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**UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON  
SEATTLE DIVISION**

SECURITIES AND EXCHANGE  
COMMISSION,

Plaintiff,

v.

ISHAN WAHI, NIKHIL WAHI, and  
SAMEER RAMANI,

Defendants.

No. 2:22-cv-01009

**DEFENDANTS ISHAN AND NIKHIL  
WAHI'S MOTION TO DISMISS**

NOTE ON MOTION CALENDAR:  
**12th** day of May, 2023.

ORAL ARGUMENT REQUESTED

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## INTRODUCTION

1  
2 This case is about the rule of law and whether the most powerful entity in our society—  
3 the United States Government—must abide by the law when it brings its power to bear against a  
4 person. In this case, the Securities and Exchange Commission (“SEC”) is trying to seize broad  
5 regulatory jurisdiction over a massive new industry via an enforcement action against a 32-year-  
6 old former Coinbase employee and his kid brother. An enforcement action against individual  
7 people—particularly ones who are already occupied with federal criminal proceedings at the  
8 other end of the country—is not how major questions of law that loom over entire industries  
9 should be resolved. Yet that is how the SEC has chosen to proceed.

10 The legal deficiencies in the SEC’s Amended Complaint are serious, and the Court should  
11 not allow the Agency’s brute-force approach to obscure them. The linchpin of the Amended  
12 Complaint is that the digital assets Ishan Wahi, his brother, and the other defendant traded are  
13 “securities” under the Exchange Act. Specifically, the SEC claims that each of those digital  
14 assets constitutes an “investment contract” (and thus a security). The SEC is wrong. The term  
15 “investment contract” requires—as the statute says—a *contract*. But here there are no contracts,  
16 written or implied. The developers who created the tokens at issue have no obligations  
17 whatsoever to purchasers who later bought those tokens on the secondary market. And with zero  
18 contractual relationship, there cannot be an “investment contract.” It is that simple.

19 But even if there *could* be an “investment contract” absent contractual obligations of any  
20 kind, the SEC’s Amended Complaint would still fail. On the SEC’s account, there is an  
21 “investment contract” whenever a person is “led to invest money in a common enterprise with  
22 the expectation that they would earn a profit solely through the efforts of the promoter or of some  
23 one other than themselves.” *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298 (1946). But *this* case  
24 involves standalone digital tokens purchased over exchanges. Such token-buyers are not part of  
25 any “common enterprise”; they do not pool their assets together as part of some shared endeavor;  
26 and their fortunes are not tied to those of the original developers. In fact, such buyers do not put  
27

1 their money *in* an enterprise at all; they send their money to unrelated third-parties in exchange  
2 for an asset—no different from when someone buys a baseball card on the secondary market.  
3 Nor do these token buyers expect the tokens’ value to rise “solely” (or even predominantly)  
4 “through” the efforts of the original developers. Rather, as the SEC’s Amended Complaint  
5 readily accepts, the tokens’ value is driven by *market forces*, not *managerial efforts*—as  
6 evidenced by the fact that the tokens are almost all functional (*i.e.*, they can operate without any  
7 centralized intermediary) and that each experiences wide price fluctuations, regardless of the  
8 status of the underlying platform. Indeed, the SEC’s *entire theory* is that the Defendants  
9 allegedly got ahead of information about these tokens being listed on an exchange—*not* that they  
10 had unique information about the “efforts” of the developers or some other “promoter.”

11 Even if the SEC could show that the tokens at issue satisfy *Howey*’s definition of an  
12 investment contract, its Amended Complaint fails to adequately allege scienter. Nowhere has  
13 the SEC alleged that the Defendants traded tokens with the mental state necessary to establish  
14 federal securities fraud. To the contrary, nobody—neither the SEC nor the legion of sophisticated  
15 counsel advising Coinbase—considered the tokens at issue to be securities before the SEC filed  
16 this suit. Because the SEC cannot establish that the Wahis had the culpable state of mind  
17 necessary to commit securities fraud, the Amended Complaint must be dismissed.

18 If the SEC really believes digital assets are securities, it should engage in a rulemaking  
19 or other public proceeding explicating that view and providing guidance to regulated parties on  
20 its implications. That orderly process—one administrative agencies have dutifully followed for  
21 decades—allows the agency to receive public comments and facilitates a deliberative process,  
22 ensuring the agency’s position is well grounded in fact and law. Should regulated parties disagree  
23 with the agency’s views in its final rule, they would have an opportunity to contest those views  
24 in court. This process ensures the law is clear *before* consequences are imposed—rather than  
25 leaving people to guess about an agency’s intentions, order their affairs based on that guess, and  
26 then suffer substantial penalties via *ex post* enforcement actions if they guess wrong.

1 The SEC’s parade of one-off enforcement actions against the likes of Kim Kardashian,  
2 DJ Khaled, Floyd Mayweather Jr., and now Ishan and Nikhil Wahi is—by contrast—a process  
3 designed to produce more heat than light. As one commentator put it, by pursuing only selective  
4 enforcement in alleged fraud cases, “which are more likely to settle out of court,” the SEC has  
5 largely “precluded judges from interpreting how securities regulations apply to digital assets.”  
6 Recent Guidance, *SEC, Framework for “Investment Contract” Analysis of Digital Assets*, 132  
7 Harv. L. Rev. 2418, 2425 (2019). The reality is that Congress has never endorsed the SEC’s  
8 sweeping view of its own authority, and the courts have interacted with it in only a handful of  
9 one-off cases carefully curated by the agency. The SEC should not be permitted to continue that  
10 gambit here, and further calcify its capacious view of its own power. The Court should dismiss  
11 the Amended Complaint.

## 12 **BACKGROUND**

### 13 **A. Crypto and Blockchain Technology**

14 Much of modern life happens online. When Fred wants to give Betsy \$500, he does not  
15 hand her cash; he pulls out his phone and “sends” the money. Most people “send” the money  
16 through an intermediary—PayPal, Venmo, Zelle, etc. Those intermediaries are linked to Fred’s  
17 bank account (or carry a balance for him) and they handle the details of getting Fred’s money to  
18 Betsy. This basic dynamic is ubiquitous. Almost every financial transaction or data exchange is  
19 executed via one of these intermediaries and thus depends on the intermediary being trustworthy.<sup>1</sup>

20 One of the key features of so-called “cryptocurrency” is that it can operate without these  
21 middlemen. It is *decentralized*. The system runs on a diffuse network of different people, rather  
22 than through a single intermediary that controls everything. The technology that makes this  
23 possible is “blockchain” technology. At its essence, a blockchain is an encoded online ledger  
24 that is viewable by all and that records all transactions on a given network.

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25  
26 <sup>1</sup> For a readable, comprehensive background on cryptocurrency, its function, and its history, see generally  
27 Matt Levine, *The Crypto Story*, BLOOMBERG BUSINESSWEEK, Oct. 31, 2022, <https://tinyurl.com/ye4cfahf>.

1           Returning to Fred and Betsy, suppose that instead of \$500 in cash, Fred wanted to give  
2 Betsy one Bitcoin. Fred’s Bitcoin would be stored on a “wallet,” which is really just an  
3 identifiable address on the Bitcoin network. (The addresses are lengthy alphanumeric strings  
4 that look like this: 3J98t1WpEZ73CNmQviecnyiWrnqRhWNLy. The addresses do not contain  
5 personal information, though some people publicly identify their Bitcoin addresses.) Because  
6 every Bitcoin transaction is verified and recorded by the decentralized Bitcoin network, the  
7 network will “know” how many Bitcoin are assigned to Fred’s wallet. If Fred wants to send one  
8 of his Bitcoins to Betsy, he simply enters her Bitcoin address into his wallet, which then  
9 broadcasts the transfer to the Bitcoin network.

10           That transaction is, in turn, bundled with other transactions into a group called a “block.”  
11 Those blocks are then validated by computers that are part of the network—a process where  
12 multiple computers otherwise unconnected from each other independently perform a checking-  
13 function to reach a consensus on what transactions just occurred. Once the block is complete, it  
14 is added to the end of the public ledger, creating an updated *chain of blocks* against which to  
15 evaluate the next set of transactions. And anyone who cares to look would be able to see that  
16 one Bitcoin moved from Fred’s Bitcoin address to Betsy’s Bitcoin address. Everything is public.

17           One of the most important issues in blockchain technology is inducing large numbers of  
18 unrelated computer operators to verify transactions accurately. Instead of a trusted bank in the  
19 middle of every transaction, there are thousands of diffused “validators” scattered across a  
20 blockchain. (Bitcoin is the most famous blockchain network, but there are many others.) One  
21 validation method is called “proof-of-work” wherein (to oversimplify a bit) validators run  
22 specialized software to solve complex math problems and, in doing so, “confirm” that a particular  
23 transaction is legitimate—*e.g.*, that Fred really had a Bitcoin to send to Betsy. Whichever  
24 computer solves the math problem and validates the transaction first receives a “reward” in the  
25 form of “tokens” that are usually native to that particular blockchain network. (Validators on the  
26 Bitcoin network earn Bitcoin.) The other validation method is called “proof-of-stake” where (to  
27

1 oversimplify again) validators essentially post tokens as collateral when they validate  
2 transactions. If the validator validates transactions accurately, the parties executing the  
3 transactions pay the validator a fee in tokens. (This is often called a “gas fee.”) If the validator  
4 validates transactions inaccurately, though, the validator risks losing some or all of its “stake.”  
5 For major blockchain networks, there are scores of validators. For instance, there are about a  
6 million global Bitcoin validators (commonly called “miners,” because validating transactions  
7 creates or “mines” Bitcoin that the validator then gets to keep).<sup>2</sup>

8 This Motion turns principally on the legal status of nine tokens on the “Ethereum”  
9 blockchain.

#### 10 **B. Platforms and Blockchain Protocols**

11 Blockchain is a general technology and there are different “blockchain networks” (*e.g.*,  
12 Bitcoin and Ethereum) upon which other programs are built. Blockchain networks are governed  
13 by “blockchain protocols.” “Protocol” just means rules. So together, a “blockchain protocol”  
14 represents the rules that govern how people interact on a “blockchain network” (*i.e.*, a particular  
15 blockchain ledger along with all of the people contributing to and using that ledger).

16 Take a (relatively) simple example. Under Bitcoin’s protocol, transactions are validated  
17 using a proof-of-work consensus mechanism (lots of computers performing extremely complex  
18 mathematical calculations). By contrast, for Ethereum, transactions are validated using a proof-  
19 of-stake consensus mechanism (far fewer computers posting assets and then checking the  
20 transaction at risk of forfeiting those assets). Consensus mechanisms are just one way  
21 “protocols” may differ. There are many others.

22 Developers who want to create “platforms” (*i.e.*, crypto projects) using an existing  
23 blockchain network have to decide which network to use. There are not very many popular  
24 blockchain networks. But there *are* many platforms that are built on top of and incorporate those

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26 <sup>2</sup> See generally, *e.g.*, Darren J. Sandler, *Citrus Groves in the Cloud: Is Cryptocurrency Cloud Mining A*  
27 *Security?*, 34 Santa Clara High Tech. L.J. 250, 253-63 (2018).

1 networks—akin to how “apps” on mobile phones are built on and use Apple’s iOS or Android.  
2 For instance, an online computer game may store its users’ essential data on a blockchain (*e.g.*,  
3 who has the most points) while using an ordinary cloud server to host its website (something like  
4 Amazon Web Services). Developers choose the best blockchain protocol for their projects.

5 Platforms frequently incorporate “tokens.” There are many types of tokens. Some are  
6 “utility tokens,” which enable people to use a platform’s goods and services. Some are  
7 “governance tokens” (which usually are also utility tokens), which give holders the ability to  
8 weigh in on how a platform operates, such as through voting. In all events, tokens are simply  
9 digital assets that serve some basic purpose on a given platform.

10 Here is one example. “Brave” is a privacy-focused web browser that shields users from  
11 pop-up ads and tracking cookies. To compensate content creators and websites in the absence of  
12 these traditional sources of revenue, the browser uses the “Basic Attention Token” (BAT).  
13 People using Brave can earn BATs by choosing to watch certain ads that are accessible through  
14 the browser. And then people can use their BATs to tip their favorite content creators. The value  
15 of a BAT derives in part from the fact people can trade it over exchanges (more on that below).

16 As this example suggests, there are many ways people can get tokens—validating (*i.e.*,  
17 confirming) transactions is not the only one. Sometimes, developers create tokens and distribute  
18 them for free to promote broad adoption of the underlying platform. In other instances,  
19 developers will sell pre-functional tokens to raise money for building a potential platform—a  
20 process sometimes called an “initial coin offering” (or “ICO”). Moreover, developers will quite  
21 often provide an incentive to productively use their platforms by rewarding users with tokens for  
22 performing certain actions (*e.g.*, choosing to watch ads on Brave).

23 As noted, this case principally involves nine tokens for nine platforms “built on top” of  
24 the Ethereum network. For reasons not relevant here, Ethereum is very popular among  
25 developers because its protocol makes it easy for developers to create tokens for the platforms  
26 that ultimately run on the Ethereum network. For instance, returning to Brave and Basic  
27

1 Attention Tokens, if Tom wanted to send Jane 10 BATs because of her funny cat video, that  
2 transaction would be packaged into a block on the Ethereum network, and then confirmed by its  
3 validators, who in doing so confirm Tom had 10 BATs to give. The validators would earn a  
4 small amount of the token native to Ethereum, Ether, if they did their job correctly.

5 Once launched, platforms running on blockchain networks are often decentralized (much  
6 like the networks themselves). In other words, no person or company controls their day-to-day  
7 operations. People can transact or interact directly with each other, without the involvement of  
8 the platform's creator or any other intermediary. This is, to state the obvious, a very significant  
9 difference from traditional websites, platforms, and the like.

10 The Amended Complaint addresses nine tokens, some of which are primarily utility  
11 tokens, others of which are primarily governance tokens, and some of which are both. The utility  
12 tokens enable token-holders to partake in a platform's goods and services ranging from receiving  
13 discounts and earning transaction fees to obtaining geographic data location queries and trading  
14 energy. *E.g.*, Dkt. #27 ("Am. Compl.") ¶¶ 106-22 (AMP), 146-55 (XYO), 172-79 (LCX), 180-  
15 92 (POWR). The governance tokens allow users to vote on certain governance issues, like what  
16 cryptocurrencies a platform will list or how certain funds should be allocated. *E.g.*, *id.* ¶¶ 123-  
17 31(RLY), 132-45 (DDX). But regardless of their exact form and function, none of these tokens  
18 are securities.

19 According to the Amended Complaint, the developers behind these tokens distributed  
20 them through a number of means. Some were sold by developers directly. *E.g.*, *id.* ¶¶ 124 (RLY),  
21 148 (XYO), 173 (LCX), 181 (POWR), 195 (DFX), 210 (KROM). Some were given to users as  
22 rewards for performing certain functions on the platforms. *E.g.*, *id.* ¶¶ 111 (AMP), 156 (RGT).  
23 Others were allocated to the public to promote use of the platform. *E.g.*, *id.* ¶ 135 (DDX). But  
24 across the board, each token was designed *to be used*. None of the above tokens was created to  
25 be a "share of" the platform or a pure passive investment therein.

1           **C.     Digital Asset Exchanges**

2           As explained above, there are lots of ways to obtain a token from a crypto platform  
3 directly. Another way is to buy the token in a secondary market.

4           “Exchanges” allow customers to buy, sell, and trade cryptocurrencies and other digital  
5 assets. Typically, they can swap one digital asset for another, or buy a digital asset with regular  
6 government-backed fiat currency. For instance, on Coinbase—the largest digital asset exchange  
7 in the United States, and Ishan Wahi’s former employer—users can (among other things) buy  
8 and sell tokens with ease from their phones, using the exchange’s mobile app.

9           For present purposes, what matters is that when someone buys a *token* on an exchange,  
10 there is no *connection* between the token-buyer and the token’s original developer. An exchange  
11 simply matches buy offers with sell offers. In other words, unlike a developer selling tokens to  
12 the public—a direct sales transaction between the developer and the token-buyers—an exchange  
13 sale deals only with the underlying *asset*. When someone buys a standalone token on the  
14 secondary market—like with Coinbase—that purchase does not create a direct relationship  
15 between the token-holder and the token’s original developer.

16           **D.     The SEC’s Action Against Ishan Wahi**

17           In 2018, Coinbase hired Ishan Wahi as a manager in its Assets and Investing Products  
18 Group. Am. Compl. ¶¶ 1, 27. As part of that job, Ishan Wahi was privy to Coinbase’s internal  
19 deliberations about what tokens the company planned on listing on its exchange. *Id.* ¶¶ 30-31.

20           Once a token is listed on Coinbase, it can be bought, sold, and traded by the platform’s  
21 98 million registered users. *Id.* ¶ 3. Thus, after a token is listed for purchase on Coinbase, the  
22 token’s market value typically increases. *See id.*

23           The thrust of the SEC’s Amended Complaint is that Ishan Wahi used information he  
24 gained at Coinbase to tip off his brother, Nikhil Wahi, and his college friend, Sameer Ramani,  
25 about tokens that were about to be listed on Coinbase. *Id.* ¶¶ 6, 16-17, 100-01. The Amended  
26 Complaint alleges that Nikhil and Sameer bought these tokens on other exchanges *before*



1 Coinbase announced it was going to list them, enabling them to acquire the tokens before their  
2 prices increased. *See id.* ¶¶ 43-45, 49-50, 55-57, 61-63, 68-72, 75-77, 83-85, 89-90. Nikhil and  
3 Sameer would then allegedly sell their tokens shortly after Coinbase made its announcements,  
4 keeping the differential in value. *Id.* ¶¶ 46, 51, 58, 73, 78, 86.

5         These activities eventually caught the attention of Coinbase (and the SEC), leading to two  
6 parallel proceedings. The first is a criminal indictment against Ishan Wahi, Nikhil Wahi, and  
7 Sameer Ramani in the Southern District of New York, charging the three of them with wire fraud  
8 and wire fraud conspiracy on the theory that they fraudulently misappropriated Coinbase’s  
9 “property” in the form of inside knowledge concerning what tokens would be listed and when.  
10 The second is this SEC action—filed on the same day at the other end of the country—against  
11 Ishan, Nikhil, and Sameer for violating Section 10(b) of the Securities Exchange Act of 1934 and  
12 Rule 10b-5. Those provisions outlaw using “any manipulative or deceptive device” “in  
13 connection with the purchase or sale of any security”—a prohibition that includes insider trading.  
14 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. According to the SEC, each of the nine tokens here  
15 is a security because each constitutes an “investment contract.” *See, e.g.*, 15 U.S.C. § 77b(a)(1);  
16 Am. Compl. ¶ 25. The SEC does not ground its jurisdiction in any other provision.

