**UNITED STATES DISTRICT COURT FOR
THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION**

LEJILEX, et al.,

Plaintiffs,

v.

SECURITIES AND EXCHANGE COMMISSION, et al.,

Defendants.

CASE NO.: 4:24-cv-00168-O

BRIEF OF *AMICI CURIAE* IOWA, ARKANSAS, INDIANA, KANSAS, MONTANA, NEBRASKA, AND OKLAHOMA, IN SUPPORT OF NEITHER PARTY

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INTEREST OF THE *AMICI*

The *Amici* States file this brief because the Securities and Exchange Commission is going where it has never gone before: regulating an asset class that is as nebulous as it is new. Despite SEC's stated desire to protect consumers, SEC now goes too far.

Amici States support neither party, because they take no position on Plaintiffs' conduct or business practices but do oppose SEC's regulation of cryptocurrency assets absent an investment contract because Congress has not delegated that authority to SEC. States have a strong interest in preventing preemption of State consumer protection and other laws by SEC's attempt to regulate crypto as securities. *See*, *e.g.*, Gary Gensler, SEC Chair, Statement on the Approval of SpotBitcoin Exchange-Traded Products (Jan. 10, 2024) ("[V]ast majority of crypto assets are investment contracts and thus subject to the federal securities laws.").

SEC ignores the basic precepts of the Supreme Court's test in *SEC v. W.J. Howey Co.*, treating any cryptocurrency it can find as an investment contract. 328 U.S. 293, 298–301 (1946). That is wrong. Applying *Howey* shows that most cryptocurrencies, like the ones here, are not investment contracts at all. Perhaps they are currencies subject to Commodity Futures Trading Commission oversight. At any rate, SEC's actions here raise the Major Questions Doctrine and federalism canon, and SEC lacks clear congressional authorization of its conduct.

Even if the agency were authorized to regulate cryptocurrencies, that authorization would be unconstitutional. There is no intelligible principle for SEC to decide what constitutes an investment contract in cryptocurrencies. And there is no way to prove where the cryptocurrency is going or what it is being used for, so the government cannot prove that cryptocurrency trading has a substantial effect on interstate commerce.

Given the States' traditional role in protecting consumers and ensuring fair treatment of commerce within State borders, the States seek to raise these important issues before the Court.

INTRODUCTION

Cryptocurrencies have become a vibrant part of the global economy. And as with any new technology, cryptocurrencies create both opportunities and challenges. Some of those challenges are regulatory in nature. As States, the federal government, and even many in the cryptocurrency industry agree, some regulations to ensure safety and to protect consumers are necessary. But where States depart from that agreement—at least with regards to the federal government—is who should be regulating. There are many choices that States or Congress could make to assign roles in our federalist system to ensure safe continued use of cryptocurrencies. Instead, SEC has decided, without Congressional authorization, that regulating cryptocurrencies is its job—and has decided to take on that new role without following the Administrative Procedure Act.

Rather than going through notice-and-comment rulemaking, SEC started a campaign of scorched-earth litigation targeting any entity it dislikes with expensive lawsuits and then muzzling its critics with unconstitutional consent decrees. For example, in *SEC v. SafeMoon LLC*, 1:23-cv-08138 (E.D.N.Y.), SEC went after SafeMoon, a cryptocurrency token not connected with any business. SEC never alleges that SafeMoon's token was a stock by another name—it repeatedly uses the term "token," and its only allegation for why it satisfies *Howey* is that SafeMoon investors "shared equally in price increases[] or together suffered price decreases." *SafeMoon LLC* Compl. ¶ 43. As *Amici* States explain below, adopting that standard for defining an investment contract would give SEC the right to regulate virtually any commodity that changes value.

This is not a one-off for SEC. The agency has an entire website bragging about the dozens of crippling enforcement actions the agency has brought against cryptocurrency sellers without even trying to tie the cryptocurrency tokens to shares in a business. U.S. Securities and Exchange Commission, *Crypto Assets and Cyber Enforcement Actions*, https://perma.cc/5SGL-TF3Y; *See*

also In re Wines, SEC No. 3-21682 (2023) (involving cryptocurrency token that was functionally equivalent to fiat currency); *SEC v. DeSalvo*, 2:23-cv-08092 (D.N.J.).

Perhaps SEC's vigor in choosing to regulate cryptocurrencies without following the APA's requirements makes sense: SEC is acting far outside its assigned regulatory role. Any move toward rulemaking would draw scrutiny for SEC's attempted *ultra vires* expansion. That is why *Amici* States file this brief—to ensure consumers are protected and reasonable regulations are imposed in accord with federal and State law, rather than imposed by the whims of a rogue federal agency.

"[I]n 2008, cryptocurrency became prominent with the deployment of Bitcoin and the blockchain ledger." Paul Andersen, Note and Comment, *Will the FTX Collapse Finally Force U.S. Policymakers to Wake Up?: Regulatory Solutions for Cryptocurrency Tokens Not Classified As Securities Under the Supreme Court's Howey Analysis*, 18 J. Bus. & Tech. L. 251, 257 (2023). "Cryptocurrency is any form of currency that exists only digitally." *Id.* (quotation marks omitted). Cryptocurrencies usually do not have a "central issuing system or regulating authority." *Id.* (footnotes omitted). Instead, they rely on "a decentralized system to record transactions and manage the issuance of new units." *Id.* at 257–58 (footnote omitted).

"A blockchain is a digital database containing information (such as records of financial transactions) that can be simultaneously used and shared within a large decentralized, publicly accessible network." *Id.* at 258 (quotation marks omitted). "A cryptocurrency coin [(or token)] is a coin built on its native blockchain." *Id.* Coins can either be "fungible, meaning each token is the same and carries the same value, or non-fungible, meaning each token is unique and carries a different value." *Id.* (footnotes omitted).

