit the SEC's ability to evaluate whether the tokens are securities until only *after* the grace period has elapsed and would alleviate the high-stakes gamble that currently discourages innovators from creating and selling digital tokens.[207]

IV. CONCLUSION

The Securities Act of 1933 and Securities Exchange Act of 1934 require companies to provide investors with important information about their business operations so that investors can make informed investment decisions.[208] Similarly, the SEC should provide companies with important and binding information about SEC enforcement decision-making so that companies can make informed decisions about how to proceed with issuing digital tokens.[209]

This Comment has illustrated that piecemeal rulemaking by enforcement action has created uncertainty and inconsistent out-

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tion as to whether a fully decentralized digital token is a security. Thus, to not render the grace period useless, regulators should codify the "modified *Howey* test" before enacting the grace period.

204. *Id.*

205. *Id.*

206. *Id.*

207. *Id.*

208. Securities Act of 1933, 15 U.S.C. §§ 77a–mm (2018); Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–qq (2018).

209. *See* Part III.A.1.

comes and curbed innovation of financial technology.[210] Congress and the SEC have before them a significant opportunity to use their legislative powers to clarify the regulatory scheme for digital assets, encourage financial technology innovation, and expand the U.S. economy.[211] Two steps would achieve these three aims. First, an amendment to exclude digital tokens from the statutory definition of a security would remove doubt and uncertainty. Such legislation or rulemaking would put the industry on notice that, under binding law, a fully decentralized digital token will not implicate federal securities laws. Second, building a grace period into enforcement procedure would provide blockchain projects with an opportunity to fully decentralize before regulators consider whether a digital token is a security. Together, these two relatively minor changes will adapt the 70-year-old *Howey* test to new financial technology—a grand win for our legal system, economy, and our financial technology industry.

210. *See* Part III.A.
211. *See* Part III.A.