17         Specifically, the SEC claims that these nine tokens are “investment contracts” because  
18 (i) the tokens’ developers initially offered them “to raise money that would be used for [their]  
19 business”; (ii) the developers made a series of public statements that each token’s value would  
20 increase on account of the developer’s efforts; and (iii) the tokens are traded on secondary  
21 markets. Am. Compl. ¶¶ 101-05. The SEC says each token is a “security” because each token’s  
22 developers “invited people to invest on the promise” that the developers “would expend future  
23 efforts to improve the value of their investment”—in this case, each purchased token. *Id.* ¶ 104.

24         But the SEC does *not* allege that any of the Defendants purchased any of the tokens at  
25 issue from developers directly. To the contrary, the SEC alleges that the Defendants purchased  
26  
27

1 the tokens at issue on the secondary market years after these platforms were founded (and years  
2 after the lion's share of statements referenced in the Amended Complaint were made).<sup>3</sup>

3 Ishan Wahi's former employer Coinbase—a publicly traded company headquartered in  
4 the United States—has maintained before, during, and after the alleged events at issue that it has  
5 never listed a federal security on its platform (including any of the tokens at issue here). *See* Paul  
6 Grewal, *Coinbase Does Not List Securities. End of Story.*, Coinbase (July 21, 2022),  
7 <https://tinyurl.com/3rph85vm>. The SEC has not brought an action against Coinbase for being an  
8 unregistered exchange. Only Ishan Wahi, his kid brother, and his college friend have faced the  
9 SEC's ire.

### 10 SUMMARY OF ARGUMENT

11 The SEC wants to broadly regulate digital assets. But rather than obtain such authority  
12 from Congress, the SEC has sought to achieve it through the courts by way of this precedent-  
13 setting action against Ishan and Nikhil Wahi. In so doing, the SEC seeks to distort the federal  
14 securities laws beyond all recognition, and win for itself regulatory domain over an entirely new  
15 industry. That gambit is an abuse of power. Federal law clearly forecloses it. And this Court  
16 should reject it.

17 The essential legal premise of this action is that something can be an “investment  
18 contract” without anything that resembles a contract. That is wrong, as statutory text, history,  
19 and precedent all confirm. The very heart of an investment contract is—and always has been—  
20 the coupling of an asset with a binding promise: The sale of land *plus* the promise to manage

21 <sup>3</sup> Compare Am. Compl. ¶¶ 43-44 (AMP purchases in June 2021), *with* 109 (Flexa founded in 2018), 109  
22 (initial token offerings between February 2019 and April 2019); 115 (token's “white paper” published in 2019);  
23 *compare* ¶¶ 48-52 (RLY purchased in July 2021), *with* 123 (Rally founded in 2018), 124 (initial token offerings  
24 from December 2020 to March 2021); *compare* ¶¶ 53-59 (DDX purchased in August 2021), *with* 135 (initial token  
25 offering in July 2020); *compare* ¶¶ 61-66 (XYO purchased in September 2021), *with* 146 (XY founded in 2012),  
26 148 (initial token offering from March to May 2018), 149-51 (token's “white paper” and posts in 2018 and 2019);  
27 *compare* ¶¶ 67-73 (RGT purchased in September 2021), *with* 157 (initial token offering in July 2020), 160 (citing  
statements from “late 2020 and early 2021”); *compare* ¶¶ 74-79 (LCX purchased in October 2021), *with* 173 (initial  
token offering in September 2019); *compare* ¶¶ 80-87 (POWR purchased in November 2021), *with* 180-181 (initial  
token offerings in August and September 2017), 183 (token's “white paper” published in 2017); *compare* ¶¶ 88-92  
(DFX purchased in April 2022), *with* 196 (initial token offering in February 2021); *compare* ¶¶ 88-92 (KROM  
purchased in April 2022), *with* 210 (initial token offering in November 2021).

1 orange groves on it; the sale of beavers *plus* the promise to raise them for fur; the sale of vineyards  
2 *plus* the promise to develop wine. But here, there is nothing of the sort. Each token at issue was  
3 sold on the secondary market; each transaction was between a buyer and some third-party seller.  
4 For tokens sold on exchanges, there is no contractual relationship between token-holders and  
5 developers, and there are thus no binding promises running from the developers to the token-  
6 holders. There is just a naked asset sale. And such a sale—decoupled from any post-sale  
7 promises on the part of any developer—has never once constituted an “investment contract.”

8         The Major Questions Doctrine along with basic principles of fair notice underscore what  
9 text, history, and precedent already make plain. The SEC may not use the phrase “investment  
10 contract” as a blank check to cash whenever it seeks to expand its regulatory ambit. And it may  
11 not lay claim over the novel and far-reaching digital asset industry without clear congressional  
12 authorization. At the least, whatever the federal securities laws provide, they do not provide *that*.

13         But even setting all that aside, as described below, the SEC cannot prevail even under its  
14 own framework—a cribbed and literalistic reading of the Supreme Court’s decision in *Howey*,  
15 328 U.S. 293. As the SEC would have it, there is an “investment contract” whenever a person is  
16 “led to invest money in a common enterprise with the expectation that they would earn a profit  
17 solely through the efforts of the promoter or of some one other than themselves.” *Id.* at 298. But  
18 here, there is no investment of money *in* anything; again, the only transactions at issue involve  
19 tokens sold on the secondary market, where money passes from buyer to third-party seller. And  
20 in any event, there is no “common enterprise” at all. Namely, token-holders are not part of the  
21 same profit-seeking venture with other token-holders or the original developers; rather, they are  
22 simply asset holders, whose financial fortunes turn on their own decisions about buying and  
23 selling. Moreover, on the Amended Complaint’s own terms, the values of the tokens at issue  
24 derive mostly from *market forces*, not *managerial efforts* (the last part of *Howey*). After all, the  
25 SEC’s entire theory of the case is that the Defendants here allegedly front-ran the tokens being  
26 *listed* (and how the market would then react)—not the announcement of any new policy or  
27

1 managerial initiative.

2         The SEC’s attempt to reinvent the term “investment contract” will have implications far  
3 beyond this case. In addition to holding Ishan and Nikhil Wahi liable for actions nobody could  
4 have anticipated would violate the securities laws—indeed, even Ishan’s publicly traded  
5 employer was convinced these tokens were not securities—it would establish sweeping SEC  
6 jurisdiction over an industry without any input from Congress. And it would, in so doing, subject  
7 an industry with tremendous potential to a regulatory apparatus that is an exceedingly poor fit  
8 for it. The securities laws exist to protect people with direct passive investments in ongoing  
9 enterprises—not to set the ground rules for blockchain technology, platforms built atop it, utility  
10 tokens, nonfungible tokens, decentralized autonomous organizations, or any of the myriad square  
11 pegs the SEC has tried to jam into this round hole.

12         There is also no need to stretch securities laws into the digital asset space, as excluding  
13 tokens from the SEC’s regulatory jurisdiction does not mean digital frauds and abuses will go  
14 unregulated. Countless other regulators already assert that digital assets are subject to the myriad  
15 financial regulations that prevent fraud and manipulation in traditional financial markets. And  
16 in addition, Congress and state legislatures are actively debating (and enacting) digital asset  
17 regulations that are properly tailored to the unique features of this cutting-edge technology.

18         Finally, the Amended Complaint does not adequately allege scienter. Scienter is a core  
19 protection in our justice system that ensures only the culpable are punished. As it stands, the  
20 SEC has not met its burden on this basic element. It is both unlawful and deeply unfair to punish  
21 Ishan and Nikhil Wahi for federal securities fraud when all available guidance—including  
22 Coinbase’s elaborate, SEC-approved internal review process—indicated that these tokens are *not*  
23 securities. Nothing in the Amended Complaint demonstrates knowing, willful, or even reckless  
24 violation of the federal securities laws.

25         In short, the SEC’s attempt to radically expand its regulatory jurisdiction on the backs of  
26 Ishan and Nikhil Wahi is unlawful, and there is no reason for this Court to countenance the  
27

1 agency’s zealous attempt at a power grab. Rather, the Court should dismiss the Amended  
2 Complaint.

### LEGAL STANDARD

3  
4 An Amended Complaint must contain “enough facts to state a claim to relief that is  
5 plausible on its face.” *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007). Dismissal under  
6 Rule 12(b)(6) may be based on “the lack of a cognizable legal theory or the absence of sufficient  
7 facts alleged under a cognizable legal theory.” *Godecke v. Kinetic Concepts, Inc.*, 937 F.3d 1201,  
8 1208 (9th Cir. 2019). A pleading that offers only “labels and conclusions” or “a formulaic  
9 recitation of the elements of a cause of action will not do.” *Ashcroft v. Iqbal*, 556 U.S. 662, 678  
10 (2009). In addition, the Court is not “required to accept as true allegations that are merely  
11 conclusory, unwarranted deductions of fact, or unreasonable inferences.” *Sprewell v. Golden*  
12 *State Warriors*, 266 F.3d 979, 988 (9th Cir. 2001). And “[m]ere legal conclusions are not entitled  
13 to the assumption of truth.” *Dougherty v. City of Covina*, 654 F.3d 892, 897 (9th Cir. 2011).

### ARGUMENT

#### **I. THE TOKENS ARE NOT “INVESTMENTS CONTRACTS” UNDER THE SECURITIES LAWS.**

14  
15  
16 The term “investment contract” has a long history. Even before the federal securities  
17 laws—which themselves date to the Great Depression—the phrase “investment contract” was a  
18 term of art for financial dealings that differed in some way from traditional securities (like stocks  
19 and bonds), but that still had the essential “characteristics of a security.” *Int’l Bhd. of Teamsters*  
20 *v. Daniel*, 439 U.S. 551, 559 (1979). In the main, “investment contracts” cover business ventures  
21 that involve the sale of some asset (like land or an oil lease) *coupled with* certain legally binding  
22 promises by the seller to manage or develop that asset in a profitable manner. Canonical  
23 examples include one-off enterprises like a businessman selling tracts of land upon which he  
24 promises to maintain a range of profitable orange groves, *Howey*, 328 U.S. at 299, or beaver-  
25 breeders who sell beavers along with a promise to raise the animals for later sale at a profit,  
26 *Continental Marketing Corp. v. SEC*, 387 F.2d 466, 468-71 (10th Cir. 1967).

1           Such ventures vary in the details, but the term “investment contract” has always carried  
2 certain core traits—most obvious, *a contract*, and one that captures the post-sale promises that  
3 transform an asset sale into something more. In using the phrase “investment contract,” Congress  
4 codified the term’s traditional definition into the federal securities laws. *Howey*, 328 U.S. at 298.

5           In its desire to seize regulatory control of an enormous (and enormously complex) new  
6 industry, the SEC asks this Court to cast all that aside. Rather than confine itself to the authority  
7 Congress long ago conferred, the SEC asks this Court to substantially expand its regulatory  
8 domain by declaring that at least nine different tokens constitute “investment contracts.” The  
9 SEC is wrong—and the implications of its position extend well beyond the circumstances here.  
10 The nine tokens at issue are no more securities than are baseball cards, beanie babies, gold  
11 doubloons, the beavers from *Continental Marketing*, or the oranges from *Howey*. This Court  
12 should turn back the SEC’s campaign to recast this long-settled term and, in so doing, dismiss its  
13 Amended Complaint.

14           **A.     The Term “Investment Contract” Had a Settled Meaning in 1933 That**  
15           **Congress “Crystallized” Within the Securities Laws.**

16           The federal securities laws do not specifically define the term “investment contract.” The  
17 term should accordingly be given its “ordinary meaning at the time Congress enacted the statute.”  
18 *New Prime Inc. v. Oliveira*, 139 S. Ct. 532, 539 (2019) (quotation marks and alterations omitted).

19           When Congress passed the Securities Act of 1933 and the Exchange Act of 1934 (both  
20 of which use “investment contract” as part of their near-identical definitions of “security”),  
21 “investment contract” was a settled term of art from state “blue sky” laws (*i.e.*, state securities  
22 laws). And “when Congress employs a term of art, it presumably knows and adopts the cluster  
23 of ideas that were attached to each borrowed word.” *FAA v. Cooper*, 566 U.S. 284, 292 (2012)  
24 (quotation marks omitted). The federal securities laws are no exception. As the Supreme Court  
25 held in *Howey*, Congress incorporated into the securities laws the definition of “investment  
26 contract” that had “crystallized” in the states. 328 U.S. at 298. The Ninth Circuit has confirmed  
27

1 as much, reaffirming that “the term ‘investment contract’ retains the same meaning it possessed  
2 under predating state ‘blue sky’ laws.” *SEC v. Rubera*, 350 F.3d 1084, 1090 (9th Cir. 2003).

3 The definition of “investment contract” under predating state “‘blue sky’ laws,” *Howey*,  
4 328 U.S. at 298, had several “essential ingredients,” *id.* at 301. Chief among them: An  
5 “investment contract” required a *contract* (written or implicit) that imposed *post-sale obligations*  
6 on the promoter, and also gave the investor a *right to receive profits* from the promoter’s venture.

7 **1. The phrase “investment contract” is a term of art derived from state**  
8 **“blue sky” laws.**

9 At the turn of the twentieth century, the American economy was booming, and  
10 entrepreneurs increasingly sought to capitalize on that boom by hawking investment  
11 opportunities to members of the country’s burgeoning middle class. *See* Jonathan R. Macey &  
12 Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 Tex. L. Rev. 347, 355 (1991). Many of these  
13 schemes were genuine; but many were not. Some ultimately promised nothing more than “so  
14 many feet of blue sky.” *State v. Gopher Tire & Rubber Co.*, 146 Minn. 52, 55 (1920). And in  
15 response to this problematic trend, the states started to adopt new securities laws that were  
16 designed “to put a stop to the sale of shares in visionary oil wells, nonexistent gold mines, and  
17 other ‘get-rich-quick’ schemes calculated to despoil credulous individuals of their savings.” *Id.*

18 By 1930, all but two states had adopted some version of a “blue sky” law. *See* Note,  
19 *Legislation: Uniform Sale of Securities Act*, 30 Colum. L. Rev. 1184, 1189 (1930). And  
20 following Minnesota’s lead, these blue sky laws predominantly defined a “security” to include  
21 “investment contracts.” Note, *Pension Plans as “Investment Contracts,”* 96 U. Pa. L. Rev. 553,  
22 553 (1948). Indeed, when legislators set out to create a uniform state securities code distilled  
23 from existing laws, “investment contract” was part of its consensus definition of “security.”  
24 Handbook, *Proceedings of the National Conference of Commissioners on Uniform State Laws*,  
25 at 173 (1929).

1 Much as Minnesota was the first state to use the term “investment contract,” its courts  
2 took the lead in explicating its meaning. At its essence, an “investment contract” was the  
3 “equivalen[t]” of a “contract which is an investment.” *Pension Plans, supra*, at 553 (citing *State*  
4 *v. Evans*, 154 Minn. 95 (1922); *Gopher Tire*, 146 Minn. 52). As the Minnesota Supreme Court  
5 explained in more detail, “[t]he placing of capital or laying out of money in a way intended to  
6 secure income or profit from its employment is an *investment* as that word is commonly used and  
7 understood.” *Gopher Tire*, 146 Minn. at 56 (emphasis added). And when that investment is  
8 folded into some kind of contractual relationship, an “investment contract” is then born. *Evans*,  
9 154 Minn. at 99.

10 “This definition was uniformly applied by state courts to a variety of situations where  
11 individuals were led to invest money in a common enterprise with the expectation that they would  
12 earn a profit solely through the efforts of the promoter or of some one other than themselves.”  
13 *Howey*, 328 U.S. at 298 & n.4 (collecting cases); *see also, e.g., People v. White*, 124 Cal. App.  
14 548, 554-55 (1932) (relying on *Gopher Tire*); *Stevens v. Liberty Packing Corp.*, 111 N.J. Eq. 61,  
15 65 (1932) (same); *Lewis v. Creasey Corp.*, 248 S.W. 1046, 1049 (Ky. 1923) (same). As such,  
16 when Congress set out to create its own securities law regime, “investment contract” was thus a  
17 clear term of art.

## 18 2. Congress incorporated that term of art into the securities laws.

19 Following the stock market crash of 1929, Congress began work on a “Federal blue sky  
20 law.” Remarks by Senator William H. King, 77 Cong. Rec. 2992 (May 8, 1933). That effort  
21 culminated in the Securities Act of 1933, which incorporated verbatim the definition of “security”  
22 that the National Conference of Commissioners on Uniform State Laws had adopted some years  
23 prior when drafting its uniform state securities code. That definition, again, included “investment  
24 contracts.” *Pension Plans, supra*, at 553. (As does the Exchange Act’s definition of “security,”  
25 enacted one year later.)  
26  
27



1           There is no doubt Congress sought to incorporate the existing definition of “investment  
2 contract” into the federal securities laws. As the *Howey* Court reasoned, “investment contract”  
3 had a “common” and “uniformly applied” definition at the time. 328 U.S. at 298. And by  
4 “including an investment contract” within the federal securities laws, Congress “crystallized”  
5 that definition within federal law. *Id.*; see also *SEC v. Edwards*, 540 U.S. 389, 395 (2004)  
6 (reiterating importance of state “blue sky law cases”). As the SEC itself explained in *Howey*:  
7 “Congress must be deemed to have intended also to adopt that construction of the term which  
8 was uniformly followed by the state courts.” Supreme Court Br. for Securities and Exchange  
9 Commission at 18, *Howey*, 328 U.S. 293 (No. 843) [hereinafter, “Br. for SEC”].

10                           **3.       The traditional definition of “investment contract” has several**  
11                           **“essential ingredients.”**

12           “When a statutory term is obviously transplanted from another legal source, it brings the  
13 old soil with it.” *Taggart v. Lorenzen*, 139 S. Ct. 1795, 1801 (2019) (quotation marks omitted).  
14 Here, that “old soil” includes at least three fundamental characteristics that were “the essential  
15 ingredients of an investment contract.” *Howey*, 328 U.S. at 301. For an “investment contract”  
16 to exist, there must be (i) a contract, that (ii) imposes post-sale obligations on the promoter,  
17 among which include (iii) giving the investor a legal entitlement to share in the venture’s profits.

18           Before *Howey*, no state decision had ever found an “investment contract” without these  
19 three characteristics. See, e.g., *Howey*, 328 U.S. at 298 n.4 (collecting cases). Same for the lower  
20 federal courts. See, e.g., *id.* at 299 n.5 (same). And in the many decades since *Howey*, neither  
21 the Supreme Court nor the Ninth Circuit has departed from that unbroken practice. Indeed, when  
22 pressed with this argument in the Southern District of New York, the SEC came up empty—  
23 unable to cite *any* genuine example of *any* court at *any* time finding an “investment contract”  
24 where the instrument did not have these fundamental threshold characteristics. Compare  
25 Defendants’ Memorandum of Law in Support of Their Motion for Summary Judgment at 19-21,  
26 *SEC v. Ripple Labs, Inc.*, No. 20-cv-10832 (S.D.N.Y. Sept. 17, 2022) [hereinafter *Ripple Summ.*  
27

1 J. Mot.], *with* Plaintiff Securities and Exchange Commission’s Memorandum of Law in  
2 Opposition to Defendants’ Motion for Summary Judgment at 19-21, *Ripple Labs*, No. 20-cv-  
3 10832 (S.D.N.Y. Oct. 21, 2022) [hereinafter SEC Summ. J. Opp’n in *Ripple*]; *see also infra* note  
4 12.