"Bitcoin was created to eliminate the need for a central monetary authority to monitor, verify and approve transactions, by enabling a peer-to-peer network in which transactions are

'mined' by individuals using software to solve mathematical puzzles." Brett Hemenway Falk & Sarah Hammer, *A Comprehensive Approach to Crypto Regulation*, 25 U. Pa. J. Bus. L. 415, 419 (2023). Cryptocurrencies are popular with scammers and other criminals because they can be difficult to track. *See* Chelsea Pieroni, *La Crypto Nostra: How Organized Crime Thrives in the Era of Cryptocurrency*, 20 N.C.J.L. & Tech. Online 111, 133–34 (2018). And the recent FTX scandal should teach observers that SEC oversight may not prevent certain fraudulent cryptocurrencies from defrauding less informed investors.

The challenges that have risen along with the surge in popularity for cryptocurrencies are both varied and complex. But this is clear: SEC has no business treating cryptocurrencies as investment contracts under the Securities Act.

Compounding its problems, SEC's conduct—rulemaking by district court enforcement action—violates the APA and threatens to render dozens of elaborate State consumer protection laws a dead letter regarding cryptocurrencies, forcing States to stand idly by as con artists misuse cryptocurrencies to swindle the States' citizens. SEC has no right to conduct rulemaking by enforcement action, but that is precisely what they have been doing to regulate cryptocurrencies. And SEC long acknowledged that cryptocurrencies were not investment contracts subject to their oversight. But rather than give a reasoned explanation for why SEC has changed its mind, the agency has ignored the basic requirements of reasoned decision-making for its arbitrary and capricious campaign of scorched earth litigation. *Cf. Grayscale Investments, LLC v. Securities and Exch. Comm'n*, 82 F.4th 1239, 1249 (D.C. Cir. 2023) (finding arbitrary and capricious differential treatment of similar cryptocurrency products).

SEC's actions do not adequately consider their consequences—potential preemption of State consumer protection laws leaving citizens without defense from predatory scammers. While

regulation-by-enforcement is bad enough, it is even worse when doing so may render thoughtful and considered laws—enacted by States to protect people from wrongdoers—unenforceable. SEC is not shy about claiming preemptive effect of its regulations—nor will those who States seek to pursue be shy in contending that States no longer have such a role in a field occupied by SEC. That is wrong on many levels but, given SEC's careless behavior, has become a real risk.

This Court should stop SEC's egregious regulatory overreach and hold that garden variety cryptocurrencies are not investment contracts under the Securities Act of 1934.

ARGUMENT

I. SEC's extreme, unprecedented, and unlawful assertions of its enforcement powers threaten to preempt dozens of state laws.

Not only is SEC's position on cryptocurrencies wrong as a matter of law, but it is a disturbing example of regulatory overreach that, in almost any other context, would violate the APA. Worse, it harms the States and may leave them unable to prosecute cryptocurrency scammers by preempting State consumer protection and related criminal laws. This Court should not endorse SEC's attempts to avoid the rigors of notice-and-comment rulemaking by allowing it to conduct rulemaking by district court enforcement action.

A. SEC must engage in notice-and-comment rulemaking, not rulemaking by district court enforcement action.

Agencies can formulate policy through either rulemakings or adjudications. *See* 5 U.S.C. §§ 551(5), (7). But that power is constrained. "An agency, after all, 'literally has no power to act'—including under its regulations—unless and until Congress authorizes it to do so by statute." *FEC v. Cruz*, 596 U.S. 289, 301 (2022) (quoting *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986)). Thus, the ultimate question is whether SEC has the authority to engage in rulemaking by district court enforcement action. It does not.

Start with SEC's enabling statute. That statute generally gives SEC the authority "to make such rules and regulations as may be necessary or appropriate to implement the provisions of" federal securities law. 15 U.S.C. § 78w(a)(1); *see also, e.g.*, *id.* §§ 77s, 77sss(a). That imposes the requirements of notice-and-comment rulemaking. *See*, *e.g.*, *Chamber of Com. of United States v. SEC*, 85 F.4th 760, 779–80 (5th Cir. 2023); 5 U.S.C. § 553(c). That cannot come through an enforcement action brought in district court. Nowhere in SEC's enabling statute is the agency allowed to engage in rulemaking through Article III judicial enforcement actions. And applying the *expressio unius est exclusio alterius* canon of construction leads to the same result—that Congress did not want to give SEC the ability to make rules and regulations through judicial enforcement actions. *See, e.g.*, *Texas v. United States*, 809 F.3d 134, 182 & n.180 (5th Cir. 2015), *aff'd by an equally divided court*, 579 U.S. 547 (2016).

Despite that, SEC has carried on its *ad hoc* enforcement rulemaking crusade. Although the agency may enforce its existing regulations in the district courts, *see*, *e.g.*, 15 U.S.C. § 77t(b), due process concerns limit the circumstances in which the agency can retroactively apply new law, *see, e.g.*, *Calumet Shreveport Ref., LLC v. EPA*, 86 F.4th 1121, 1134–37 & nn.22–24 (5th Cir. 2023). SEC's insistence on trying to change regulations and mark its territory through district court enforcement action runs headlong into those principles.

SEC's new practice of engaging in rulemaking by district court enforcement action is particularly problematic given the nature of securities litigation. Enforcement actions can be incredibly expensive to litigate, and a loss on the merits could result in a lifetime ban from the securities industry. *See, e.g.*, 15 U.S.C. §§ 78*o*(b)(4)(C)–(E), 80b-3(e)(4)–(6). And if someone wants to settle with SEC after becoming the target of a rulemaking by district court enforcement action, that person is barred from publicly defending themselves. *See* 17 C.F.R. § 202.5(e).