5 **(a) A Contract**

6 Most obvious, an “investment contract” requires a “contract”—specifically, a contract  
7 between the investor and the promoter. The SEC itself has historically recognized as much,  
8 explaining to the Supreme Court in *Howey* that an “investment contract” is a “contractual  
9 arrangement” that possesses certain additional characteristics. Br. for SEC, *supra*, at 9. Or as  
10 one state court put it on the eve of Congress enacting the Securities Act: “The term [investment  
11 contract] is not defined in the act, but it implies the apprehension of an investment as well as of  
12 a contract.” *State v. Heath*, 153 S.E. 855, 857 (N.C. 1930). Indeed, state courts evaluating  
13 whether a given venture amounted to an “investment contract” often followed a two-step process,  
14 first identifying whether there was a contract at all, and only *then* turning to whether it had the  
15 other necessary traits. *See, e.g., Klatt v. Guaranteed Bond Co.*, 250 N.W. 825, 829 (Wis. 1933).

16 Counsel has thus far found no example of any state blue sky case finding an “investment  
17 contract” in the absence of any contract whatsoever. In fact, counsel has not found any example  
18 of someone even being *accused* of illegally dealing in an “investment contract” where there was  
19 not any contractual relationship (written or implicit) between the promoter and the investor at all.

20 **(b) Post-Sale Obligations**

21 Nor can just *any* contract constitute an “investment contract.” As touched on above, an  
22 “investment contract” is an asset sale *coupled with* legally binding promises by the promoter to  
23 manage or develop that asset in a profitable way. *See, e.g., State v. Robbins*, 185 Minn. 202,  
24 204-05 (1932) (sale of muskrat breeding pairs *plus* promise to rear pairs until later sold for fur);  
25 *Prohaska v. Hemmer-Miller Dev. Co.*, 256 Ill. App. 331, 334-35 (1930) (sale of land *plus* promise  
26 to harvest crops on it); *Kerst v. Nelson*, 171 Minn. 191, 193-95 (1927) (sale of land *plus* promise  
27

1 to cultivate vineyard, harvest crops, and market wine). Without binding post-sale legal  
2 obligations, there is just an asset sale. It is not a muskrat investment; it is a muskrat simpliciter.

3 In the years before the federal securities laws, state courts consistently treated the absence  
4 of such binding post-sale obligations as dispositive. In *Lewis v. Creasey Corp.*, for instance, a  
5 wholesale grocery distributor gave a local supermarket the right to purchase groceries at a  
6 discount in exchange for a \$300 deposit. 248 S.W. 1046, 1047 (Ky. Ct. App. 1923). The court  
7 held this contractual arrangement was *not* an investment contract because there were no post-sale  
8 obligations on the part of the distributor to use the supermarket's money "in such a manner as to  
9 reap a profit to the [investor]." *Id.* at 1049. Rather, the deal was simply a one-off payment for a  
10 discount. And the term "investment contract" did not extend to "contracts [only] containing  
11 mutual obligations, such as are daily entered into commercial life, and from which a profit can  
12 only be reaped by the uses which the investor alone makes of them." *Id.* Otherwise, the term  
13 "investment contract" could be manipulated to extend to all "exchange[s] of commodities" and  
14 "all [other] sorts and kinds of contracts," contrary to the phrase's well-established meaning. *Id.*

15 The requirement of post-sale obligations for an "investment contract" runs throughout the  
16 state blue sky cases. See, e.g., *McCormick v. Shively*, 267 Ill. App. 99, 103-04 (1932) (no  
17 investment contract where land sale involved "no obligation [by promoter] . . . to do anything  
18 other than to deliver a deed upon the payment of the purchase price); *Hanneman v. Gratz*, 170  
19 Minn. 38, 41-42 (1927) (same where scheme only involved "purchase of lands"); *Creasey Corp.*  
20 *v. Enz Bros. Co.*, 187 N.W. 666, 667 (Wis. 1922) (holding same grocery contract as above not a  
21 security). Here too, counsel has not come across a single counter-example in any blue sky case.<sup>4</sup>

22  
23 <sup>4</sup> See also, e.g., *People v. White*, 124 Cal. App. 548, 550, 554-56 (1932) (investment contract where seller  
24 promised to re-invest the funds and return \$7,500); *State v. Robbins*, 240 N.W. 456, 457 (Minn. 1932) (investment  
25 contract where, in addition to sale contract for fox breeding trios, buyers would enter into a breeding contract where  
26 the company would "feed, breed, care for, pelt, and generally supervise and manage the animals to the best interest  
27 of the purchaser"); *Prohaska*, 256 Ill. App. at 338 (investment contract where promoter was obligated to "break,  
seed, cut and thresh" the crops on the sold land); *Kerst*, 171 Minn. at 194 (investment contract where seller of  
vineyard retained "exclusive control and management of planting, cultivating, and caring for the land"); *State v.*  
*Bushard*, 205 N.W. 370 (Minn. 1925) (investment contract where, as part of a bus-operator agreement, company  
agreed to pay for part of the bus, the bus's maintenance and operating expenses, and indemnify the bus operator).

1 (c) **Right to Share Profits**

2 Finally, an “investment contract” must give the investor a right to share in the venture’s  
 3 profits. To borrow again from *Lewis*, an “investment contract” is a contractual scheme where “a  
 4 profit is promised and expected without any active efforts on the part of the investor.” 248 S.W.  
 5 at 1049. Or as the Minnesota Supreme Court put it, an “investment contract[.]” is a contract that  
 6 by definition “entitl[es] the investor to participate in a profit-sharing scheme.” *Kerst*, 171 Minn.  
 7 at 196; *see also Evans*, 154 Minn. at 99 (“[I]f the defendant issued and sold its certificates to  
 8 purchasers who paid their money justly expecting to receive an income or profit from the  
 9 investment, such certificates might properly be regarded as investment contracts[.]”).

10 As above, the absence of an entitlement to profit sharing has always been dispositive. In  
 11 *Enz Bros.*, for example, the Wisconsin Supreme Court held that a contractual arrangement was  
 12 not a security because the investor “acquired no rights either in the capital or profits of the  
 13 company.” 187 N.W. at 667. And here too, counsel has not come across a single example where  
 14 a court found an “investment contract” *without* this basic characteristic in any blue sky case.<sup>5</sup>

15 \* \* \*

16 When Congress passed the federal securities laws, it quite purposefully used a term of art  
 17 that had a well-established meaning. In that light, then as now, the definition of “investment  
 18 contract” is (i) a contract, that (ii) imposes post-sale obligations on the promoter, among which  
 19 include (iii) giving the investor a legal entitlement to share in the business venture’s profits.

20 **B. None of the Tokens at Issue Fits the Traditional Definition of an “Investment**  
 21 **Contract.”**

22 The nine tokens underlying the SEC’s suit uniformly fail this test. The SEC does not—  
 23 and cannot—allege that the tokens involve contracts among developers and token-holders. In

24 \_\_\_\_\_  
 25 <sup>5</sup> *See, e.g., People v. Claggett*, 19 P.2d 805, 805 (Cal. Ct. App. 1933) (promising “one-twentieth interest  
 26 in all of the gold and other values” recovered from a gold mine, “after operating expenses have been paid”); *Stevens*  
 27 *v. Liberty Packing Corp.*, 111 N.J. Eq. 61, 61-65 (1932) (promising \$1 per offspring in a rabbit-breeding contract);  
*State v. Ogden*, 191 N.W. 916, 917 (Minn. 1923) (promising to pay holders of fractional oil leases profits from oil  
 drilling “in proportion to their holdings”).

1 fact, the tokens impose no legal obligations on their developers after the time of sale. And they  
2 carry no legal entitlement to share in the developers' profits. In no sense are these nine tokens  
3 securities under the "uniformly applied" definition of "investment contract" Congress  
4 "crystallized" into the securities laws. *Howey*, 328 U.S. at 298.

5 **1. None of the tokens involves a contract between the developers and the**  
6 **token-holder.**

7 Foremost, there is no "contract" here that could give rise to an "investment contract."

8 The Amended Complaint concedes that the tokens at issue were purchased in secondary  
9 markets through an exchange. *See, e.g.*, Am. Compl. ¶ 7. But when a token is sold on an  
10 exchange, there is (by definition) no contract between the buyer and the promoter. *See, e.g.*,  
11 Michael J. O'Connor, *Overreaching Its Mandate? Considering the SEC's Authority to Regulate*  
12 *Cryptocurrency Exchanges*, 11 Drexel L. Rev. 539, 582-83 (2019). Secondary sales are one-off  
13 transactions between someone who owns the token and someone else who buys the token,  
14 facilitated through blind bids done with an exchange. The token's original developer is not a  
15 party to the transaction, and does not enter any contract in connection with it. That is dispositive.

16 In other cases, the SEC has taken the contrary view that if the tokens were initially  
17 distributed by way of an investment contract—say, through an ICO where investors bought  
18 tokens from the developers directly—then the tokens are securities for time immemorial. But  
19 even assuming the premise of that argument is right, the SEC nonetheless conflates here the  
20 *investment arrangement* with the *specific object* that underlies it. Suppose investors agreed to  
21 give Mr. Howey money in exchange for him periodically sending them bushels of oranges from  
22 the groves he promised to manage. That agreement is certainly a contract and may—depending  
23 on the details—be an "investment contract." But even if *that* arrangement were an "investment  
24 contract," the items exchanged pursuant to it—the *oranges*—would not constitute federal  
25 securities, because they carry with them no enforceable rights and obligations running from the  
26 orange-holder back to Mr. Howey. Put differently, if Mr. Howey's investors decided to resell  
27

1 those oranges at a farmers’ market, nobody would think they had engaged in some unregistered  
2 securities offering.

3 In all material respects, that is the fact pattern here. Even if the *initial* sale of the relevant  
4 tokens by their developers could have been deemed an investment contract—a possibility on  
5 which the Defendants take no position—the *tokens themselves* were not. The resold oranges are  
6 not securities for the simple reason that they carry with them no contractual relationship between  
7 the orange-buyer and Mr. Howey. The resold tokens are no different; they lack any contractual  
8 relationship connecting the buyer and the promoter. At bottom, there is a fundamental difference  
9 between an investment *transaction* (which may give rise to an “investment contract”) and that  
10 transaction’s *underlying asset* (which cannot). Here, there is only the latter; a bushel of oranges.

11 **2. None of the tokens comes with post-sale obligations on the part of the**  
12 **developers.**

13 Next, none of the tokens imposes post-sale legal obligations on the developers for the  
14 benefit of token-holders. To be sure, the Amended Complaint alleges that the developers of the  
15 tokens here made public declarations about how they *intended* to develop their platforms and  
16 protocols, and how token-holders would *likely* be able to turn a profit by flipping tokens on  
17 secondary exchanges. *See, e.g.*, Am. Compl. ¶¶ 117-21 (AMP); 126-27 (RLY); 141 (DDX); 149-  
18 52 (XYO); 160-65 (RGT); 176-78 (LCX); 183-86 (POWR); 201-02 (DFX); 213-14 (KROM). It  
19 alleges, for example, that the developers behind the XYO Network publicized a “‘Roadmap’ with  
20 target dates for [their] plans to develop the business,” and touted “opportunities for profit from  
21 XYO, including . . . the availability of secondary markets.” *Id.* ¶¶ 149, 151. But that is not  
22 sufficient.

23 Public declarations by token developers about the software they hope to create do not  
24 create post-sale *legal* obligations, and cannot convert tokens sold on secondary markets into  
25 investment contracts. Indeed, suppose Mr. Howey adopted a “roadmap” with a plan to heavily  
26  
27

1 market his oranges nationwide, thereby boosting their price. Nobody would say that pledge  
2 transforms the *oranges* into securities, or the above farmers’ market into an unlawful exchange.

3 This is all because there is no “investment contract” absent a *binding promise* running  
4 from the developer to the token-holder. To continue the analogy to *Howey*, if Mr. Howey had  
5 suddenly stopped working on his orange groves, his investors could have sued him for breach of  
6 contract. That is because Mr. Howey had entered into an agreement with investors that imposed  
7 binding post-sale obligations on him. But what if the developers behind the XYO Network  
8 decided to depart from their “roadmap”? Someone who had later bought XYO tokens on an  
9 exchange in *hopes* that the developers would execute their roadmap would have no legal recourse  
10 because they have no contractual relationship with the developers. Importantly, transferring a  
11 token to a third-party is not like assigning a contract; tokens do not inherently confer any legal  
12 rights upon the token-holder that are enforceable against the developer (and the SEC alleges  
13 nothing to the contrary for the tokens at issue here).<sup>6</sup> Transferring a token is instead like selling  
14 a beanie baby—an asset that can either be played with or stored as an investment, but one that  
15 innately carries none of the obligations and rights that were part of any original transaction. Of  
16 course, a token-holder may expect their tokens will “appreciat[e]” due to their “proximity” to the  
17 developers’ efforts—but that is not enough without an actual obligation on the developers to  
18 follow through. *De Luz Ranchos Inv. Ltd. v. Coldwell Banker & Co.*, 608 F.2d 1297, 1301 (9th  
19 Cir. 1979); *see also, e.g., Rodriguez v. Banko Cent. Corp.*, 990 F.2d 7, 11 (1st Cir. 1993) (sellers’

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20  
21  
22  
23 <sup>6</sup> The Amended Complaint does not allege that the four so-called governance tokens—RLY, DDX, RGT,  
24 and DFX—provide any *legal* rights enforceable against the developer. At most, the SEC alleges that the tokens  
25 provide users with the limited *technological* ability to participate in how the platform prioritizes funding or lists  
26 cryptocurrency. *E.g.*, Am. Compl. ¶¶ 123 (RLY token-holders can “propose changes” to Rally community); 164  
27 (RGT token-holders can vote on allocation of tokens on the Rari platform); *id.* ¶ 205 (DFX token-holders can “can  
vote on the crypto assets to be included for exchange in the protocol”). But giving technology users functional  
tools—no different from enabling social media users to increase visibility of posts by “liking” them or providing  
tools to edit Wikipedia pages—is fundamentally different from those companies shouldering a *legal* obligation to  
do anything on behalf of users.

1 “strong and repeated suggestions” land would be developed did not create security without actual  
2 obligation to develop); *Woodward v. Terracor*, 574 F.2d 1023, 1026 (10th Cir. 1978) (similar).<sup>7</sup>

3 To that end, not every promotion creates a binding promise running to all asset-holders.  
4 Consider a baseball player who sells autographs while telling buyers he plans to hit more home  
5 runs. Or the musician who sells branded sneakers while promising to put out more hit albums.  
6 Or a bit on the nose, an entrepreneur who sells physical tokens as commemorative coins while  
7 stressing he will try to get celebrities to endorse them, thereby bumping their market value. In  
8 all of these examples, buyers—whether directly or on the secondary market—might *expect* their  
9 purchases to appreciate in value: homers drive autograph prices, platinum records boost the  
10 demand for merchandise, and celebrity endorsements enhance market value. But none of these  
11 examples features “actual commitments” on the part of the seller to the buyer of the asset that  
12 could transform the asset into a security. *Happy Inv. Grp. v. Lakeworld Props., Inc.*, 396 F. Supp.  
13 175, 181 (N.D. Cal. 1975). In each instance, the ballplayer, musician, or coin peddler is free to  
14 sell the relevant asset and then quit the business. And without a real “obligation” to “develop,  
15 improve, or manage” the underlying asset later on, there is no “investment contract.” *De Luz*  
16 *Ranchos*, 608 F.2d at 1301.

### 17 3. None of the tokens furnishes a legal right to share in profits.

18 Finally, none of the relevant tokens comes with a legal right for token-holders to share in  
19 their respective ventures’ profits. Again, there is a difference between being able to profit from  
20 the *re-sale of an asset* (e.g., an orange), and having an entitlement to share in the *profits from a*  
21 *business venture* (e.g., an orange grove). The latter can give rise to a security; the former cannot.

22 \_\_\_\_\_  
23 <sup>7</sup> What is true for XYO tokens holds true for the whole batch. For instance, comments from the DerivaDEX  
24 CEO discussing “development plans” that included a new “feature” would not provide a DDX token-holder a right  
25 to sue if that feature was not integrated into the platform. *See* Am. Compl. ¶ 143. So too for the vague intentions  
26 expressed by Rari’s founders that they would, among other things, “create a strong ecosystem around the Rari  
27 Protocol,” to “avoid RGT ‘price dilution,’” and “invest the protocol’s holdings in an intelligent way.” *Id.* ¶ 164.  
Likewise for LCX’s aspirational statements to become a “new category leader in the blockchain industry,” “revamp”  
its trading platform, and challenge mainstream financial firms like Goldman Sachs, *id.* ¶ 179, or Power’s abstract  
goal of creating an “attractive” trading environment for POWR tokens, *id.* ¶ 181. Across the board, none of these  
sorts of statements, nor any other statement proffered by the SEC, create a binding post-sale *obligation* running to  
token-holders.



1 None of the tokens here comes with a legal entitlement to share in the platform’s profits.  
2 At most, for a handful of tokens, the Amended Complaint alleges token-holders can “share in the  
3 profits” if they help “stake” the token on its given network. Am. Compl. ¶ 103; *see also, e.g., id.*  
4 ¶¶ 140 (DDX), 197 (DFX), 214 (KROM). But this is different in kind. “Staking” is when  
5 someone locks up some of their tokens to help support the operation of a platform in exchange  
6 for a certain yield or percentage of a transaction fee. (Conceptually, it is not all too different  
7 from putting money in a high-yield savings account at a bank and receiving interest payments in  
8 return.) The key point, though, is that *staking is optional*. And the *option* to make money with  
9 tokens by staking them does not convert the tokens themselves into an *entitlement* to share in the  
10 venture’s profits. Rather, it is like having the option of picking Mr. Howey’s oranges for a wage.

11 For two of the tokens, the Amended Complaint hints that they come with the right to  
12 share in their ventures’ profits, akin to a dividend. Of course, having *one* of the *three* essential  
13 traits of an “investment contract” is not enough. But even still, the Amended Complaint is  
14 deficient. For RGT, the Amended Complaint says the developers “*suggested* RGT buyers *may*  
15 *eventually* earn dividends.” *Id.* ¶ 164 (emphases added). And for POWR, the Amended  
16 Complaint alleges that on a Reddit thread once, the developers said that token-holders would be  
17 able to “receive a portion of revenue.” *Id.* ¶ 184. But the SEC conspicuously avoids alleging  
18 that RGT or POWR token-holders *actually* have any right—legally enforceable or by operation  
19 of the underlying code—to share in the ventures’ profits. And that silence is telling, given that  
20 such information is by no means a secret: Both tokens are now on the market, and have been  
21 sold on a number of exchanges. *Id.* ¶¶ 171, 190.

22 **C. Following the Traditional Definition of “Investment Contract” Makes Sense.**

23 Rejecting the SEC’s claim that the tokens at issue are all “investment contracts” also  
24 makes good sense. The purpose of the securities laws (as opposed to laws regulating other asset  
25 classes like commodities) is to ensure that investors can make informed judgments before  
26 investing money in an *ongoing* enterprise. So for instance, when an investor buys a stock (*i.e.*,  
27

1 an ownership share of a company run by professional managers), it makes sense to require the  
2 company to provide extensive disclosures concerning the company's financial condition. The  
3 investor needs to understand the condition of the ongoing enterprise that he or she is buying into.

4 The disclosure requirements for "investment contracts" serve the same basic purpose.  
5 Individuals who enter investment contracts are effectively purchasing a stake in an ongoing  
6 enterprise—raising muskrats for future sale, growing oranges for future harvesting, developing  
7 land for future winemaking. These investors are not purchasing an equity stake in an enterprise  
8 managed by corporate executives, but they *are* investing in an ongoing enterprise that someone  
9 else will manage. It makes sense to require detailed disclosures about that enterprise up front.

10 These disclosures make no sense, however, when there is *not* an ongoing legal  
11 relationship between purchaser and promoter. When the investor is really just a purchaser buying  
12 an asset—a token, an orange, a baseball card, a sneaker, or a commemorative coin—the person  
13 has no ongoing legal claim to the promoter's efforts (particularly where, as here, the purchase is  
14 in a secondary market). The seller's business operations, risk factors, management, audited  
15 financial statements, and the like are beside the point because the purchaser is *not investing in*  
16 *the seller*—the purchaser is merely *buying its asset*. To be sure, the purchaser might *hope* that  
17 the asset goes up in value based on the seller's future behavior; and the seller might encourage  
18 people to buy the product by touting plans to enhance its value. But when the transaction does  
19 not include ongoing legal obligations, the buyer is not investing *in* the seller, has no claim over  
20 the seller's *future actions*, and thus has no need to know detailed information about the seller's  
21 financial condition. See *SEC v. Life Partners, Inc.*, 87 F.3d 536, 547 (D.C. Cir. 1996) (“[I]f  
22 neither the promoter nor anyone else is expected to make further efforts that will affect the  
23 outcome of the investment, then the need for federal securities regulation is greatly diminished.”).  
24 It should thus be no surprise that all of the digital asset regulation proposals currently being  
25 debated in Congress principally treat tokens like the ones here as *commodities*. *Infra* Section  
26 II.B.2.

1 Holding that the tokens here are not securities does not mean they would go unregulated.  
2 To the contrary, federal and state regulators assert that tokens remain subject to a litany of  
3 possible regulations already on the books—including state and federal laws concerning consumer  
4 protection, commodities, and fraud.<sup>8</sup> But the sale of tokens on a secondary market does not—  
5 without more—trigger the SEC’s elaborate registration and disclosure requirements designed for  
6 investments in an ongoing enterprise.

7 \* \* \*

8 In short, the Amended Complaint fails in all respects to allege that the tokens at issue  
9 satisfy the “uniformly applied” definition of “investment contract” that Congress “crystallized”  
10 in the federal securities laws. *Howey*, 328 U.S. at 298. They involve no contracts, their sale  
11 imposes no ongoing legal obligations on developers, and they provide no entitlement to profit  
12 sharing. They are not “investment contracts” as that term has always been understood. The  
13 Amended Complaint therefore must be dismissed.

14 **II. BOTH *HOWEY* AND THE MAJOR QUESTIONS DOCTRINE FORECLOSE THE SEC’S**  
15 **ATTEMPT TO SCRAP THE TRADITIONAL DEFINITION OF AN “INVESTMENT CONTRACT.”**

16 Precedent confirms what text and history already make clear: The federal securities laws  
17 use the traditional definition of “investment contract.” Indeed, the Supreme Court held as much  
18 in *Howey*, stating in quite plain terms that, “[b]y including an investment contract within the  
19 scope of . . . the Securities Act, Congress was using a term the meaning of which had been  
20 crystallized by this prior judicial interpretation [in state blue sky cases].” 328 U.S. at 298.

21 Despite this straightforward sentiment, the SEC appears to contend the *Howey* Court  
22 actually *replaced* the traditional definition of “investment contract” with something else—a  
23 malleable standard that does not require *any* “contract,” much less the *specific sort of contract*  
24 uniformly required under the blue sky laws. The SEC is wrong. Neither the Supreme Court nor

25 \_\_\_\_\_  
26 <sup>8</sup> See, e.g., U.S. Dep’t of Justice, *The Role of Law Enforcement in Detecting, Investigating, and*  
*Prosecuting Criminal Activity Related to Digital Assets* 14-32 (Sept. 2022).

1 the Ninth Circuit has ever found an “investment contract” where the instrument does not satisfy  
 2 that term’s traditional definition.<sup>9</sup> This Court should not accept the SEC’s invitation to break  
 3 new ground.

4 The “Major Questions Doctrine” dispels any doubts. The Supreme Court has explained  
 5 that an “[e]xtraordinary grant[] of regulatory authority”—a term that plainly captures a broad  
 6 power over the new, trillion-dollar digital asset industry<sup>10</sup>—requires “clear congressional  
 7 authorization.” *West Virginia v. EPA*, 142 S. Ct. 2587, 2614-16 (2022). The SEC’s attempt to  
 8 wring broad jurisdiction over digital assets from the text of the Depression-era securities laws or  
 9 the spirit of Justice Murphy’s 1946 *Howey* opinion fits that doctrine to a tee. The SEC needs  
 10 “clear” statutory authority to regulate digital assets like the ones at issue. It does not have it here.

11 **A. Neither *Howey* Nor Its Progeny Gives the SEC License to Depart From the**  
 12 **Traditional Definition of an “Investment Contract.”**

13 Once more, when a statutory term is “obviously transplanted from another legal source”  
 14 it “brings the old soil with it.” Felix Frankfurter, *Some Reflections on the Reading of Statutes*,  
 15 47 Colum. L. Rev. 527, 537 (1947). The *Howey* Court thus held the term “investment contract”  
 16 in the federal securities laws carried the “common” and “uniformly applied” definition from the  
 17 state blue sky laws that preceded the federal securities laws. *Howey*, 328 U.S. at 298.  
 18 Nevertheless, the SEC now claims that *Howey* actually (and covertly) displaced the traditional  
 19 definition of “investment contract” with a new standard. That counterintuitive claim is wrong.

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 21  
 22  
 23 <sup>9</sup> See generally Lewis Rinaudo Cohen et al., *The Ineluctable Modality of Securities Law: Why Fungible  
 Crypto Assets Are Not Securities* 36-72 (Nov. 10, 2022) (discussion draft) (exhaustively surveying federal appellate  
 cases applying *Howey*) (<https://tinyurl.com/2s35rtxr>).

24 <sup>10</sup> Michelle Neal, *Advances in Digital Currency Experimentation*, FED. RES. BANK N.Y. (Nov. 4, 2022),  
 25 <https://tinyurl.com/d4bfkeb4> (“Currently, the total cryptoasset market capitalization rests around \$1 trillion[.]”);  
 Cristina Polizu et al., *A Deep Dive Into Crypto Valuation*, S&P GLOBAL (Nov. 10, 2022),  
 26 <https://tinyurl.com/yc6h9k79> (“As of August 2022, the total market capitalization of cryptocurrencies stood at \$1.1  
 trillion . . . or about 2.5% of the U.S. equity market capitalization.”); COINMARKETCAP, <https://tinyurl.com/bdkc6dta>  
 27 (last visited Feb. 3, 2023) (valuing the global cryptocurrency market cap at nearly \$1.1 trillion).

1                   **1.       The SEC misreads *Howey*.**

2           The SEC’s view is that there is an “investment contract” whenever a person is “led to  
3 invest money in a common enterprise with the expectation that they would earn a profit solely  
4 through the efforts of the promoter or of some one other than themselves” (a formulation often  
5 called the “*Howey Test*”). *Howey*, 328 U.S. at 298; *see also, e.g.*, SEC Summ. J. Opp’n in *Ripple*,  
6 *supra*, at 11-12. The SEC has applied that view here, alleging the tokens at issue are securities  
7 under the *Howey Test* alone, *see, e.g.*, Am. Compl. ¶ 105, regardless of whether they have the  
8 traditional attributes discussed above. Relying on stray lines from *Howey* that are stripped from  
9 context, the SEC reasoned in another case that the term “investment contract” is not cabined by  
10 its historical definition, but is open-ended, embodying “a flexible rather than static principle, one  
11 that is capable of adaption to meet the countless and variable schemes devised by those who seek  
12 the use of the money of others on the promise of profits.” *Howey* 328 U.S. at 299; SEC Summ.  
13 J. Opp’n in *Ripple, supra*, at 10, 21.

14           The SEC deeply misunderstands *Howey*. The opinion is not at war with itself; the Court  
15 does not recognize and endorse the uniform state law definition of “investment contract” in one  
16 breath, yet silently displace that settled definition in the next for something wholly new. Rather,  
17 the *Howey Test* is an *elaboration upon*—not a *substitute for*—the traditional definition of  
18 “investment contract.” In other words, the *Howey Test* captures the extensive array of business  
19 ventures that may conceivably fit within the four corners of an “investment contract,” but it does  
20 not eliminate the basic qualities needed for there to be an “investment contract” *in the first place*.

21           A pie may have any number of fillings. A term paper may cover any number of subjects.  
22 But a pie needs a pastry, and a term paper needs a paper. So too here. There is no question an  
23 “investment contract” may include “countless and variable schemes”—from orange production  
24 to muskrat rearing to real estate. But for those schemes to become federal securities, the pre-  
25 requisites of an “investment contract” still must be present. There must be a contract that imposes  
26 post-sale obligations and carries a right to share in profits. To be sure, those pre-requisites are  
27

1 not exceedingly demanding, and allow for broad application. But they are at the heart of the  
2 “uniformly applied” definition that Congress “crystallized” into law. *Howey*, 328 U.S. at 298.

3 In arguing in another case that an “investment contract” does not need a contract, the SEC  
4 has also latched onto *Howey*’s description of an “investment contract” as “mean[ing] a contract,  
5 transaction, or scheme.” SEC Summ. J. Opp’n in *Ripple, supra*, at 15-16 (quoting *Howey*, 328  
6 U.S. at 298-99). That too is mistaken. See *Edwards*, 540 U.S. at 397 (“We are considering  
7 investment *contracts*.”). Rather, the *Howey* Court was simply saying that courts need to look at  
8 the full picture, and consider the full “economic reality” of a business venture. 328 U.S. at 298.  
9 Sometimes, the full picture resides within a single contract. But often it does not, and a court  
10 should not disregard “substance” for “[f]orm” in doing its analysis. *Id. Howey* itself, for instance,  
11 involved two *transactions*—a *sales contract* for the land, and a *management contract* for the  
12 citrus groves atop that land. *Id.* at 295-96. Neither contract was *alone* an “investment contract”;  
13 but in combination, the *overall scheme* was. The SEC misapprehends *Howey*’s commonsense  
14 command to consider context as license for discarding the most elemental trait of an “investment  
15 contract”—an actual contract, whether written or implicit. See *id.* at 300 (investment contracts  
16 exist “regardless of the legal terminology in which *such contracts* are clothed” (emphasis  
17 added)).

18 In short, *Howey* elaborated upon the traditional definition of “investment contract.” It  
19 did not purport to replace it. The *Howey* Court meant what it said when it said the very opposite.

20 **2. The uniform practice of the Supreme Court and the Ninth Circuit**  
21 **confirms the SEC’s error.**

22 Perhaps the most telling indication of a problem with the SEC’s reading of *Howey* is the  
23 absence of any precedent to support it. Indeed, the traditional definition of “investment contract”  
24 has brooked no departures. Neither the Supreme Court nor the Ninth Circuit has *ever* found an  
25 “investment contract” where the instrument at issue did not meet the term’s traditional definition.  
26  
27

1 Even before *Howey*, the traditional definition of “investment contract” had taken hold in  
 2 the federal courts. *See, e.g., SEC v. Bailey*, 41 F. Supp 647, 650 (S.D. Fla. 1941) (“investment  
 3 contract” is “a contract providing for the investment or laying out of capital in a way intended to  
 4 secure income or profit from its employment, which will arise through the activities and  
 5 management of others than the owner”). And since *Howey*, the Supreme Court has *never*  
 6 recognized an “investment contract” that lacks the three defining characteristics described above.  
 7 *See, e.g., Edwards*, 540 U.S. at 391 (finding payphone sale-and-leaseback arrangement to be  
 8 investment contract where company contracted to maintain phones and deliver fixed monthly  
 9 return); *Tcherepnin v. Knight*, 389 U.S. 332, 337 (1967) (same for “withdrawable capital shares”  
 10 that paid “dividends” from savings and loan association’s “profits”); *SEC v. United Benefit Life*  
 11 *Ins. Co.*, 387 U.S. 202, 205 (1967) (same for annuity contracts providing right to a “pro rata  
 12 share” of returns from “portfolio of equity interests”); *SEC v. Variable Annuity Life Ins. Co.*, 359  
 13 U.S. 65, 71 (1959) (similar); *see also SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 348-49  
 14 (1943) (same for oil lease sales conditioned on promoters’ contractual agreement to drill wells).

15 Nor has the Ninth Circuit—in any case of which we are aware—ever deviated from this  
 16 consistent understanding of the term. *See, e.g., SEC v. Schooler*, 905 F.3d 1107, 1110-13 (9th  
 17 Cir. 2018) (finding land sale to be an investment contract where promoter contractually promised  
 18 to operate development project and return pro rata profits); *Warfield v. Alaniz*, 569 F.3d 1015,  
 19 1024 (9th Cir. 2008) (same for charitable gift annuities that promised regular returns); *SEC v.*  
 20 *R.G. Reynolds Enters., Inc.*, 952 F.2d 1125, 1131 (9th Cir. 1991) (same for interests in similar  
 21 investment programs).<sup>11</sup> Indeed, where an instrument has *lacked* an essential part of the

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 23 <sup>11</sup> *See also, e.g., SEC v. Hui Feng*, 935 F.3d 721, 726-27 (9th Cir. 2019) (investments in regional centers  
 24 that financed construction projects, that promised investors a fixed annual return); *Daniels-Hall v. Nat’l Educ. Ass’n*,  
 25 629 F.3d 992, 1006 (9th Cir. 2010) (variable annuities); *Rubera*, 350 F.3d at 1087, 1093 (payphone purchase and  
 26 service agreements where company agreed to operate the payphones and return at least \$58.34 each month, and up  
 27 to 30% of the phone’s monthly revenue); *Webster v. Omnitrion Int’l, Inc.*, 79 F.3d 776, 784 (9th Cir. 1996) (multi-  
 level marketing program); *SEC v. Eurobond Exch., Ltd.*, 13 F.3d 1334, 1338-41 (9th Cir. 1994) (agreement where  
 seller would use investor’s money to obtain foreign-currency loans and purchase foreign-treasury bonds, and return  
 to invest “profit . . . derived from the difference” between the loan’s and bonds’ interest rates); *Hocking v. Dubois*,  
 885 F.2d 1449, 1455 (9th Cir. 1989) (en banc) (agreement where broker packaged condominium sale with  
 development agreements); *Davis v. Metro Prods., Inc.*, 885 F.2d 515, 517 (9th Cir. 1989) (“production service

1 traditional definition of “investment contract,” this Circuit has held it is not a security. *See, e.g.,*  
 2 *Salameh v. Tarsadia Hotel*, 726 F.3d 1124, 1131-32 (9th Cir. 2013) (finding no investment  
 3 contract where real estate agreement did not clearly involve post-sale obligations or legal  
 4 entitlement to share profits); *De Luz Ranchos*, 608 F.2d at 1301 (same where promoter “did not  
 5 represent that it would develop, improve, or manage” the lands and also “did not promise to  
 6 distribute profits”); *Chapman v. Rudd Paint & Varnish Co.*, 409 F.2d 635, 640-41 (9th Cir. 1969)  
 7 (same where product distributorship agreement expressly disclaimed guarantee of any  
 8 entitlement to regular profits).<sup>12</sup>

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 11 agreements” where company sold television tapes, advised investor that he must engage a management services  
 12 group to market the videotapes and thereby make income, and introduced him to the management company that he  
 13 retained); *United States v. Kessi*, 868 F.2d 1097, 1101, 1103 (9th Cir. 1989) (agreements where investors would  
 14 receive 50% of the profits from seller’s trading); *United States v. Morse*, 785 F.2d 771, 773-74, 776 (9th Cir. 1986)  
 15 (investments in oil and gas drilling, in video-game placement program, and in heavy-equipment leasing program);  
 16 *SEC v. Goldfield Deep Mines Co. of Nev.*, 758 F.2d 459, 462-65 (9th Cir. 1985) (ore purchase program where  
 17 investors would purchase tons of ore dump material, and where seller would by default process, refine, store, and  
 18 market the ore and return proceeds of ore’s sale); *United States v. Jones*, 712 F.2d 1316, 1319, 1322 (9th Cir. 1983)  
 19 (sale-leaseback arrangements for tractors and trailers); *SEC v. Murphy*, 626 F.2d 633, 640 (9th Cir. 1980) (limited  
 20 partnership agreement); *United States v. Farris*, 614 F.2d 634, 641 (9th Cir. 1979) (mortgage notes where sellers  
 21 agreed to collect on notes and pay off the principal if the lot’s buyer defaulted); *Smith v. Gross*, 604 F.2d 639, 641-  
 22 43 (9th Cir. 1979) (earthworm purchase agreement where seller promised to buy back the worm offspring at \$2.25  
 23 per pound); *United States v. Carman*, 577 F.2d 556, 559, 564 (9th Cir. 1978) (federally insured student loan  
 24 “packages” that included, among other things, a “contract” where a company agreed to service the loan, an  
 25 agreement to repurchase any defaulted loans, and a buy-back agreement); *SEC v. Commodity Options Int’l, Inc.*, 553  
 26 F.2d 628, 632-33 (9th Cir. 1977) (double-options contract where seller would reinvest money and return to buyer a  
 27 share of the profits); *Safeway Portland Emps.’ Fed. Credit Union v. C. H. Wagner & Co.*, 501 F.2d 1120, 1122-24  
 (9th Cir. 1974) (sale of certificates of deposit coupled with a promise to pay bonus interest on the certificates);  
*Parvin v. Davis Oil Co.*, 524 F.2d 112, 115-16 (9th Cir. 1975) (fractional oil and gas leases where seller would  
 “conduct oil exploration operations on the leased land”); *El Khadem v. Equity Sec. Corp.*, 494 F.2d 1225, 1226,  
 1230 (9th Cir. 1974) (agreement where company promised to use invested capital for own investment, for which  
 investor would receive tax benefits and investment leverage); *SEC v. Glenn W. Turner Ents., Inc.*, 474 F.2d 476,  
 478, 480-82 (9th Cir. 1973) (arrangements where purchaser would receive a right to sell company’s self-  
 improvement plans to others and a guaranteed commission on each sale); *L.A. Tr. Deed & Mortg. Exch. v. SEC*, 285  
 F.2d 162, 171-72 (9th Cir. 1960) (trust deeds where seller promised 10% earnings and to, among other things, service  
 the loan and handle foreclosure on it); *Penfield Co. of Cal. v. SEC*, 143 F.2d 746, 750-51 (9th Cir. 1944) (whiskey  
 purchase and bottling contracts where the company would bottle whiskey and sell it, and then pay contract holders  
 90% of the profits); *see* Cohen, *supra*, at 53 (“[I]n those very limited appellate cases in which an investment contract  
 was found without there being a written contract between the parties that related to the investment contract  
 transaction, the elements of an implied-in-fact contract are always present.”).