SEC's new practice of rulemaking by district court enforcement action is legally suspect and risks harming the securities industry. By holding that cryptocurrencies are not *per se* investment contracts under the Securities Act, this Court can end that troubling practice.

B. SEC has changed its position on the meaning of "investment contracts" without any explanation.

SEC's troubling new practice of rulemaking by district court enforcement action avoids the burdens and rigors required by APA review. The APA requires courts to "hold unlawful and set aside agency action" that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). Although agencies can change their position, *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 514–15 (2009), they must still provide a reasoned explanation for why the change is appropriate, *e.g.*, *Wages & White Lion Invs., LLC v. FDA*, 90 F.4th 357, 381–84 (5th Cir. 2024). But when the agency engages in rulemaking by district court enforcement action, it need not justify its position in the same way it would through APA review. Instead, it can simply show that its interpretation is correct.

SEC's rulemaking by district court enforcement action crusade is a prime example of SEC changing its position without providing a reasoned basis for the change. In the past, SEC has made clear that it did not think most cryptocurrencies were investment contracts. Compl. ¶ 43. Indeed, even the current SEC Chair himself did not think cryptocurrencies were investment contracts. *Id.* ¶ 44. Only after the current administration took over did SEC take its new (and incorrect) position that all cryptocurrencies were investment contracts under the Securities Act.

Even worse, determining what amounts to an "investment contract" is a process that the Supreme Court found required "crystalliz[ation]" through State cases. *Howey*, 328 U.S. 293 at 298. As *Howey* explained, "investment contract" in the Securities Act was defined in the context of State courts applying those States' "blue sky" laws. *Id.* at 33. States had blue sky laws that

addressed speculative schemes, and *Howey* was informed by those States' approach. *Id.*; *see State v. Gopher Tire & Rubber Co.*, 177 N.W. 937, 938 (Minn. 1920); *Lewis v. Creasey Corp.*, 248 S.W. 1046, 1049 (Ky. 1923). The Securities Act was not meant to serve as a general consumer protection statute, *see Wals v. Fox Hills Dev. Corp.*, 24 F.3d 1016, 1018–19 (7th Cir. 1994), because protecting consumers is the States' role.

Had SEC taken this position in the normal way agencies take positions, it would have had to explain itself. But because it short circuited its rule-making process and substituted for it with rule-through-enforcement, it does not. SEC failed to explain the basis for its change in position on regulating cryptocurrencies. That violates the APA and this Court should rule that SEC does not have plenary authority to regulate anything that it calls a cryptocurrency as an investment contract.

C. SEC is threatening to render States powerless to prosecute cryptocurrency scammers.

Federal law preempts State laws in areas governed by federal securities law. *See* 15 U.S.C. § 77r. If SEC makes cryptocurrencies investment contracts under the Securities Act, the States will be powerless to enforce their longstanding consumer protection laws against bad actors in the cryptocurrency community. True, the States can outlaw "fraud or deceit," *see id.* § 77r(c)(1)(A)(i), but cryptocurrency scams come in all shapes and sizes, and the States need to be able to exercise their traditional police powers to deal with that.

Beyond consumer protection, many States have started to squarely address cryptocurrencies and their regulation. Courts have long recognized that "States [are] laboratories for devising solutions to difficult problems." *Oregon v. Ice*, 555 U.S. 160, 171 (2009). But States cannot fulfill that role when they are preempted by federal regulations. Utah, for example, has formed a "Blockchain and Digital Innovation Task Force" with several government officials and experts in cryptocurrencies to develop legislation on this issue. Utah Code Ann. § 36-29-110.

Meanwhile other States have started including cryptocurrencies in their statutes governing money transfers and regulating them accordingly. *See, e.g.*, *United States v. Harmon*, 474 F. Supp. 3d 76 (D.D.C. 2020); *State v. Espinoza*, 264 So. 3d 1055 (Fla. Dist. Ct. App. 2019). These regulatory schemes have been carefully calibrated to the needs of each State and are designed to ensure people can freely transfer money while preventing fraud and harm to consumers. Allowing SEC to regulate cryptocurrencies as investment contracts would blow up those statutory schemes.

And many other States have started to regulate cryptocurrencies in the money transmitter context. Some directly define money transmitters to include virtual currencies. *See*, *e.g*., Ala. Code §§ 8-7A-2, 8-7A-5; Conn. Gen. Stat. § 36a-600(c); Fla. Stat. § 560.204; Ga. Code § 7-1-680(30); *see also Harmon*, 474 F. Supp. 3d at 89 (explaining that Bitcoin and other cryptocurrency assets are "money" under the D.C. Money Transmitters Act); *Espinoza*, 264 So. 3d at 1064 (holding that virtual currencies fall within the State's regulation of money services businesses).

Not only will a decision in SEC's favor here potentially render the States' cryptocurrency-specific statutes preempted, but it could also preempt dozens of criminal laws. For example, FTX collapsed in part because Sam Bankman-Fried stole money from investors using his platform. But garden variety theft is a State law matter, not a federal matter. *Compare* 18 U.S.C. §§ 641–670 (federal theft and embezzlement statutes), *with, e.g.*, Iowa Code § 741.1; Fla. Stat. § 812.014; *and* 18 Pa. Cons. Stat. Ann. § 3921 (state theft statutes). Because garden variety theft does not necessarily involve "fraud or deceit," 15 U.S.C. § 77r, potential cryptocurrency scammers could have an escape route from criminal liability for theft.