12 When pressed with these arguments in the *Ripple* case pending in the Southern District of New York,  
 the SEC failed to cite a single genuine counter-example (other than a thimbleful of cases involving other digital  
 assets) in which a court found an “investment contract” without the traditional definition of that term being satisfied.  
*Compare* Ripple Summ. J. Mot., *supra*, at 21-23, with SEC Summ. J. Opp’n in *Ripple*, *supra*, at 19-21. At most,  
 the SEC raised out-of-circuit cases that stand for the uncontroversial proposition that an “investment contract” does



1 The SEC’s attempt to regulate the digital assets here—tokens sold on secondary markets,  
2 involving no contract, no post-sale obligations, nor any right to share in profits—deviates from  
3 the long-settled understanding of the securities laws’ scope. The Court should squarely reject it.

4 **B. The Major Questions Doctrine Confirms the SEC May Not Jettison the**  
5 **Traditional Definition of “Investment Contract” Here.**

6 Precedent and text plainly require dismissal of the SEC’s Amended Complaint. But even  
7 if the SEC were able to conjure some ambiguity about the scope of its authority—whether from  
8 *Howey* or the federal securities laws themselves—the Major Questions Doctrine would foreclose  
9 exploiting that ambiguity here. That is, *even if* the SEC’s competing understanding of the law  
10 were “colorable” or “plausible,” that is not enough. *West Virginia*, 142 S. Ct. at 2609. As  
11 between two possible interpretations of the law—one that confers vast power on federal agencies  
12 to resolve substantial policy questions, and one that ensures Congress makes major policy  
13 choices—the Major Questions Doctrine requires the federal courts to opt for the latter reading.

14 It is hard to fathom a more archetypal violation of the Major Questions Doctrine than the  
15 SEC’s assertion of authority over digital assets. That doctrine holds, at heart, that an agency may  
16 not bring about a major policy without clear statutory authorization. *Id.* And here, the SEC is  
17 pressing a novel construction of an isolated term from a Depression-era law to assert regulatory  
18 authority over a trillion dollar industry built upon revolutionary technology poised to define the  
19 next generation of the internet—all as Congress is actively debating the issue, considering *zero*  
20 proposals that bless the SEC’s view of its own authority. Time and again, the Supreme Court  
21 has rejected this sort of expansionism by federal agencies. This Court should do the same here.

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not require a *written* contract. Sure. But saying that contractual obligations need not be committed to paper does  
27 *not* mean they need not exist *at all*.

1                   **1. How to regulate digital assets is a major question requiring clear**  
 2                   **congressional authorization before an agency may act.**

3                   The Supreme Court has repeatedly held that “an agency must point to clear congressional  
 4 authorization when it seeks to regulate a significant portion of the American economy.” *West*  
 5 *Virginia*, 142 S. Ct. at 2621 (Gorsuch, J., concurring) (collecting cases). The Court has not set a  
 6 precise dollar amount for this economic trigger, but precedent and common sense give a sense of  
 7 where the line is drawn. *See, e.g., id.* at 2622 (regulation imposing over \$200 billion in costs);  
 8 *Utility Air Regulatory Grp. v. EPA*, 573 U.S. 302, 321-22 (2014) (regulation imposing around  
 9 \$150 billion in costs); *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 159 (2000)  
 10 (agency asserting jurisdiction over domestic tobacco industry valued roughly near \$100 billion).

11                   Here, the SEC is claiming regulatory domain over a digital asset industry worth around  
 12 \$1 trillion.<sup>13</sup> The industry employs thousands of Americans; has attracted record sums of venture  
 13 capital funding; and has given rise to scores of new businesses.<sup>14</sup> Moreover, digital assets have  
 14 become a fact of daily life for many Americans. Almost one-in-five Americans have invested in  
 15 cryptocurrency at some point.<sup>15</sup> And the per-day volume for trading tracks around \$100 billion.<sup>16</sup>

16                   Digital assets are also built on a pathmarking technology—the blockchain—that is  
 17 destined to reshape the financial sector and define the next generation of the internet. As noted,  
 18 blockchain technology lets parties transact without a centralized intermediary, like a broker or  
 19 bank. This has profound implications for financial services. Blockchain also allows people to  
 20 store, transfer, and verify data without an intermediary—that is, to interact online without relying  
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22                   <sup>13</sup> *See* sources cited *supra* note 10.

23                   <sup>14</sup> *See, e.g.,* Jamie Redman, *Crypto Employment Abounds with More Than 8,000 Jobs in 2020*, Bitcoin.com  
 24 (Jan. 18, 2020), <https://tinyurl.com/3ph27fsk>; Tom Wilson et al., *Cryptoverse: What Crisis? Venture Capitalists Bet*  
 25 *Big on Crypto*, REUTERS (July 26, 2022), <https://tinyurl.com/3b65ybtd>; *Blockchain in Financial Services Startups*  
 26 *in the United States*, TRACXN (Sept. 20, 2022), <https://tinyurl.com/3azj4tuv> (reporting 3,941 U.S. startups using  
 27 blockchain in financial services).

28                   <sup>15</sup> *See, e.g.,* Thomas Franck, *One in Five Adults Has Invested in, Traded or Used Cryptocurrency*, NBC  
 29 *News Poll Shows*, CNBC (Mar. 31, 2022), <https://tinyurl.com/6ksnk3pa>.

30                   <sup>16</sup> *See Q2 2022 Cryptocurrency Report*, COIN GECKO (July 13, 2022), <https://tinyurl.com/dpuyw5sr>.

1 (as we do today) on a handful of large tech companies to facilitate and monitor those interactions.  
 2 In this light, blockchain technology will be at the center of future debates about privacy,  
 3 surveillance, and government power. All told, blockchain technology has already been used for  
 4 such varied purposes as tracking tangible items via “smart contracts” (ranging from lettuce to  
 5 diamonds), empowering foreign refugees to identify themselves digitally after fleeing their home  
 6 countries, and permitting local communities to securely maintain land registration records.<sup>17</sup>

7 Because of both the monetary value and societal potential of digital assets, who regulates  
 8 them and how is a big deal. Or put another way, regulating digital assets plainly concerns “a  
 9 significant portion of the American economy.” *West Virginia*, 142 S. Ct. at 2608 (quotation  
 10 marks omitted). And for that reason, the question of how to regulate digital assets principally  
 11 falls to Congress, not an administrative agency like the SEC. *Id.* at 2609 (“We presume that  
 12 Congress intends to make major policy decisions itself, not leave those decisions to agencies.”).

13 Recognizing that the regulation of digital assets presents a major question would not put  
 14 every digital asset beyond the reach of the SEC. It would, however, require that the SEC satisfy  
 15 the longstanding meaning of “investment contract” before it can assert authority over a particular  
 16 digital asset. The SEC’s ability to concoct a “novel” reading of a statute—however “colorable”  
 17 or “plausible”—is insufficient. *Id.* Only “clear congressional authorization” will do. *Id.*

18 **2. The SEC lacks clear congressional authorization to deem the tokens**  
 19 **at issue to be “securities.”**

20 The SEC does not have clear congressional authorization for its assertion of regulatory  
 21 power in this case, or broadly over the digital asset space. Five independent points show why.

22 *First*, far from clearly authorizing the SEC’s assertion of regulatory power, the term  
 23 “investment contract” *affirmatively forecloses* it. As explained above, “investment contract” is

24 <sup>17</sup> See, e.g., Michael Corkery & Nathaniel Popper, *From Farm to Blockchain: Walmart Tracks Its Lettuce*,  
 25 N.Y. TIMES, Sept. 24, 2018, <https://tinyurl.com/jkcvrey8>; *De Beers Group Successfully Tracks First Diamonds from*  
 26 *Mine to Retail on Industry Blockchain*, DE BEERS GRP. (May 10, 2018), <https://tinyurl.com/e9cdj8yt>; Fixing Aid,  
 27 *Can Blockchain Help Fix the I.D. Problem for a Billion People?*, NEW HUMANITARIAN (Mar. 31, 2022); Eli Abrams,  
*How European Countries Are Using Blockchain to Reform the Land Registration Process*, EMERGING EUROPE (Aug.  
 17, 2022), <https://tinyurl.com/436tewjc>.

1 a term of art that Congress incorporated into the federal securities laws—a term of art that  
2 necessarily excludes the tokens at issue. *Supra* Section I.A.1. This case is thus far simpler than  
3 those in which courts have had to grapple with vague terms that lacked established definitions.  
4 *See, e.g., Brown & Williamson*, 529 U.S. at 126-27 (“drugs” and “devices”); *Utility Air*, 573 U.S.  
5 at 310 (“air pollutant”); *West Virginia*, 142 S. Ct. at 2610 (“system”). At minimum, the SEC  
6 cannot divine a *clear* statement of *existing* authority by recasting a term of art in an entirely novel  
7 way.

8 *Second*, the SEC’s position would massively expand its own power. Congress included  
9 the phrase “investment contract” in the securities laws to cover one-off business ventures where  
10 the investment interests had the basic attributes of a traditional security. *See Edwards*, 540 U.S.  
11 at 393-94. And that term has been applied consistently with its limited focus, covering  
12 investment schemes involving orange groves, beavers, and real estate.<sup>18</sup> The SEC is now trying  
13 to dust off this obscure term to ensnare an *entire industry* worth around \$1 trillion. The SEC has  
14 “never relied on [this] authority to regulate [business] . . . [in] such a remarkable manner.” *West*  
15 *Virginia*, 142 S. Ct. at 2609. And the Major Questions Doctrine forecloses its attempt to  
16 “discover” such an “unheralded power” in “a long-extant statute.” *Utility Air*, 573 U.S. at 324.

17 *Third*, the SEC’s sweeping view of an “investment contract” is in tension with the existing  
18 framework for securities regulation. Not only is the SEC’s view inconsistent with the basic  
19 function of securities regulation. *Supra* Section I.C. It is also, as a practical matter, an  
20 exceedingly poor fit for the securities laws. And when an agency’s position is “inconsistent with  
21 the design and structure of the statute as a whole,” it flunks the Major Questions Doctrine. *Id.* at  
22 321.

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25 <sup>18</sup> *See Howey*, 328 U.S. at 299; *Joiner*, 320 U.S. at 348-49; *Continental Marketing*, 387 F.2d at 468-71;  
26 *see also, e.g., Rubera*, 350 F.3d at 1087, 1093 (payphone purchase and service agreements); *Goldfield Deep Mines*,  
27 758 F.2d at 462-65 (ore purchase and refinement program); *Penfield*, 143 F.2d at 750-51 (whiskey bottling scheme).

1 Consider, for instance, how digital assets may interact with the many disclosure rules in  
2 the securities laws. To take one example, before a security is sold to the public, an “issuer”  
3 usually needs to file a registration statement with the SEC detailing information about the issuer’s  
4 business. The Securities Act defines “issuer” as “every person who issues or proposes to issue  
5 any securities.” 15 U.S.C. § 77b(a)(4). But what does that mean for digital assets? Is the issuer  
6 the computer software that creates and distributes tokens? Is it the person who originally wrote  
7 that program, even if he no longer has anything to do with the platform? Is it each validator on  
8 the platform who gets tokens by verifying transactions? Each user who earns new tokens as  
9 rewards? Other examples abound.<sup>19</sup> But the basic point is that there is a mismatch between the  
10 securities laws’ focus on *centralized* companies (e.g., General Motors) and digital assets’  
11 *decentralized* networks. A legal regime designed around singular companies and business  
12 ventures—with clear point people and leaders—does not map cleanly onto a set of products  
13 *defined* by their diffuse nature.

14 *Fourth*, Congress is actively considering how to best regulate digital assets. The reality  
15 is that digital assets do not fit cleanly into any existing federal regulatory regime—they blur the  
16 lines across money, commodities, and securities. That has led to confusion among regulators.  
17 The Commodity Futures Trading Commission (“CFTC”), for example, has taken the view that  
18 some digital assets are commodities. *See, e.g.,* Commodity Futures Trading Comm’n, *Digital*  
19 *Assets Primer* 23 (2020); Amended Complaint ¶ 1, *Commodity Futures Trading Comm’n v.*  
20 *Bankman-Fried*, No. 22-cv-10502 (S.D.N.Y. Dec. 13, 2022). One CFTC Commissioner even  
21 criticized the SEC’s decision to allege here “that dozens of digital assets,” including utility tokens  
22 and governance tokens, “are securities.” Statement, Commodity Futures Trading Comm’n,  
23 Statement of Commissioner Caroline D. Pham on *SEC v. Wahi* (July 21, 2022),

24 \_\_\_\_\_  
25 <sup>19</sup> *See, e.g.,* Chris Brummer, *Disclosure, Dapps and DeFi*, 5 Stan. J. Blockchain L. & Pol’y 137, 144-49  
26 (2022); Carol R. Goforth, *Cinderella’s Slipper: A Better Approach to Regulating Cryptoassets as Securities*, 17  
27 Hastings Bus. L.J. 271, 294-301 (2021); Lewis Renaudo Cohen, *Ain’t Misbehavin’: An Examination of Broadway*  
*Tickets and Blockchain Tokens*, 65 Wayne L. Rev. 81, 97 (2019).

1 <https://tinyurl.com/47wdzu2a>. Meanwhile, one SEC Commissioner has conceded that, if the  
 2 SEC “seriously grappled with the legal analysis and [its] statutory authority,” it “would have to  
 3 admit that [it] likely need[s] more, or at least more clearly delineated, statutory authority to  
 4 regulate certain crypto tokens and to require crypto trading platforms to register with us.” Hester  
 5 M. Peirce, Comm’r, Secs. & Exch. Comm’n, Outdated: Remarks Before the Digital Assets at  
 6 Duke Conference (Jan. 20, 2023), <https://tinyurl.com/eh8cmtbk>. That same Commissioner  
 7 added: “Congress can figure out whether and how to fill the regulatory gaps.” *Id.* And given  
 8 this novel terrain and the jurisdictional questions digital asset regulation presents, Congress  
 9 appears to have taken on that task and begun to “debate[] the matter frequently.” *West Virginia*,  
 10 142 S. Ct. at 2621 (Gorsuch, J., concurring); *see also, e.g.*, S. 4760 (Aug. 3, 2022) (“Digital  
 11 Commodities Consumer Protection Act”); S. 4356 (June 7, 2022) (“Lummis-Gillibrand  
 12 Responsible Financial Innovation Act”); H. 4741 (July 2021) (“Digital Asset Market Structure  
 13 and Investor Protection Act”).<sup>20</sup>

14 Congress is not now actively debating a question it has already answered. And the  
 15 Congress that passed the federal securities laws did not make the policy choice about how to  
 16 regulate something like crypto. If anything, the current congressional debates strongly suggest  
 17 that the SEC should *not* be in charge of digital assets. None of the current proposals in Congress  
 18 assigns primary regulatory authority to the SEC. Indeed, a wide number of proposals have been  
 19 introduced *specifically* to clarify the SEC *currently lacks* regulatory jurisdiction over broad  
 20 swaths of digital assets—including tokens like the ones here. *See, e.g.*, H.R. 1628, §§ 2-5 (Mar.

21  
 22 <sup>20</sup> *See also* S. 5030 (Sept. 29, 2022) (“Digital Trading Clarity Act of 2022”); H.R. 7614 (Apr. 28, 2022)  
 23 (“Digital Commodity Exchange Act of 2022”); H.R. 4451 (July 16, 2021) (“Securities Clarity Act”); H.R. 1628  
 24 (Mar. 8, 2021) (“Token Taxonomy Act”); H.R. 1602 (Mar. 8, 2021) (“Eliminate Barriers to Innovation Act of  
 25 2021”); H.R. 923 (Jan. 30, 2019) (“U.S. Virtual Currency Market and Regulatory Competitiveness Act of 2019”);  
 26 H.R. 6154 (Mar. 9, 2020) (“Crypto-Currency Act of 2020”). The Chairman of the House Financial Services  
 27 Committee has also recently established a Subcommittee on Digital Assets, Financial Technology and Inclusion  
 tasked with, among other things, “[p]roviding clear rules of the road among federal regulators for the digital asset  
 ecosystem.” Press Release, Fin. Servs. Comm., McHenry Announces Financial Services Subcommittee Chairs and  
 Jurisdiction for 118th Congress (Jan. 12, 2023), <https://tinyurl.com/yc7h4kua>. Since then, the Committee’s majority  
 wing has announced that the “Howey Test is not fit for the purpose of determining whether many digital assets are  
 a security” and that its members “are committed to fixing this in legislation.” Financial Services GOP  
 (@FinancialCmte), TWITTER (Jan. 26, 2023, 1:20 PM), <https://tinyurl.com/3zhkucfh>.

1 8, 2021) (“Token Taxonomy Act”); H.R. 4451 §§ 2(a)(2)-(5), 3 (July 16, 2021) (“Securities  
2 Clarity Act”). Congress has thus “conspicuously and repeatedly declined” to accede to the SEC’s  
3 broad view of its own authority. *West Virginia*, 142 S. Ct. at 2610; *see also id.* at 2620-21  
4 (Gorsuch, J., concurring) (“This Court has found it telling when Congress has considered and  
5 rejected bills authorizing something akin to the agency’s proposed course of action.”).

6 *Finally*, practical consequences weigh heavily against the SEC’s position. *See id.* at 2608.  
7 Given the unprecedented nature of the SEC’s interpretation of “investment contract,” there are  
8 minimal real world consequences to rejecting it; we are aware of no case in which either the  
9 Supreme Court or this Circuit has *ever* countenanced an “investment contract” that departs from  
10 the term’s traditional definition. The repercussions of adopting the Commission’s broad view  
11 would, by contrast, be momentous, and would expand far beyond digital assets. In its plainest  
12 form, it is hard to see how the SEC’s view—unburdened by the traditional definition of  
13 “investment contract”—would not extend to baseball cards, beanie babies, designer sneakers,  
14 commemorative coins, initial sales of concert tickets (often bought to flip for a profit), and much  
15 more besides. With that interpretation, as SEC Commissioner Peirce has noted, “functionally  
16 the ‘most important’ factor of the *Howey* Test is an SEC-invented ‘fifth shadow factor’: whether  
17 the SEC wants to regulate the asset.” *See Peirce, Remarks, supra.* But Congress likely did not  
18 delegate the question whether to regulate any asset—and thereby an entire industry—to an  
19 agency to decide on a whim. Thus, even if the SEC’s interpretation were potentially plausible,  
20 “the sheer scope of [its] claimed authority . . . would counsel against [its] interpretation.”  
21 *Alabama Ass’n of Realtors v. Dep’t of Health & Hum. Servs.*, 141 S. Ct. 2485, 2489 (2021) (per  
22 curiam). The Court should decline to go down that perilous path and should instead enforce the  
23 law as Congress wrote it.