Indeed, the relative novelty of cryptocurrency and many people's lack of familiarity with how cryptocurrency works makes it a favorite for criminal enterprises. Being unable to enforce State laws protecting consumers from scams because the underlying matter is mischaracterized as

an investment contract subject to sole SEC jurisdiction could jeopardize all manner of prosecutions. Consider Georgia's racketeering statute. Like the federal Racketeering Influenced and Corrupt Organizations Act, a person cannot be convicted under Georgia's statute unless he commits two predicate crimes. *Compare Thompson v. State*, 440 S.E.2d 670, 672 (Ga. App. 1994), *with* 18 U.S.C. §§ 1961–1962. If a gang committing crimes uses cryptocurrencies to commit those crimes, then the Securities Act's preemption clause strongly suggests that criminal activities involving cryptocurrencies cannot serve as a predicate act for a Georgia RICO violation.

The only way to prevent those problems for the States is for this Court to hold that cryptocurrencies that do not involve investment contracts fall outside SEC's purview.

II. Cryptocurrencies are not investment contracts.

This Court should find that cryptocurrencies are not investment contracts subject to SEC regulation under the Securities Act for two fundamental reasons. *First*, SEC's attempted arrogation of authority is a Major Question and violates the federalism canon. SEC does not have clear congressional authorization to treat cryptocurrencies like investment contracts. *Second*, ordinary cryptocurrencies do not satisfy *Howey*'s test. Although there are some investment vehicles that satisfy *Howey* and are labelled cryptocurrencies, that is because those so-called cryptocurrencies are investment contracts by a different name. The label should not matter in determining whether a financial instrument is an investment contract under Securities Act.

A. The Major Questions Doctrine and federalism canon foreclose SEC's position.

Because of the public importance of SEC's unilateral decision to regulate around $2 trillion in cryptocurrencies as investment contracts, the Major Questions Doctrine and federalism canon require that SEC point to a clear congressional authorization to do so. It cannot.

1. This is a Major Questions case.

When an agency asserts newly found authority to regulate areas of broad "economic and political significance," courts should "hesitate before concluding that Congress meant to confer such authority." *West Virginia v. EPA*, 597 U.S. 697, 721 (2022) (quoting *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 159–160 (2000)) (quotation marks omitted). The Major Questions Doctrine requires Congress to "speak clearly when authorizing an agency to exercise powers of vast economic and political significance." *Alabama Ass'n of Realtors v. DHHS*, 594 U.S. 758, 764 (2021) (per curiam) (quoting *Util. Air Regul. Grp. v. EPA*, 573 U.S. 302, 324 (2014)) (quotation marks omitted). After all, "[e]xtraordinary grants of regulatory authority are rarely accomplished through modest words, vague terms, or subtle devices." *West Virginia*, 597 U.S. at 723 (quoting *Whitman v. Am. Trucking Assocations*, 531 U.S. 457, 468 (2001)) (cleaned up).

Major questions cases tend to have several characteristics in common.

First, major questions cases tend to involve assertions of authority over large swaths of the American population. For example, courts applied the doctrine to OSHA's vaccine mandate because it covered over 84 million people. *NFIB v. OHSA*, 595 U.S. 109, 117 (2022) (per curiam). Meanwhile, EPA's attempt to regulate carbon emissions was subject to major questions scrutiny because the agency tried to assert authority over almost the entire economy. *See West Virginia*, 597 U.S. at 723–24. Finally, the CDC's eviction moratorium was subject to major questions scrutiny because it covered "[a]t least 80% of the country, including between 6 and 17 million tenants at risk of eviction." *Ala. Realtors*, 594 U.S. at 764.

Second, major questions cases tend to involve agencies trying to assert power in areas outside their expertise and that they had never previously regulated. For example, the Fifth Circuit set aside as unconstitutional the federal government's vaccine mandate for government contractors because the Procurement Act had never been used to regulate public health issues. *See Louisiana*

v. Biden, 55 F.4th 1017, 1029–1030 (5th Cir. 2022). Likewise, the OSHA vaccine-or-test mandate was a workplace safety agency trying its hand at public health regulation for the first time. *See NFIB*, 595 U.S. at 117. And the CDC's eviction moratorium involved a public health agency dabbling in landlord-tenant law. *Ala. Realtors*, 594 U.S. at 764.

Third, major questions cases tend to involve an agency settling a national debate through its rulemaking authority. For example, the Fifth Circuit subjected the Nuclear Regulatory Commission's rules governing "away-from-reactor storage facilit[ies]" to major questions scrutiny because the appropriate way to dispose of nuclear waste "has been hotly politically contested for over half a century." *Texas v. NRC*, 78 F.4th 827, 844 (5th Cir. 2023). The Supreme Court subjected the federal government's student loan cancellation efforts to major questions scrutiny because student loan reform is the subject of near-constant debate in Congress. *See Biden v. Nebraska*, 600 U.S. 477, 504 (2023). And EPA's attempt to regulate carbon emissions warranted major questions scrutiny because it would have resolved once and for all the question "of how much coal-based" pollution the government would be willing to tolerate "over the coming decades." *West Virginia*, 597 U.S. at 729.