#### 24 **C. Due Process Concerns Similarly Militate Against the SEC’s Position.**

25 At minimum, principles of due process forbid the SEC from recasting the term  
26 “investment contract” to pick up the tokens at issue here. Fair notice requires that laws be defined  
27

1 with sufficient clarity that ordinary people like the Wahi brothers may understand what conduct  
2 is prohibited. *See Skilling v. United States*, 561 U.S. 358, 402 (2010). Congress may not cast a  
3 “net large enough to catch all possible offenders,” while leaving “it to the courts to step inside  
4 and say who could be rightfully detained.” *United States v. Reese*, 92 U.S. 214, 221 (1876).

5 If the SEC’s reading of “investment contract” were permissible—that is, if an “investment  
6 contract” does not require anything resembling a contractual relationship or binding obligations  
7 thereunder—then the law would be unconstitutional, at least as applied to the Defendants. Recall,  
8 not even the phalanx of sophisticated counsel at Coinbase thinks the tokens at issue are securities.  
9 *Supra* p. 10. The industry has been raising the alarm for years that nobody has any clue what  
10 digital assets the SEC considers to be federal securities.<sup>21</sup> And one Commissioner has admitted  
11 that the regulatory environment is “opaque,” with the SEC’s “regulation-by-arbitrary-and-tardy-  
12 enforcement-actions approach” being “the opposite of a rational regulatory framework.” Peirce,  
13 Remarks, *supra*. Indeed, if the SEC is able to detach the term “investment contract” from its  
14 historical meaning, then all sorts of assets become potentially fair game—virtually all items that  
15 people buy for investment purposes based on expectations about what some other person or entity  
16 will do. There is no reason to invite such constitutionally problematic chaos. This Court should  
17 instead reject the SEC’s open-ended conception of an “investment contract” and dismiss the  
18 Amended Complaint.

### 19 **III. THE TOKENS ARE NOT “INVESTMENT CONTRACTS” UNDER *HOWEY*’S TERMS ALONE.**

20 The most straightforward basis for dismissal is that none of the tokens at issue here are  
21 “investment contracts” under that term’s traditional definition, as explained above. But even  
22 under the prongs of *Howey*—removed from context and stripped of their historical meaning—  
23 the SEC still loses. Under *Howey*, an “investment contract” must include “(1) an investment of

24 <sup>21</sup> *See, e.g.*, Petition for Rulemaking – Digital Assets Securities Regulation, SECS. & EXCH. COMM’N (July  
25 21, 2022), <https://tinyurl.com/22xb6e52>; Sumathi Bala, *Ripple CEO Says the U.S. Lacks Regulatory Clarity on*  
26 *Cryptocurrency*, CNBC (Apr. 30, 2021), <https://tinyurl.com/bdzcrxmc>; *Is XRP a Security? We May Never Know*,  
27 COIN TELEGRAPH (Sept. 29, 2019), <https://tinyurl.com/32tyebdt>; Kate Rooney, *Crypto Industry Leaders Warn*  
*Congress: Figure out Regulation, or Watch Innovation Leave the US*, CNBC (Sept. 25, 2018),  
<https://tinyurl.com/3ckujbfd>.



1 money (2) in a common enterprise (3) with an expectation of profits produced solely by the  
2 efforts of others.” *Warfield*, 569 F.3d at 1020. The *Howey* Test is conjunctive, so failing any of  
3 its elements means the instrument is not a security. *Howey*, 328 U.S. at 301. And here, on the  
4 Amended Complaint’s own terms, none of the tokens satisfies *Howey*’s latter two prongs. Even  
5 under the SEC’s preferred framework, the Amended Complaint must therefore be dismissed.

6 **A. None of the Tokens Involves a “Common Enterprise.”**

7 As noted, an “investment contract” is something more than an ordinary asset sale. Among  
8 other things, it requires an investment in a “common enterprise.” Courts have divided over the  
9 precise meaning of this term, but the basic notion captures a shared endeavor where the  
10 participants’ fortunes are intertwined. James D. Gordon, *Defining a Common Enterprise in*  
11 *Investment Contracts*, 72 Ohio St. L.J. 59, 61 (2011). There are two ways to establish a “common  
12 enterprise” in the Ninth Circuit—through “horizontal commonality” or “strict vertical  
13 commonality.” *Hocking v. Dubois*, 885 F.2d 1449, 1455 (9th Cir. 1989) (en banc). Broadly  
14 speaking, *horizontal* commonality focuses on the relationship *across* similarly situated investors,  
15 while strict *vertical* commonality focuses on the relationship *between* promoter and investor. *Id.*

16 The SEC does not say whether it thinks the tokens here exhibit a “common enterprise”  
17 under a theory of horizontal or strict vertical commonality. But it does not matter. The SEC fails  
18 to plausibly allege a “common enterprise” for any token under either theory.

19 **1. None of the tokens satisfies horizontal commonality.**

20 Again, horizontal commonality focuses on the relationship across investors. Namely,  
21 horizontal commonality requires investors to commingle assets in a common pool so that their  
22 fortunes rise and fall as one (something called “pooling”). *Hocking v. Dubois*, 839 F.2d 560, 566  
23 (9th Cir. 1988), *aff’d in relevant part*, 885 F.2d 1449 (9th Cir. 1989) (en banc). In other words,  
24 investors “pool their investments together and split the net profits and losses in accordance with  
25 their pro rata investments.” *Id.* And by “pooling their assets and giving up their claims to any  
26  
27

1 profit or loss attributable to their particular investments, investors make their collective fortunes  
2 dependent on the success of a single common enterprise.” *Id.*

3 As an example of horizontal commonality, consider the facts of *Howey*. There, investors  
4 did not purchase particular orange groves or specific allocations of fruit. Instead, they put their  
5 money together as part of a shared endeavor, where Mr. Howey commingled fruit from all the  
6 groves and allocated pro rata profits to investors based on overall production. *Howey*, 328 U.S.  
7 at 296. If there was a good harvest, investors received a higher pro rata distribution; if there was  
8 a bad one, lower, consistent with those “investors’ allocable shares of the profits.” *Id.* at 300.

9 By contrast, horizontal commonality is lacking whenever an individual purchaser may  
10 “make profits or sustain losses independent of the fortunes of other purchasers.” *Revak v. SEC*  
11 *Realty Corp.*, 18 F.3d 81, 88 (2d Cir. 1994); *see also* 3 Harold S. Bloomenthal & Samuel Wolff,  
12 *Securities and Federal Corporate Law* § 2:26 (2d ed.) (explaining an investment scheme “does  
13 not involve the pooling of one investor’s moneys with the other, [when] they are in fact separately  
14 invested and accounted for”). For instance, in *Revak*, the Second Circuit held individual condo  
15 owners who bought their units from the same property company lacked horizontal commonality,  
16 because the “rents and expenses attributable to each unit were not shared or pooled in any  
17 manner, but were instead the sole responsibility of the unit owner.” 18 F.3d at 88.

18 Here, the SEC fails to plausibly allege horizontal commonality for any of the tokens. This  
19 is because no token involves “pooling” across purported investors. For starters, where, as here,  
20 token-holders purchase their tokens on an exchange, no money accrues in a common “pool”  
21 under the developer’s discretionary control. In the typical exchange transaction, money flows  
22 from the token-buyer to the *individual* token-seller (or perhaps the exchange itself), not the token  
23 developer. *See O’Connor, supra*, at 577. The SEC cannot allege a common “pooling” of assets  
24 based on transactions where no money ever goes to the promoter.

25 Fundamentally, horizontal commonality is lacking because, among other reasons, each  
26 token-holder is simply an individual asset-holder, whose “profits or losses [are] attributable to  
27

1 their particular investment,” not some pro rata distribution of shared earnings. *See Hocking*, 885  
2 F.2d at 1459; *see also Lavery v. Kearns*, 792 F. Supp. 847, 858-59 (D. Me. 1992) (no horizontal  
3 commonality where developers “may have had a plan by which they would use the capital from  
4 [condo] sales for their other projects” but “[condo] owners were not a part of that plan” because  
5 they could chose to “hold on to their property, using or renting it, or resell it”).

6 Consider POWR. As the Amended Complaint tells it, people who bought POWR bought  
7 individual tokens that they could “buy and sell” “whenever they want.” Am. Compl. ¶ 184. That  
8 is irreconcilable with horizontal commonality. Horizontal commonality “requires that investors  
9 share in the profits and risks *of the enterprise*,” *SEC v. SG Ltd.*, 265 F.3d 42, 50 (1st Cir. 2001)  
10 (emphasis added), and so relinquish any claim to profits or losses attributable *to their individual*  
11 *investments*, *see Revak*, 18 F.3d at 88. But here, POWR token-holders own their tokens outright,  
12 and profits or losses turn wholly on when they choose to sell. That is apples to *Howey*’s oranges;  
13 an individual investment as compared to a pro rata distribution from a collective pot. *Id.*

14 It makes no difference that the market price of POWR tokens fluctuates the same way for  
15 all token-holders. That is all true for the sale of *any* fungible asset that could be resold on a  
16 secondary market—gold bars, concert tickets, condominiums, beanie babies, etc. What disables  
17 horizontal commonality in those examples is that an *individual* buyer can earn profits or incur  
18 losses on an *individual* basis. *Hocking*, 839 F.2d at 566. Because buyers can profit individually  
19 in those examples—as token-holders could here—horizontal commonality is lacking. *See, e.g.,*  
20 *Wals v. Fox Hills Dev. Corp.*, 24 F.3d 1016, 1019 (7th Cir. 1994) (pooling requires “an undivided  
21 share in the same pool of assets and profits”).

22 This fundamental defect is common to all the tokens at issue. For each, the SEC does not  
23 allege a scheme whereby token-buyers cede control of assets to a common pool of funds. *E.g.,*  
24 Am. Compl. ¶¶ 114 (AMP); 125 (RLY); 136 (DDX); 149 (XYO); 160 (RGT); 174 (LCX); 183  
25 (POWR); 197 (DFX); 211 (KROM). Rather, each individual investor acts on his own accord  
26 when buying or selling tokens—earning profits and incurring losses according to his own  
27

1 decisions. *E.g., id.* ¶¶ 122 (AMP); 131 (RLY); 145 (DDX); 155 (XYO); 171 (RGT); 178 (LCX);  
2 190-91 (POWR); 207 (DFX); 214-15 (KROM). That forecloses horizontal commonality for  
3 every token.

4 Finally, the fact some tokens allow for “staking” does not change the analysis. As noted  
5 above, “staking” involves token-holders posting their own tokens as collateral for their work  
6 helping the platform operate. But staking is both *optional* (it is not something every token-holder  
7 has to do) and *individualized* (what a person earns via “staking” turns on individual conduct). It  
8 does not involve investors pooling their funds together on the front end, nor pro rata distributions  
9 drawn from common earnings on the back end. As such, any suggestion by the SEC that staking  
10 may give rise to horizontal commonality is deeply mistaken. *E.g., id.* ¶ 114 (AMP).

11 **2. None of the tokens satisfies strict vertical commonality.**

12 The Amended Complaint also fails to plausibly allege strict vertical commonality.  
13 Vertical commonality generally focuses on the relationship among the promoter and investor  
14 (rather than across the investors themselves). And *strict* vertical commonality requires the  
15 fortunes of promoter and investor to be inextricably linked; if one can do well while the other  
16 does poorly, strict vertical commonality is destroyed. But that very dynamic defines each of the  
17 tokens here.

18 Stated simply, the distinction between broad vertical commonality and strict is that the  
19 former requires only that the fortunes of the investor be linked to the *efforts* of the promoter while  
20 the latter requires that the fortunes of the investor be linked to the *fortunes* of the promoter. *See,*  
21 *e.g., Brodt v. Bache & Co.*, 595 F.2d 459, 461 (9th Cir. 1978) (rejecting “broad” vertical  
22 commonality). In particular, strict vertical commonality turns on a “direct relation between the  
23 success or failure of the promoter and that of his investors.” *Mordaunt v. Incomco*, 686 F.2d  
24 815, 817 (9th Cir. 1982). Something more is needed than a link between the “fortunes of  
25 investors” and the “*efforts* of the promoter.” *Revak*, 18 F.3d at 88. Rather, as the Ninth Circuit  
26 has made plain, strict vertical commonality exists only where the “fortunes of the investor are  
27

1 *interwoven with and dependent upon* the efforts and success of those seeking the investment or  
2 of third parties.” *Brodt*, 595 F.2d at 460 (emphases added). Critically, strict vertical  
3 commonality does not exist whenever an investor’s fortunes can operate independently from  
4 those of the promoter; that is, whenever an investor can experience profits while the promoter  
5 can experience losses (or vice versa). *Mordaunt*, 686 F.2d at 817.

6 As the Amended Complaint itself explains, however, no token-holder’s fortune is  
7 *interwoven* with that of the developers. Rather, for each of the tokens, the Amended Complaint  
8 describes how token price turns principally on market forces *rather than* the vitality of the  
9 underlying platform. *See, e.g.*, Am. Compl. ¶¶ 122 (describing 1000% price swing in AMP), 131  
10 (100% for RLY), 145 (300% for DDX), 155 (200% for XYO), 171 (6300% for RGT), 173 (700%  
11 for LCX), 191 (300% for POWR), 208 (700% for DFX), 214 (1200% for KROM). A token-  
12 holder could turn a profit by selling a token despite the platform struggling. *See, e.g., id.* ¶¶ 143-  
13 45 (noting possible 300% return for platform that still is not fully operational). And a platform  
14 could be performing well even while the price of its token sags. *See, e.g., id.* ¶¶ 172-78  
15 (describing how price for LCX fluctuated during period while platform earned money from  
16 “crypto-related services”).

17 Contrast this dynamic again to the facts of *Howey*. There, the orange harvest affected  
18 Mr. Howey and his investors in equal measure. All profited alike from selling the grove’s  
19 oranges. But that is not true for the tokens here. For each of the tokens, a token-holder’s success  
20 turns on *individual* decisions about when to buy and sell tokens—as the allegations that the  
21 Defendants strategically timed their token purchases and sales amply confirm—rather than the  
22 “sound management and continued solvency” of the developers. *SEC v. Eurobond Exch., Ltd.*,  
23 13 F.3d 1334, 1340 (9th Cir. 1994). That fundamental mismatch defeats strict vertical  
24 commonality. *See, e.g., Meyer v. Thomas & McKinnon Auchincloss Kohlmeyer, Inc.*, 686 F.2d  
25 818, 819 (9th Cir. 1982).

1           The SEC says each token involves a “common enterprise” because the interests of token-  
2 holders and developers are broadly aligned, in part because the developers often hold tokens  
3 themselves, and in part because both token-holders and developers generally want the underlying  
4 platform to do well. *See, e.g.*, Am. Compl. ¶ 175. But that proves too much. If a mere alignment  
5 of interests could satisfy strict vertical commonality, then *Howey*’s requirement that an investor  
6 and a promoter share in a “common enterprise” (*i.e.*, “a profit-seeking business venture”) would  
7 be rendered meaningless. 328 U.S. at 299-300; *see, e.g.*, *Mordaunt*, 686 F.2d at 817; *Bobrowski*  
8 *v. Red Door Grp., Inc.*, No. CV-09-02077, 2011 WL 3875424, at \*1 (D. Ariz. Aug. 31, 2011)  
9 (rejecting similar argument based on “tenuous link” between investor’s profits and promoter’s  
10 success).

11           Indeed, investors and promoters will *always* want the overarching venture to succeed  
12 rather than fail. As such, more is needed to show *strict* vertical commonality. *See Revak*, 18  
13 F.3d at 88. Someone who buys gold from a jeweler is not in strict vertical commonality with that  
14 jeweler, even if the jeweler also owns gold and even though both generally hope that gold prices  
15 will increase. To establish strict vertical commonality, an investor’s profits and losses must be  
16 *tied* in some meaningful way to the profits and losses of the promoter. For this reason, courts  
17 have typically found that where (as here) investors and promoters can sell their assets at different  
18 times for varying profits and losses, that is fatal to strict vertical commonality—even where  
19 general market conditions will have a common effect on investor and promoter alike. *See, e.g.*,  
20 *Marini v. Adamo*, 812 F. Supp. 2d 243, 257-58 (E.D.N.Y. 2011) (“[W]hile the valuation of their  
21 portfolios may have paralleled one another given their similar contents, and any deal that [the  
22 promoter] found could have affected the prices of the coins that [the investor] owned, [their]  
23 portfolios were not intertwined such that [their] fortunes *had* to rise and fall together.”).

24           These defects are common to all the tokens underlying the Amended Complaint. That is,  
25 as alleged, each of the nine tokens at issue were sold on the secondary market, and thus  
26 necessarily came with the possibility that the token could perform well while the underlying  
27

1 platform struggled (or vice versa). Accordingly, on the Amended Complaint’s own terms, the  
2 fortunes of token-holders and developers do not invariably rise-and-fall together as one. There  
3 is in turn no strict vertical commonality.

4 **3. There is no investment *in* any common enterprise.**

5 Even if some of the tokens here exhibit a common enterprise (be it on a horizontal or  
6 strict vertical theory of commonality), the SEC still cannot satisfy *Howey*’s second prong. This  
7 is because *Howey* requires “a person invests his money *in* a common enterprise.” 328 U.S. at  
8 299 (emphasis added); *see, e.g., Tarsadia Hotel*, 726 F.3d at 1130. And here, where tokens are  
9 purchased on the secondary market from a third-party seller rather than the developer, there is no  
10 investment *in* a common enterprise. There is just a token purchase; there cannot be an *investment*  
11 of money in a common enterprise without *money* being invested *in* that enterprise. Unlike shares  
12 purchased on the New York Stock Exchange—which represent fractional ownership of a public  
13 company—tokens are not an ownership stake in anything beyond the tokens themselves.

14 Compare this all again to the facts of *Howey*. There, investors paid Mr. Howey directly  
15 for a piece of his orange grove operation. 328 U.S. at 295. They invested money with him, and  
16 hoped they would turn a profit based on his efforts. But here, there is nothing of the sort. Again,  
17 when a token is purchased on an exchange, the money stays between buyer and third-party  
18 seller—it does not pass through to the underlying platform, or become managed by its developers.

19 Of course, if someone purchases tokens on the secondary market, the value of those  
20 tokens may be *affected* by the actions of the platforms (or its developers). That, however, is not  
21 enough. Mr. Howey could affect the secondary market price for his oranges—say, by espousing  
22 radical political views. But the fact remains that people who purchased his *oranges* are  
23 differently situated than those who invested in his *orange groves*. So too for any good bought  
24 on the secondary market. De Beers can always drive down the general price for diamonds by  
25 flooding the market. But that has no bearing on the question of whether someone who purchased  
26 a De Beers diamond on the secondary market has somehow invested money *in* De Beers itself.

1 In short, the Amended Complaint fails to plausibly allege any common enterprise. But  
2 even more fundamental, the Amended Complaint fails to show how any money was invested in  
3 any common enterprise, assuming one exists. That independent defect is also fatal to the entire  
4 Amended Complaint.

5 **B. All Tokens Fail the “Expectation of Profits” Prong.**

6 Even if the nine tokens here each involved a “common enterprise,” they are still not  
7 securities. No token satisfies *Howey*’s final prong, which says an investment must be made on  
8 the “expectation that [the investor] would earn a profit solely through the efforts of the promoter  
9 or of some one other than themselves.” *Howey*, 328 U.S. at 298. This prong has two dimensions.  
10 *See Warfield*, 569 F.3d at 1020. First, a product must be sold as a *profit-making* investment  
11 rather than an item be *used* or *consumed*. *United Hous. Found., Inc. v. Forman*, 421 U.S. 837,  
12 858 (1975). Second, profits must derive significantly from *managerial efforts* rather than *market*  
13 *forces*. *Noa v. Key Futures, Inc.*, 638 F.2d 77, 79 (9th Cir. 1980) (per curiam). All nine tokens  
14 fail both fronts.

15 **1. All of the tokens are “utility tokens.”**

16 There is a critical distinction between investments that have some utility, and utilitarian  
17 purchases that may have some investment value. The former *may* give rise to an “investment  
18 contract”; the latter *cannot*. For instance, in *Tarsadia Hotel*, the Ninth Circuit held the purchase  
19 of a condo unit did not constitute an “investment contract” because the units served as “short-  
20 term vacation homes” rather than investment properties. 726 F.3d at 1132; *see also, e.g.*,  
21 *Bronstein v. Bronstein*, 407 F. Supp. 925, 930 (E.D. Pa. 1976) (distinguishing ventures with “an  
22 eye towards personal use or consumption of the underlying interest [and those for] the purpose  
23 of acquiring an interest in a profit-making venture”). The question here is objective; courts look  
24 to what an investor was reasonably led to expect. *Warfield*, 569 F.3d at 1021.

25 Applying that principle here, none of the nine tokens at issue is a security, because each  
26 is a “utility token”—something that, by nature and design, is *used* on a platform rather than *stored*  
27



1 as an investment. *See, e.g.,* Carol Goforth, *Securities Treatment of Tokenized Offerings Under*  
2 *U.S. Law*, 46 Pepp. L. Rev. 405, 429-30 (2019). Indeed, each token was principally branded as  
3 having a primarily consumptive purpose—be it facilitating transactions, voting on issues related  
4 to the platform’s operation, or accessing the platform itself:

- 5 1) **Flexa** is a digital payment platform designed to facilitate safe, fast, and private retail  
6 transactions. These transactions are done with its **AMP** tokens. AMP token-holders  
7 may choose to deposit or “stake” their tokens in “pools” to collateralize transactions  
8 on the Flexa network. In turn, Flexa’s protocols distribute rewards to those users in  
9 the form of more AMP tokens. AMP is a utility token. *Am. Compl.* ¶¶ 106-22.
- 10 2) **Rally** is a platform that, among other things, helps content creators, brands, and  
11 celebrities launch their own “social tokens.” People use the **RLY** token to interact  
12 with one another over the platform. RLY tokens enable users to vote on governance  
13 issues and to propose how money in the Rally treasury should be spent. RLY is a  
14 governance token and a utility token. *Id.* ¶¶ 123-31.
- 15 3) **DerivaDex** is an exchange for derivative contracts. Its **DDX** token would enable  
16 users to make trades on the platform, and vote on governance issues. The DDX token  
17 would also enable users to obtain fee discounts and receive rewards in exchange for  
18 staking insurance pools on the platform. DDX is both a governance token and a more  
19 traditional utility token. *Id.* ¶¶ 132-45.
- 20 4) **XY Labs** hosts a platform where people can submit geographic data location queries.  
21 People put up **XYO** tokens when asking questions, and receive XYO tokens when  
22 successfully answering them. The XYO token is used as the “gas” or transaction fee  
23 that facilitates transactions on the platform. XYO is a utility token. *Id.* ¶¶ 146-55.
- 24 5) **Rari** allows users to deposit digital assets and receive high-yield interest. The **RGT**  
25 token enables users to obtain fee discounts, vote on investing decisions, and otherwise  
26 participate on the platform. The Rari platform lets users earn RGT tokens in exchange  
27

1 for depositing their cryptocurrencies in liquidity pools, a process known as “liquidity  
2 mining.” RGT is both a governance token and a utility token. *Id.* ¶¶ 156-71.

3 6) The **Liechtenstein Cryptoassets Exchange** is an exchange where people can trade  
4 digital assets and obtain financial services. The **LCX** token enables users to make  
5 transactions or receive discounts over the platform. Some services on the platform  
6 can only be purchased with LCX tokens. LCX is a utility token. *Id.* ¶¶ 172-79.

7 7) **Power Ledger** is a peer-to-peer platform that lets people trade energy in real time.  
8 The **POWR** token allows users to access the platform as well as receive certain  
9 discounts or rewards for their participation. There is a limited supply of POWR  
10 tokens in circulation, and users cannot trade energy on the platform without them.  
11 POWR is a utility token. *Id.* ¶¶ 180-92.

12 8) **DFX Finance** operates as an exchange for foreign digital assets. **DFX** tokens are the  
13 mode of payment across transactions on the platform. DFX tokens enable users to  
14 vote on some governance issues, such as what cryptocurrencies the exchange will list,  
15 and allow users to earn more DFX tokens through liquidity mining. DFX is a  
16 governance token and a utility token. *Id.* ¶¶ 193-207.

17 9) **Kromatika Finance** runs a platform where users can efficiently trade digital assets  
18 by placing range orders on certain exchanges. The **KROM** token, among other  
19 things, is how people pay for transactions on the platform. The platform also allows  
20 token-holders to earn more KROM by collateralizing or “staking” the platform with  
21 cryptocurrency. KROM is a utility token. *Id.* ¶¶ 208-17.

22 At bottom, each token was chiefly created to be *used*. *E.g.*, Am. Compl. ¶ 151 (XYO  
23 developers stating that “mak[ing] a profit from trading . . . [was] not the intended purpose of an  
24 XYO token”). None of the tokens were like stock—something that sits as an investment with no  
25 practical utility. Rather, the *very object* of each token was to facilitate activity on the underlying  
26 platforms and, in so doing, enable each network to develop and grow. *See, e.g.*, Goforth,  
27

1 *Securities Treatment, supra*, at 429 (“[Utility tokens] are designed to offer intrinsic utility that  
2 powers a decentralized, distributed network that delivers to the users of the network a  
3 consumptive good or service.”).

4 The fact that tokens may *also* have investment value—or that some people may have  
5 bought tokens for investment reasons—does not alter the analysis. *See, e.g., Rice v. Branigar*  
6 *Org., Inc.*, 922 F.2d 788, 790-91 (11th Cir. 1991). A utility token’s investment value is derivative  
7 of its primary function; the token is designed to be used even if that usability also makes the  
8 token ultimately more valuable. *See, e.g., Nate Crosser, Initial Coin Offerings As Investment*  
9 *Contracts: Are Blockchain Utility Tokens Securities?*, 67 U. Kan. L. Rev. 379, 393 (2018)  
10 (“[Utility tokens] primarily exist to integrate into the blockchain application they are issued  
11 for. . . . [A]lthough the utility token may appreciate as the usefulness of the application is proved,  
12 its primary function is as an internal currency that incentivizes people to [utilize the underlying  
13 platform.]”). That is especially true where, as here, a token’s presence on secondary markets  
14 *further*s its functional ends. Indeed, as alleged, the developers here regularly promoted trading  
15 their tokens on secondary exchanges *because* doing so would advance their intended  
16 consumptive purposes. The more people that purchase the token, the more people who will be  
17 able to participate in (and improve) the related platform. *See, e.g., Am. Compl.* ¶ 119 (quoting  
18 Flexa blog post touting that AMP’s precursor coin was available to buy on secondary markets  
19 because that would then bring more people to Flexa’s payment platform).

20 In short, *Howey* requires that the SEC plausibly allege each token was chiefly branded as  
21 an *investment* rather than an *instrument*; that the tokens here were ultimately more like the shares  
22 in Mr. Howey’s orange groves than the keys to the vacation condominiums from *Tarsadia Hotel*.  
23 The Amended Complaint does not do so. Rather, the Amended Complaint confirms that the  
24 tokens here were all principally “utility tokens” to be used for functional purposes on each  
25 platform. And for that reason, the Amended Complaint fails to state sufficient factual allegations  
26 to get over *Howey*’s last hurdle.  
27

1                   **2. The value of each token is driven by market forces.**

2                   The nine tokens here fail to satisfy *Howey*'s third prong for an independent reason. For  
 3 there to be an "investment contract," profits must come from "undeniably significant . . . [and]  
 4 essential managerial efforts [that] affect the failure or success of the enterprise." *SEC v. Glenn*  
 5 *W. Turner Enters., Inc.*, 474 F.2d 476, 482 (9th Cir. 1973).<sup>22</sup> That is, profits must come from  
 6 *significant managerial efforts* as opposed to solely from *external market forces*. Once again,  
 7 *Howey* is a good example: There, investors either gained or lost money depending on how well  
 8 Mr. *Howey* managed his groves. By contrast, the Ninth Circuit held there was no "investment  
 9 contract" where a business sold silver bars to people, given that "the profits to the investor  
 10 depended upon the fluctuations of the silver market, not the [seller's] managerial efforts." *Noa*,  
 11 638 F.2d at 79; *see also, e.g., SEC v. Belmont Reid & Co., Inc.*, 794 F.2d 1388, 1391 (9th Cir.  
 12 1986) (*Howey*'s third prong not met where primary purpose of purchase of gold coins was "to  
 13 profit from the anticipated increase in the world price of gold"); *Sinva, Inc. v. Merrill, Lynch,*  
 14 *Pierce, Fenner & Smith, Inc.*, 253 F. Supp. 359, 367 (S.D.N.Y. 1966) ("In a sense anyone who  
 15 buys or sells a horse or an automobile hopes to realize a profitable 'investment.' But the expected  
 16 return is not contingent upon the continuing efforts of another.").

17                   All of the nine tokens at issue fall on the latter side of this line. Indeed, the Amended  
 18 Complaint details how the price of every token here widely fluctuated on secondary markets.  
 19 Am. Compl. ¶¶ 122 (describing 1000% price swing in AMP), 131 (100% for RLY), 145 (300%  
 20 for DDX), 155 (200% for XYO), 171 (6300% for RGT), 173 (700% for LCX), 191 (300% for  
 21 POWR), 208 (700% for DFX), 214 (1200% for KROM). These price swings were not

22  
 23                   <sup>22</sup> In *Howey*, the Supreme Court actually said profits must come "*solely* from the efforts of others." 328  
 24 U.S. at 299 (emphasis added). The Ninth Circuit has declined to read "solely" literally, opting for a more flexible  
 25 standard. *Glenn W. Turner*, 474 F.2d at 482. But the Supreme Court has never blessed this interpretation of *Howey*,  
 26 and has in fact expressly reserved judgment on the Ninth Circuit's decision to adopt it. *See United Hous.*, 421 U.S.  
 27 at 852 n.16. While this Court is of course bound by the Ninth Circuit's precedent, we respectfully submit that such  
 precedent is wrong and should be overturned. *Howey* is best read as meaning what it says, and its final prong  
 requires profits *solely* from the efforts of others. In any event, the SEC's Amended Complaint fails even under the  
 Ninth Circuit's looser interpretation of "solely," and the Defendants need not take any position on the foregoing in  
 order to prevail here.

1 accompanied by parallel radical changes in company policy or managerial efforts. As such, these  
2 swings illustrate that the value of the tokens turned on the market, not the managers. After all,  
3 the whole theory of the SEC’s case is that Ishan Wahi allegedly front-ran the announcements of  
4 these tokens *being listed*—not some change in policy at each platform or new set of “managerial  
5 efforts” by their developers.

6 This is all especially true for the tokens here that were already functional at the time of  
7 the purchases at issue (which describes every token but DDX). *See id.* ¶ 134. As noted, by the  
8 time any of the purchases at issue were made, the platform underlying each token was already  
9 up-and-running—that is, each network was functional and operated on its own without extensive  
10 managerial supervision. *Supra* pp. 48-50. But once a token became functional, its value was  
11 largely out of the hands of its developers. Indeed, the entire point of blockchain technology is to  
12 create platforms that become functional such that they can operate *independent* from their  
13 original developers and early managers. *See, e.g.,* Scott W. Maughan, *Utility Token Offerings:  
14 Can A Security Transform into A Non-Security?*, 2019 BYU L. Rev. 1113, 1137 (2019) (“Once  
15 the network is functional, developers have completed the lion’s share of the work. While they  
16 may make some additional improvements or tweaks to the network, those small efforts will not  
17 affect the value of the tokens nearly as much as supply and demand, government action, public  
18 sentiment, and other events over which neither the investor nor the promoter has any control.”).

19 Moreover, the fact that any given set of developers may have retained the ability to *affect*  
20 a token’s price does not change the analysis. *Howey*’s third prong requires that profits come  
21 from “undeniably significant [and] essential managerial efforts.” *Glenn W. Turner*, 474 F.2d at  
22 482. That requires something more than merely having the capacity to *influence* a token’s price.  
23 Managerial efforts must drive price in order to satisfy *Howey*. *See, e.g., SEC v. Mut. Benefits  
24 Corp.*, 408 F.3d 737, 744 n.5 (11th Cir. 2005) (“[I]f the realization of profits depends  
25 significantly on the post-investment operation of *market forces*, pre-investment activities by a  
26 promoter would not satisfy *Howey*’s third prong.”); *Grenader v. Spitz*, 537 F.2d 612, 619 (2d  
27

1 Cir. 1976) (“While efficient management of the cooperative will enhance its desirability as a  
 2 place of residence, it is hardly a factor which would result in the appreciation in value of the  
 3 shares . . . . Realistically, that will depend upon the general housing market, the status of the  
 4 neighborhood and the availability of credit.”); *Lehman Bros. Com. Corp. v. Minmetals Int’l Non-  
 5 Ferrous Metals Trading Co.*, 179 F. Supp. 2d 159, 164 (S.D.N.Y. 2001) (holding no investment  
 6 contract where “any gain likely would result in large part from market movements, not from  
 7 capital appreciation due to Lehman’s efforts”).

8 To satisfy *Howey*, the SEC needs to plausibly allege that the value of the nine tokens here  
 9 turns on significant managerial efforts rather than market forces. As shown above, it has not  
 10 done so.

11 **C. The “Initial Coin Offering” Cases Are Irrelevant Here.**

12 To the extent the SEC intends to rely on cases where other courts have found tokens from  
 13 “initial coin offerings” to be securities, those cases have no bearing on this case—where all the  
 14 allegations concern purchases of tokens in secondary markets. *See, e.g., SEC v. Kik Interactive  
 15 Inc.*, 492 F. Supp. 3d 169 (S.D.N.Y. 2020); *SEC v. Telegram Grp. Inc.*, 448 F. Supp. 3d 352  
 16 (S.D.N.Y. 2020); *Balestra v. ATBCOIN LLC*, 380 F. Supp. 3d 340 (S.D.N.Y. 2019).<sup>23</sup> Each of  
 17 these cases turned on the promises and circumstances made *by the developer to the purchasers*  
 18 in connection with the initial coin offering. Any discussion of the attributes of the tokens  
 19 themselves were purely incidental to the outcome.

20 \_\_\_\_\_  
 21 <sup>23</sup> Almost all of the federal cases dealing with digital assets have arisen in the context of initial coin  
 22 offerings. One recent outlier is *SEC v. LBRY, Inc.*, No. 21-cv-260, 2022 WL 16744741 (D.N.H. Nov. 7, 2022), but  
 23 that out-of-circuit district court case also has no bearing here. One, the parties in that case did not raise—and the  
 24 court did not grapple with—the arguments made above about the traditional definition of “investment contract.”  
 25 *Supra* Parts I and II. Two, there, unlike here, the defendants *conceded* the first two prongs of *Howey*, including the  
 26 existence of a “common enterprise.” 2022 WL 16744741, at \*3. And beyond that, respectfully, the court’s analysis  
 27 is not persuasive. The court obscured the difference between an *investment contract* and its *underlying asset*—  
 reasoning that a token itself can be a security *even if* the token-holder has no ongoing relationship with the token’s  
 developer. As explained, that is a fundamental error. *Supra* Section I.A.3.b. Also, the court based its analysis  
 entirely on the view that people who bought LBRY (the token at issue) did so in large part because they expected  
 its value to go up due to actions taken by LBRY’s developers. But as also explained, that is simply not enough to  
 create an “investment contract.” *Supra* Section I.A.3. What is essential for there to be an “investment contract” is  
 not the ability of the promoter to *affect* the asset’s price, but an *obligation* on the part of the promoter to take certain  
 actions with respect to the asset, and to do so in a manner that ties the promoter’s fortunes to the investor’s.