SEC's decision to regulate cryptocurrencies has all the hallmarks of a major questions case. *First*, SEC is trying to regulate massive portions of the economy. The cryptocurrency industry is worth "more than a trillion dollars," and "its daily trading volume is in the tens of billions of dollars." Compl. ¶ 29. There are more than $450 billion in Bitcoin in circulation alone. *Id.* The industry has created "hundreds of thousands of new jobs," and cryptocurrencies have the potential to take the economy to places it has never been before. *Id.* ¶ 30. *Second*, SEC has never asserted authority over cryptocurrencies. Even though cryptocurrencies have been around for much of two decades, Andersen, 18 J. Bus. & Tech. L. at 257, SEC did not start taking enforcement actions

against cryptocurrency exchanges until 2022, Compl. ¶ 47. *Third*, SEC is trying to stop a debate that has raged in the law reviews for years over what Congress can or should do to regulate cryptocurrencies. But Congress has the responsibility to assert its authority to control the money supply in interstate commerce. *See* U.S. Const. art. I, § 8, cls. 3, 5. And Congress has never tasked SEC with doing so through rulemaking by district court enforcement action.

Because this case is a quintessential major questions case, SEC must demonstrate it has a clear congressional authorization to regulate cryptocurrencies.

2. SEC's attempted regulation violates the federalism canon.

SEC's attempt to regulate cryptocurrencies "would upset the usual constitutional balance of federal and state powers," so "federal courts [must] be certain of Congress' intent before finding that federal law overrides this balance." *Gregory v. Ashcroft*, 501 U.S. 452, 460 (1991) (quoting *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 243 (1985)) (quotation marks omitted).

Consumer protection law is uniquely State law's domain. Garden variety fraud is a State law cause of action. *See*, *e.g.*, *Bowden v. Med. Ctr., Inc.*, 845 S.E.2d 555, 563 n.10 (Ga. 2020); *Koury v. Ready*, 911 So. 2d 441, 445 (Miss. 2005); *Beeck v. Aquaslide 'N' Dive Corp.*, 350 N.W.2d 149, 155 (Iowa 1984). Meanwhile, States have enacted a bevy of laws that bar unfair or unconscionable trade practices in their States. *See, e.g.*, Iowa Code § 537.5108; Mo. Rev. Stat. § 407.020.1; N.J. Stat. Ann. § 56:8-2. But SEC's foray into consumer protection threatens to tear down States' delicately balanced statutory schemes and common law causes of action. And it risks not only upsetting any given State's approach to regulation but also preempting those regulations.

Because SEC is trying to intrude on an area of the law that is uniquely within the purview of the States, it must point to "unmistakably clear" language authorizing it to do so. *Gregory*, 501 U.S. at 460 (quoting *Atascadero*, 473 U.S. at 242). And it cannot.

3. SEC cannot point to a statute clearly giving it the authority to regulate the sale of cryptocurrencies.

Federal securities laws do not allow SEC to regulate cryptocurrencies.

No one contests that SEC has general authority to prosecute people for engaging in securities fraud. *See* 15 U.S.C. § 78u. But general language like that is not enough to overcome a clear statement rule like that in *Gregory*. For example, the Supreme Court in *Atascadero* refused to hold California waived its sovereign immunity, even though the California Constitution gave its citizens the general right to sue the State. 473 U.S. at 241. And the Court in *Gregory* refused to strike down Missouri's age limits for judges, even though the law banning age discrimination applied to the States. 501 U.S. at 466–47.

What is more, clear statement rules like the Major Questions Doctrine and the federalism canon prevent Congress from "hid[ing] elephants in mouseholes." *Whitman*, 531 U.S. at 468. Here, the Securities Act's definition of a "security" is long and includes several dozen different types of investment vehicles. 15 U.S.C. § 77b. The word "investment contract" is buried in the middle of that lengthy definition. *See id.* To read the Securities Act and find that Congress allowed SEC to regulate cryptocurrencies as investment contracts would be finding a mammoth in that mousehole. And SEC recognizes that, which is why it has proceeded on this *ad hoc* basis of *seriatim* enforcement actions rather than through rulemaking that would exceed its authority.

B. Precedent forecloses SEC's position.

Applying longstanding precedent to the Securities Act shows that cryptocurrencies are not investment contracts. The Supreme Court has explained that investment contracts must be a contract "whereby [(1)] a person invests his money in [(2)] a common enterprise" (3) through which the investor would "expect profits solely from the efforts of the promoter or a third party." *Howey*, 328 U.S. at 298–99. A financial instrument meets *Howey*'s first prong only if the investor

can make "a voluntary investment choice." *Matassarin v. Lynch*, 174 F.3d 549, 562 (5th Cir. 1999). A financial instrument meets *Howey*'s second prong only if "the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties." *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 478 (5th Cir. 1974) (quoting *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, 482 n.7 (9th Cir. 1973)). And a financial instrument meets *Howey*'s third prong only if someone other than the investor has "managerial" control that could "affect the failure or success of the enterprise." *SEC v. Arcturus Corp.*, 928 F.3d 400, 409–10 (5th Cir. 2019) (quoting *Williamson v. Tucker*, 645 F.2d 404, 418 (5th Cir. 1981)).

If cryptocurrencies look like a strange fit for the Supreme Court's definition for an investment contract, it is because they are. When the average person thinks of investing in an "enterprise" they think of investing in a business. That is why the Ninth Circuit held speculating in gold futures did not create an investment contract—investing in a product involves reliance on the price of the underlying product, not someone's business acumen. *See SEC v. Belmont Reid & Co.*, 794 F.2d 1388, 1391 (9th Cir. 1986). So too with cryptocurrencies; the value of a cryptocurrency has nothing to do with the success of a business and everything to do with the price of the underlying token. Since the investor is not investing in a business, it would be weird to hold that speculating in cryptocurrencies creates an investment contract within SEC's jurisdiction.