1 Again, the *Howey* Test turns on the promises and circumstances surrounding a  
2 transaction, which is why that test can encompass investment schemes involving assets that range  
3 from beaver pelts to oranges. But when the promises and circumstances surrounding a  
4 transaction change, the nature of the transaction (as far as *Howey* is concerned) changes with it.  
5 In other words, as one Commissioner describes the argument, “an initial fundraising transaction  
6 can create an investment contract, but the token itself is not necessarily the security even if it is  
7 sold on the secondary market.” Peirce, Remarks, *supra*. That is because forming an investment  
8 contract requires *both* an underlying asset (*Howey*’s land) *and* attendant contractual obligations  
9 (*Howey*’s promise to cultivate oranges on his investors’ behalf). Secondary sales of *only* the  
10 asset *without* promises by the promoter are categorically and fundamentally distinct.<sup>24</sup>

11 This is true for several reasons. Most basically, there is a critical difference between  
12 when someone buys a token in an “initial coin offering” versus on an exchange. An ICO is the  
13 (provocative and tendentious) term that is broadly used when a developer sells a new token to  
14 the public to raise money for its platform. The important feature of the ICO is not, however, the  
15 standalone token-sale; it is the promises that *accompany* the token-sale, and the promises that  
16 *induce* the buyer to invest money with the upstart enterprise. What matters is the direct  
17 relationship between the token-buyer and the developer—and that relationship arises not from  
18 the mere fact the token-buyer holds a token, but because the buyer received the token *as part of*  
19 an enforceable exchange with the developer. In that light, as compared to ICOs, secondary sales  
20 are horses of a different color. Yes, in both instances, the buyer has in his possession some token.  
21 But crucially, in the latter instance, the original developers do not *owe* any obligations to the  
22 token-holders. Again, tokens primarily enable people to *use* an underlying platform (*e.g.*, enter

23 \_\_\_\_\_  
24 <sup>24</sup> This distinction is longstanding in the academic literature on *Howey* and digital assets. *See, e.g.*,  
25 Maughan, *supra* at 1135 (noting “a number of legal and policy-based arguments” that “suggest a token can transform  
26 from a security into a non-security once it crosses a certain line”); Yuliya Guseva, *A Conceptual Framework for*  
27 *Digital-Asset Securities: Tokens and Coins as Debt and Equity*, 80 Md. L. Rev. 166, 192-93 (2021) (conceptualizing  
token sales as a “two-stage” process in which “what [developer] originally promised to the Initial Purchasers is  
irrelevant” to subsequent token-buyers); *see also* Juan Batiz-Benet et al., *The SAFT Project: Toward a Compliant*  
*Token Sale Framework*, PROTOCOL LABS (Oct. 2, 2017), <https://tinyurl.com/yp2arwr5>.

1 transactions, vote on subjects, confer rewards); they do not inherently confer to the possessor any  
2 rights enforceable *against* the platform’s original developers. The tokens themselves are just  
3 assets, nothing more.

4 For these reasons, it would be a mistake to think that all token-holders are equal, or that  
5 the token itself holds dispositive weight in the analysis. Once more, the asset underlying any  
6 “investment contract”—be it a digital token or a physical orange—is not what gives rise to the  
7 security; rather, what matters are the legally enforceable obligations that run between promoter  
8 and investor. Those obligations do not ordinarily run with the token, and the SEC alleges nothing  
9 to the contrary for any of the tokens here. And without those running obligations, there is nothing  
10 that can transform the sort of naked digital assets here into federal securities. *See, e.g.,* Yuliya  
11 Guseva, *A Conceptual Framework for Digital-Asset Securities: Tokens and Coins as Debt and*  
12 *Equity*, 80 Md. L. Rev. 166, 197 (2021). That is as true for tokens as it would be for an orange.

13 Each ICO case above tracks these principles. In each one, developers sold tokens to raise  
14 capital to develop platforms they promised investors would become operational in the future.  
15 *Kik*, 492 F. Supp. 3d at 174; *Telegram*, 448 F. Supp. 3d at 367; *Balestra*, 380 F. Supp. 3d. at 347.  
16 In each, the court concluded that the developer had promised very real post-sale obligations to  
17 its buyers—even taking the form of explicit *written contracts* in *Telegram* and *Kik*—to deliver a  
18 functional product to the investors who capitalized their projects. *Kik*, 492 F. Supp. 3d at 174-75;  
19 *Telegram*, 448 F. Supp. 3d at 361-62, 372, 377; *Balestra*, 80 F. Supp. 3d at 355-56. And in each,  
20 the court concluded that those promises were what defined and animated each transaction. *Kik*,  
21 492 F. Supp. 3d at 180 (“without the promised digital ecosystem, Kin would be worthless”);  
22 *Telegram*, 448 F. Supp. 3d at 375 (similar); *Balestra*, 380 F. Supp. 3d at 357 (similar).

23 All told, with each ICO case, the court focused on the relationship between the developer  
24 and the token-buyer. And each court found it was the *relationship* that ultimately mattered, not  
25 the token. For instance, the *Telegram* Court specifically parsed the token at issue from the overall  
26 investment scheme, reasoning that the former alone did not give rise to a security. *See* 448 F.  
27



1 Supp. 3d at 379 (“[T]he security in this case is not simply the Gram, which is little more than  
2 alphanumeric cryptographic sequence.”); *see also SEC v. Telegram Grp. Inc.*, No. 19-cv-9439,  
3 2020 WL 1547383, at \*1 (S.D.N.Y. Apr. 1, 2020) (explaining that the security at issue was  
4 “neither the Gram Purchase Agreement nor the Gram but the entire scheme that comprised the  
5 Gram Purchase Agreements and the accompanying understandings and undertakings made by  
6 Telegram”).<sup>25</sup>

7 But here, as explained, there is no investment scheme, no ongoing relationship, and no  
8 binding promises across developer and buyer. There are only tokens, without anything else.

9 Even on more granular points, the ICO cases are inapposite. This is because, at bottom,  
10 those cases all involved pre-functional tokens; tokens that required the ongoing efforts of the  
11 original developers to become operational. (And further, it bears mention that in *Telegram* and  
12 *Kik*, the defendants affirmatively *conceded* that their token offerings were securities offerings—  
13 they only disputed whether immediately subsequent public sales should be considered part of the  
14 same investment scheme. In both cases, the court disagreed with the developers, and collapsed  
15 their intertwined transactions into a single public offering. *See Kik*, 492 F. Supp. 3d at 174;  
16 *Telegram*, 448 F. Supp at 367.)

17 For example, some developers in the ICO cases raised the defense that their tokens were  
18 not securities because they would be designed primarily to be consumed and used. The courts  
19 rejected that argument, but only because the tokens were *pre-functional*, and thus could not (at  
20 least for the foreseeable future) be used *at all*. *Kik*, 492 F. Supp. 3d at 180 (noting the Kin token’s  
21

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22 <sup>25</sup> The fact that *Telegram* technically involved a “secondary public market” sale is irrelevant here. In  
23 *Telegram*, the developers held an initial private sale for Gram tokens where investors provided “upfront capital in  
24 exchange for a discounted future delivery of a discounted asset” with the expectation of quickly reselling their Gram  
25 tokens to the public at a profit. 448 F. Supp. 3d at 367. But the “economic reality” of this transaction, the court  
26 concluded, was a singular public offering of Gram tokens, not a true secondary sale. *Id.* The court disregarded  
27 Telegram’s attempt to “disguise[]” its public offering through “investors” who really functioned as “statutory  
underwriters.” *Id.* at 380-81. Instead, the court concluded that the initial private sale constituted “merely a step” in  
Telegram’s “ongoing public distribution” scheme of trading Gram tokens in exchange for capital. *Id.* Unlike  
*Telegram*, the secondary sales here cannot be merged with any initial offering because, among other reasons, the  
secondary sales involving the Wahis took place on exchanges years or months after any initial offering, and were  
far removed from the token developers’ original investment scheme. *Supra* note 3 and accompanying text.

1 consumptive use “would materialize only if the enterprise advertised by Kik turned out to be  
2 successful”); *Telegram*, 448 F. Supp. 3d at 374 (“Consumptive uses for Grams were not features  
3 that could reasonably be expected to appeal to the Initial Purchasers targeted by Telegram.”). In  
4 contrast, the tokens at issue in this case all exist on a functional blockchain; all have been listed  
5 on prominent secondary markets (like Coinbase); and all (except DDX, which functions in beta)  
6 are fully functional. *Supra* pp. 48-50. The tokens *can* be used, and buyers purchase them *to* use  
7 them.

8 Similarly, the ICO cases’ observations about “common enterprise” are inapposite. The  
9 developers there took investors’ money with the stated purpose of building out the blockchain  
10 and/or the functionality of their token—something, the courts found, readily met the “pooling”  
11 element necessary for horizontal commonality. *Telegram*, 448 F. Supp. 3d at 369-70; *Kik*, 492  
12 F. Supp. 3d at 179; *Balestra*, 380 F. Supp. 3d at 353. But such “pooling” is lacking here, where  
13 secondary market buyers neither transmitted funds to developers, nor expected collective returns  
14 as part of some pooled investment. *Supra* Section III.A. Likewise, when tokens are *pre*-  
15 functional, strict vertical commonality is more intuitive, given that if the underlying platform  
16 failed to launch, the investors “would be equally affected as all would lose their opportunity to  
17 profit.” *Telegram*, 448 F. Supp. 3d at 369-37; *see Kik*, 492 F. Supp. 3d at 178-79; *Balestra*, 380  
18 F. Supp. 3d at 354. But here, where the platforms are operational and the tokens are subject to  
19 market forces, there is no such dynamic tying the fortunes of the investor and those of the  
20 developer. *Supra* Section III.B.2.

21 In sum, token sales might constitute investment contracts when the sale includes promises  
22 by the developer that amount to contractual obligations (as in some ICOs) but that does not  
23 convert the tokens into investment contracts for all time. In each of the ICO cases, the developer  
24 made promises to its initial buyers in connection with its token sales and those promises gave  
25 rise to investment contracts. Here, there is nothing of the kind.

26 \* \* \*

1 In bringing this action, the SEC woefully misreads *Howey*, and seeks to sever the term  
2 “investment contract” from its historical and statutory moorings. But even excusing those fatal  
3 errors, the Amended Complaint is still deficient. On *Howey*’s terms alone, none of the tokens is  
4 a federal security. From all vantage points, the SEC is operating outside its statutory authority.

5 Given this, one final point bears mention. The SEC suggests in its Amended Complaint  
6 that it might be relying upon *other* tokens besides the nine specifically discussed as part of its  
7 action against the Wahis. *See, e.g.*, Am. Compl. ¶¶ 8, 25, 93-96. But if the nine tokens identified  
8 by the SEC are not securities, the agency’s secret tokens cannot save the Amended Complaint.  
9 The SEC is required to state a *plausible* claim upon which relief may be granted. And to do so,  
10 the SEC must identify at least one actual security to support its jurisdiction and this action under  
11 the federal securities laws. Because it has not—and cannot—the Court should dismiss the  
12 Amended Complaint.

#### 13 **IV. THE SEC’S AMENDED COMPLAINT DOES NOT PLAUSIBLY ALLEGE SCIENTER.**

14 Finally, the SEC’s Amended Complaint should be dismissed for a more elementary  
15 reason. To press the sort of claim the SEC is pressing against the Defendants, the agency must  
16 plausibly allege that they knew (or were recklessly indifferent to the possibility) that the  
17 information at issue was “material for *securities* trading purposes.” *SEC v. Obus*, 693 F.3d 276,  
18 286, 287 (2d Cir. 2012) (emphasis added); *see also Ernst & Ernst v. Hochfelder*, 425 U.S. 185,  
19 193 n.12 (1976) (identifying scienter requirement for claims under § 10(b) and Rule 10b-5); *id.*  
20 at 197 (noting knowing or intentional conduct suffices); *id.* at 201 (holding that negligence is not  
21 enough); *Hollinger v. Titan Cap. Corp.*, 914 F.2d 1564, 1569 (9th Cir. 1990) (en banc) (holding  
22 that reckless conduct is sufficient).

23 But here, the SEC offers nothing to suggest that the Wahis even had an inkling that the  
24 tokens at issue were securities. Nor could it. Ishan Wahi worked at Coinbase—a massive, multi-  
25 billion dollar publicly traded company whose *entire* business model is premised on *not* listing  
26 securities. The company uses a legion of lawyers and other employees to conduct a “rigorous  
27

1 process to analyze and review each digital asset before making it available on our exchange.”  
2 Paul Grewal, *Coinbase Does Not List Securities. End of Story.*, Coinbase (July 21, 2022),  
3 <https://tinyurl.com/3rph85vm>. It has also worked with the Crypto Ratings Council to develop a  
4 point-based framework for analyzing tokens under the *Howey* Test. *See Asset Legal Review*,  
5 Coinbase (last visited Feb. 2, 2023), <https://tinyurl.com/3ketxen5>; *Crypto Rating Council’s*  
6 *Securities Law Framework*, Crypto Rating Council (May 10, 2021),  
7 <https://tinyurl.com/ycxzewbu>.<sup>26</sup> And it independently performs a three-part review before a  
8 potential listing: (1) factual diligence on a token, (2) “an analysis under the *Howey* line of  
9 securities cases to determine the likelihood that an asset qualifies as an investment contract under  
10 U.S. securities laws,” and (3) an evaluation to determine “whether the asset has characteristics  
11 of other instruments that may be deemed to be securities, such as a note or stock,” or of a  
12 derivative. *Asset Legal Review, supra*. Every token at issue was listed on Coinbase and thus had  
13 passed that “rigorous” process—a process that the SEC *itself* has reviewed and approved.  
14 Grewal, *supra*. There was no reason for Ishan Wahi to think that any of those tokens were  
15 nonetheless securities, and the SEC has alleged nothing to indicate otherwise. Nor has it alleged  
16 anything that suggests that Nikhil Wahi somehow knew more about the tokens’ nature than his  
17 older brother.

18 More still, it is especially implausible to suggest the *Wahis* knew what tokens were  
19 securities when the SEC cannot even say. The SEC alleges that the Defendants traded in  
20 “dozens” of digital assets, Am. Compl. ¶¶ 93-96, but can only muster that “at least” nine of these  
21 tokens were securities, *id.* ¶ 8. When the *regulator* cannot readily parse a security from a non-  
22 security, it is deeply unfair to expect the *regulated* to do so. Especially so, where, as here, the  
23 *regulators* cannot even agree among themselves. *Supra* p. 37 (describing statement from CFTC  
24 Commissioner Caroline Pham criticizing the SEC’s conception of a “security” in this Amended  
25

26 <sup>26</sup> An earlier version of this framework used a similar scorecard methodology. Coinbase, Coin Center,  
27 USV & Consensys, *A Securities Law Framework for Blockchain Tokens* (Dec. 7, 2016),  
<https://tinyurl.com/dsz65yyd>.

1 Complaint); Peirce, Remarks, *supra* (explaining that the SEC has “implied that secondary trading  
2 of tokens that were once sold as part of a securities contract is also governed by the securities  
3 laws *without adequately explaining why that trading constitutes securities transactions*”  
4 (emphasis added)).

5 It is not enough for the SEC to insist that Ishan Wahi knew he was misappropriating  
6 Coinbase’s confidential information. As the Supreme Court has made clear, § 10(b) “does not  
7 catch all conceivable forms of fraud involving confidential information,” just “fraudulent means  
8 of capitalizing on such information *through securities transactions.*” *United States v. O’Hagan*,  
9 521 U.S. 642, 656 (1997) (emphasis added). Absent a plausible allegation that Ishan Wahi knew  
10 he was interfering with the securities markets, the “animating purpose” behind the federal  
11 securities fraud laws is not implicated. *Id.* at 658-59. In other words, the SEC’s allegations,  
12 taken as true, may give rise to an employee misconduct claim or some other charge; but not  
13 *securities* fraud.

14 In short, the only certain feature of the SEC’s approach to digital asset regulation is its  
15 uncertainty. Nobody—from Congress to Coinbase, Washington regulators to Wahis—can state  
16 with any degree of assuredness what token is or is not an “investment contract” in the eyes of the  
17 SEC. At some point, the SEC’s Delphic strategy of revealing one-off securities via enforcement  
18 actions has to run up against the basic protections of the legal system. A scienter requirement is  
19 one of those protections. And at the very least, it guards against Amended Complaints like this  
20 one.

### 21 **CONCLUSION**

22 For the reasons detailed above, Defendants Ishan and Nikhil Wahi respectfully request  
23 that this Court dismiss with prejudice the SEC’s Amended Complaint pursuant to Rule 12(b)(6)  
24 of the Federal Rules of Civil Procedure.

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2  
3 DATED this 6th day of February, 2023.  
4

5 Respectfully submitted,

6 /s/ James M. Burnham

7 David I. Miller, Admitted *Pro Hac Vice*  
8 Charles J. Berk, Admitted *Pro Hac Vice*  
9 GREENBERG TRAURIG, LLP  
10 One Vanderbilt Avenue  
11 New York, NY 10017  
12 Phone: 212-801-9200  
13 Email: david.miller@gtlaw.com  
14 Email: berkc@gtlaw.com

James M. Burnham, Admitted *Pro Hac Vice*  
Harry Graver, *Pro Hac Vice* Pending  
S. Matthew Krsacok, *Pro Hac Vice* Pending  
JONES DAY  
51 Louisiana Avenue NW  
Washington, DC 20001-2113  
Phone: 202-879-5429  
Email: jburnham@jonesday.com

12 Andrew St. Laurent, Admitted *Pro Hac Vice*  
13 HARRIS ST. LAURENT & WECHSLER LLP  
14 40 Wall Street, 53rd Floor  
15 New York, NY 10005  
16 Phone: 646-248-6010  
17 Email: andrew@hs-law.com

Mark W. Rasmussen, *Pro Hac Vice* Pending  
JONES DAY  
2727 North Harwood Street  
Dallas, TX 75201  
Phone: 214-220-3939  
Email: mrasmussen@jonesday.com

16 Eric Tung, *Pro Hac Vice* Pending  
17 JONES DAY  
18 555 South Flower Street, 50th Floor  
19 Los Angeles, CA 90071  
20 Phone: 213-243-2151  
21 Email: etung@jonesday.com

22  
23  
24  
25  
26  
27  
*Attorneys for Defendant Ishan Wahi*

1 /s/ Priya Chaudhry \_\_\_\_\_  
2 Priya Chaudhry, Admitted *Pro Hac Vice*  
3 CHAUDHRYLAW PLLC  
4 147 West 25th Street, 12th Floor  
5 New York, NY 10001  
6 Phone: 212-785-5550  
7 Email: priya@chaudhrylaw.com

8 *Attorney for Defendant Nikhil Wahi*

1 /s/ Todd Maybrown \_\_\_\_\_  
2 Todd Maybrown  
3 ALLEN HANSEN MAYBROWN & OFFENBECHER  
4 600 University Street, Suite 3020  
5 Seattle, WA 98101  
6 Phone: 206-447-9681  
7 Email: todd@ahmlawyers.com

8 *Local Counsel for Defendants Ishan Wahi and*  
9 *Nikhil Wahi*

1 **CERTIFICATE OF CONFERRAL**

2 Pursuant to Judge Lin’s Standing Order for All Civil Cases, I certify that undersigned  
3 counsel met and conferred with the Plaintiff, and determined that the basis for this motion cannot  
4 be cured by filing an amended pleading.

5  
6 /s/ James M. Burnham  
James M. Burnham

7  
8 *Attorney for Defendant Ishan Wahi*



1 **CERTIFICATE OF SERVICE**

2 I hereby certify that on February 6, 2022, I electronically filed the foregoing with the  
3 Clerk of the Court using the CM/ECF system, which will send notification of this filing to the  
4 counsel of record.

5 I further certify that I have sent this filing to Sameer Ramani by email to his counsel in a  
6 criminal proceeding, David Kornblau, at david.kornblau@dentons.com, and to a Gmail account  
7 Ramani has used, at samyramani@gmail.com. Ramani has not yet appeared in this proceeding,  
8 and a motion for alternative service (Dkt. #28) by these methods is pending before this Court.

9  
10 /s/ James M. Burnham  
11 James M. Burnham

12 *Attorney for Defendant Ishan Wahi*