1. Cryptocurrency trading does not involve contracts under *Howey*.

Howey's test is often described as having three-prongs but there is also a fourth prong that SEC's approach violates—that is, that the financial instrument be *a contract*. *See, e.g.*, *Howey*, 328 U.S. at 298–99. As one commentator has explained, "speculat[ing] on a global market" will not involve investment contracts "without any post-sale obligations undertaken by the seller." Matt Donovan, Note, *Ripple Effect: The SEC's Major Questions Doctrine Problem*, 91 Fordham L. Rev. 2309, 2319 (2023). In other words, the "meeting of the minds" that forms the backbone of

American contract law, *see, e.g.*, *Peak v. Adams*, 799 N.W.2d 535, 544 (Iowa 2011); *Chisholm v. Ultima Nashua Indus. Corp.*, 834 A.2d 221, 225 (N.H. 2003); *Milner v. Milner*, 360 S.W.3d 519 (Tex. App. 2010), *aff'd,* 361 S.W.3d 615 (Tex. 2012), never happens when someone speculates in cryptocurrencies. *See also* Donovan, *supra* at 2322 (noting that the average secondary buyer—that is, someone who buys cryptocurrency off an exchange—"has no legal relationship" with whoever invented that coin).

And that makes sense. Calling a stock a contract (and, by extension, an investment contract) is reasonable because there is a meeting of the minds. For example, an investor could pay Apple at an IPO in return for a share of stock representing a piece of the company's ownership. That investor understands Apple has a duty to maximize its value to its investors. But that agreement does not exist for cryptocurrencies. There is no one to call at Bitcoin Headquarters who can allow you to buy shares of Bitcoin in exchange for Bitcoin, Inc. maximizing shareholder value. Treating a Bitcoin like a share of Apple stock is a category error. Without an underlying agreement between the purchaser and the seller there is no meeting of the minds—the fundamental requirement of a contract. That alone precludes calling cryptocurrencies investment contracts.

2. Normal cryptocurrencies fail under *Howey*, even assuming they involve a contract under *Howey*.

The preliminary problems take cryptocurrencies outside of *Howey*'s reach. But even if they did not, cryptocurrencies do not satisfy *Howey*.

First, there is no investment under *Howey*. "[T]here are many reasons one would buy Bitcoin or Ethereum not as an investment; the common one being to transact anonymously." Justin Henning, Note, *The* Howey *Test: Are Crypto-Assets Investment Contracts?*, 27 U. Miami Bus. L. Rev. 51, 65 (2018). If the person buying the cryptocurrency so they can use the cryptocurrency as currency, they are not investing. By analogy, although someone might buy Euros because they

hope they will increase in value, another person might buy Euros to buy goods on a trip to Europe. That second person is not investing in Euros. So too here. The person buying cryptocurrency is not investing their money because the goal is to use the cryptocurrency, not wait for it to increase in value.

Second, there is not necessarily any common enterprise when someone buys cryptocurrency. A cryptocurrency buyer's fortunes are not interwoven with an entity seeking an investment—because nobody is seeking an investment. Bitcoin is a currency that is designed to serve as a store of value and a way to make purchases. In that way Bitcoin is like other currencies, from the Swiss Franc to the British Pound Sterling. Just as those currencies are not businesses seeking an investment, many cryptocurrencies are not businesses seeking an investment, either.

That makes sense given the reasons the cryptocurrencies' values fluctuate. With most investments, the success of the business determines the value of a given security—the value will increase during the good times and decrease during the bad times. *See generally, e.g.*, *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336 (2005). But a cryptocurrency is not a business, so it does not increase or decrease in value based on whether the business is doing well or poorly. Instead, the value of a given cryptocurrency is simply whatever the next person in line is willing to pay for it. Put differently, someone investing in a business is betting on the company doing well. Someone "investing" in a cryptocurrency is betting on the willingness of other people to bet on the success of the cryptocurrency. As a result, the fortunes of the investor are not interwoven with or dependent upon the fortunes of the person seeking the investment.

SEC has argued that "the promoter[]" of the cryptocurrency can serve as the person seeking the investment for *Howey*'s second prong, *see* Jerry W. Markham, Securities and Exchange Commission vs. Kim Kardashian*, Cryptocurrencies and the "Major Questions Doctrine"*, 14 Wm.

& Mary Bus. L. Rev. 515, 540 (2023) (quoting SEC guidance), but that proves too much. For context, celebrities and social media influencers will promote a cryptocurrency the same way they might endorse a pair of headphones. But if someone like that were to meet *Howey*'s second prong, then any investment advisor who recommends a specific investment would.

Congress did not want to turn a financial instrument into an investment contract simply because someone recommended that the investor buy it. What is more, it is unclear how the influencer's success is interwoven with the investor's success. The influencer would (ostensibly) either receive a flat fee or a commission for the endorsement deal, while the investor's profit would fluctuate with the value of the cryptocurrency. Because the influencer's profits do not change with the investor's, the influencer's success is not interwoven with the investor's success under *Howey*.

Indeed, the case SEC mainly relies on shows why that argument must fail. In *SEC v. International Loan Network, Inc.*, a group of people was found to have illegally sold unregistered securities. 968 F.2d 1304, 1305 (D.C. Cir. 1992). But the unregistered security there was shares in a business, and the promoters of that business were the owners of that business. Rather than being a third-party influencer, the people seeking the investment were the ones who stood to profit off the investment.

Third, the profits do not come solely through the acts of a third party. There is no business, so for many cryptocurrencies no one exercises managerial control over the cryptocurrency. *See Arcturus*, 928 F.3d at 409–10. In those cases, the token's seller and buyer set the price, even if those cryptocurrencies have a management structure. After all, buying a cryptocurrency is often a bet that other people will be willing to buy that currency later. And a cryptocurrency purchaser can influence whether people are willing to buy his tokens later by changing the price at which he is

willing to sell the token. But those pricing decisions are made by the cryptocurrency owners, not a business management team.

C. Cases finding cryptocurrencies to be investment contracts are unpersuasive.

The District of Connecticut found that the cryptocurrency Paycoin was an investment contract, but that is because Paycoin was a stock. *See Audet v. Fraser*, 605 F. Supp. 3d 372, 394 (D. Conn. 2022). The token represented shares in the defendant company. *Id.* at 381. And no one disputes that a stock is an investment contract under *Howey*. That is also why the Southern District of New York's reasoning in *SEC v. Terraform Labs Pte. Ltd.* and *SEC v. Kik Interactive Inc.* is unhelpful—in both cases, a company was selling stocks by a different name. *SEC v. Terraform Labs Pte. Ltd.*, 2023 WL 4858299, at *13 (S.D.N.Y. July 31, 2023); *SEC v. Kik Interactive Inc.*, 492 F. Supp. 3d 169, 177–78 (S.D.N.Y. 2020). A company cannot avoid SEC regulation through clever attempts at labeling.

That distinction sounds technical, but it matters. The tokens at issue in those cases were all investments in a company. The fluctuations in the tokens' values were really fluctuations in the companies' values. That differs from the situation here. The crux of this case is not that SEC is regulating the purchase and sale of traditional stocks or shares in a company. Rather, it is that SEC is trying to regulate cryptocurrencies generally, not tokens connected to the value of the company that issued the cryptocurrencies.

To be clear, the States are not saying that SEC is powerless when someone uses the words "cryptocurrency" or "blockchain" to try launder what would otherwise be an investment contract into a cryptocurrency. *Howey* "is to be applied in light of 'the substance—the economic realities of the transaction—rather than the names that may have been employed by the parties.'" *Int'l Bhd. of Teamsters, Chauffeurs, Warehousemen & Helpers of Am. v. Daniel*, 439 U.S. 551, 558 (1979) (quoting *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 851–52 (1975)). What the States *are*

saying is that SEC's authority does not extend to all cryptocurrencies that could ever be sold. It only applies to tokens that also meet the traditional definition of investment contracts.

Indeed, the nuance in this discussion highlights why SEC's position is such a gross overreach. Like the Covid pandemic, the challenges of cryptocurrencies require "a delicate exercise of" regulatory power. *BST Holdings, LLC v. OSHA*, 17 F.4th 604, 612 (5th Cir. 2021) (quoting *Pub. Citizen Health Rsch. Grp. v. Auchter*, 702 F.2d 1150, 418 (D.C. Cir. 1983)) (cleaned up). But "rather than a delicately handled scalpel, the [SEC's position] is a one-size-fits-all sledgehammer that makes hardly any attempt to account for differences in" the financial instruments it is trying to regulate. *Id.*

III. If Congress has authorized SEC to regulate cryptocurrencies, then Congress has exceeded its constitutional authority.

If the Securities Act authorized SEC to regulate cryptocurrencies, it would violate Article I of the Constitution in two independent ways. *First*, the Securities Act has provided no intelligible principle for determining what is or is not an investment contract. *Second*, the government cannot demonstrate that investing in cryptocurrencies implicates foreign or interstate commerce.

A. The SEC exceeds its delegated authority under the Securities Act by regulating cryptocurrencies.

"Congress is not permitted to abdicate or to transfer to others the essential legislative functions with which it is thus vested." *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495, 529 (1935). As a result, "Congress unconstitutionally delegate[s] legislative power to the SEC when it [gives] the SEC the unfettered authority to" make the law. *Jarkesy v. SEC*, 34 F.4th 446, 459 (5th Cir. 2022), *cert. granted,* 143 S. Ct. 2688 (2023), and *cert. denied,* 143 S. Ct. 2690 (2023). In other words, Congress must provide "an 'intelligible principle' by which" SEC "can exercise" its executive authority. *Id.* at 461 (quoting *Mistretta v. United States*, 488 U.S. 361, 372 (1989)). Congress fails to provide an intelligible principle for exercising executive authority when

it "declare[s] no policy," "establishe[s] no standard," or "la[ys] down no rule." *Panama Ref. Co. v. Ryan*, 293 U.S. 388, 430 (1935). That, at bottom, is an exercise in statutory interpretation. *See*, *e.g.*, *Gundy v. United States*, 139 S. Ct. 2116, 2123 (2019) (plurality op.).

Turning to the text, Congress has enacted no rule of decision for determining whether a financial instrument is an investment contract under the Securities Act. "The term 'security' means any . . . investment contract." 15 U.S.C. § 77b(a)(1). The Securities Act then makes it "unlawful for any person . . . to sell" any "security" "[u]nless a registration statement is in effect as to" that "security." *Id.* § 77e(a)(1); *see Howey*, 328 U.S. at 294. Finally, SEC has the right "to make, amend, and rescind such rules and regulations as may be necessary to" enforce and implement federal securities laws. 15 U.S.C. § 77s(a).

But the Securities Act never defines "investment contract." *See Howey*, 328 U.S. at 298. That matters because an investment contract does not carry a clear and fixed meaning. Indeed, *Howey* was cobbled together by trying to draw the common thread between various State cases where someone was convicted of securities fraud. *See id.* at 298–99 & n.4. If the courts had to invent a definition from persuasive state authority, then Congress has created no clear and intelligible principle for determining when SEC can exercise its authority.

That delegation resembles *A.L.A. Schechter*, where Congress gave the President the right to approve legally binding codes of conduct for the poultry industry that were created by the poultry industry. 295 U.S. at 521–23. Congress had no say over what the codes of conduct would say, and the statute included no requirements other than that the codes cannot create a monopoly. *Id.* at 521–23. The Court explained that, unlike in previous non-delegation cases, "the question" in that case was "more fundamental. It [was] whether there is any adequate definition of the subject to which the codes are to be addressed." *Id.* at 530–31. The Supreme Court then explained that the

statute did not define "unfair competition," and common law definitions were not helpful because the statute was broader than the common law definition of the term. *Id.* at 531–32. The Court continued by explaining that other statutes defining "unfair competition" created rules of decision for the courts and agencies to follow. *Id.* at 532–33. But, as here, the statute at issue in *A.L.A. Schechter* Congress did not do that. *Id.* at 533. That statute also gave the President unlimited discretion in determining whether to approve the codes of conduct. *Id.* at 538–39. That meant there was no rule of decision to apply, rendering the statute unconstitutional. *Id.* at 541–42.

While nondelegation's scope is hotly debated, at the very least the lack of delegation and scope of attempted arrogation authority by SEC here amounts to a major question. Congress has said SEC is allowed to enact regulations banning the sale of unregistered investment contracts. But Congress has not defined "investment contract," and it has provided no guardrails on SEC's ability to declare something an "investment contract." To be sure, there were common law definitions for "investment contract" at the time the Securities Act was enacted, *see Howey*, 328 U.S. at 298–99 & n.4, but the Court in *A.L.A. Schechter* explained that Congress cannot rely on others to define terms. Congress cannot rely on investment contract's common law meaning to apply to this novel context because it has failed to define the outer limits of the term. Given that failure, there is no intelligible principle for determining when something is an investment contract. The SEC thus exceeds its delegated authority under the Securities Act when regulating cryptocurrencies.

B. The Securities Act violates the Commerce Clause as applied to cryptocurrencies.

Congress has the authority "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. Const. art. I, § 8, cl. 3. But that authority is limited. Congress properly exercises its Commerce Clause authority only when (1) the law "regulate[s] the use of the channels of interstate commerce," (2) the law regulates "the instrumentalities of interstate commerce," (3) the law protects "persons or things in interstate commerce," or (4) the

regulated activities "substantially affect interstate commerce." *United States v. Lopez*, 514 U.S. 549, 558–59 (1995).

Regulations that do not directly apply to interstate commerce must prove the conduct regulated "affects interstate commerce." *Id.* at 561; *see also id.* at 562–63 (explaining how the government would prove there is an effect on interstate commerce when the statute does not facially apply to interstate commerce). To answer that, Courts consider "whether (1) the activity at which the statute is directed is commercial or economic in nature; (2) the statute contains an express jurisdictional element involving interstate activity that might limit its reach; (3) Congress has made specific findings regarding the effects of the prohibited activity on interstate commerce; and (4) the link between the prohibited conduct and a substantial effect on interstate commerce is attenuated." *United States v. Patton*, 451 F.3d 615, 623 (10th Cir. 2006) (quoting *United States v. Grimmett*, 439 F.3d 1263, 1272 (10th Cir. 2006)). Under the first prong, if the regulated act is commercial, it likely may be regulated under the Commerce Clause. *Id.* But if the regulated activity is noncommercial, the latter three factors are all significant. *Id.*

Cryptocurrency trading is not necessarily commercial. "The distinction between what is and is not commercial therefore lies at the heart of the Commerce Clause." *Id.* at 624. It is not clear that cryptocurrency trading is commerce at all, much less *interstate* commerce, especially given the Supreme Court's admonition not to so expansively define commercial so that "any activity can be looked upon as commercial" as that would "obliterate the intended limits on federal power." *Id.* (quoting *Lopez*, 514 U.S. at 565). Just as SEC cannot regulate trading baseball cards as securities, neither can SEC regulate cryptocurrencies here. To be sure, perhaps cryptocurrencies are moving in interstate commerce, but SEC must do more than rely on theory—especially given no findings supporting such an approach from Congress. *See Lopez*, 514 U.S. at 567; *United States v.*

Morrison, 529 U.S. 598, 614–15 (2000). Until Congress either enacts a law responding to finding cryptocurrencies effect on interstate commerce or limits the statute's reach, the Securities Act is unconstitutional as applied to cryptocurrencies.

To be sure, Congress has restricted SEC's reach by making unregistered security sales illegal when the seller "make[s] use of any means or instruments of transportation or communication in interstate commerce," 15 U.S.C. § 77e, but SEC has not treated that as limiting its authority to interstate cryptocurrency trades. Section 77e could be read to limit the SEC's authority to interstate commerce but SEC has shown no work to show that is its own view.

SEC's approach downplays Supreme Court precedent. Indeed, the Supreme Court found unconstitutional bans on possessing firearms in school zones and statutes punishing violence against women because the government failed to prove either form of activity fell within the four categories noted above. *Lopez*, 514 U.S. at 567 ("To uphold the Government's contentions [that it could ban firearms in school zones] here, we would have to pile inference upon inference in a manner that would bid fair to convert congressional authority under the Commerce Clause to a general police power of the sort retained by the States."); *Morrison*, 529 U.S. at 615 (enjoining enforcement of part of the Violence Against Women Act because no more than an attenuated link between violence against women and interstate commerce). This Court should follow that path and enjoin SEC from applying the Securities Act if the SEC's actions violate the Commerce Clause.

CONCLUSION

This Court should reject SEC's enforcement of crypto assets absent an investment contract. SEC's exercise of this undelegated authority puts our consumers at risk by preempting state statutes better tailored to the specific risks of non-securities products.

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CERTIFICATE OF SERVICE

I certify that the foregoing was filed with the Clerk using the appellate CM/ECF system on July 10, 2024. All counsel of record are registered CM/ECF users, and service will be accomplished by the CM/ECF system.

July 10, 2024

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