III. *The Current State of XRP: A Summary of the SEC's Lawsuit Against Ripple*

A. Introduction

The emergence of cryptocurrencies, such as bitcoin, ether, and XRP, has raised many issues, including how these newly developed assets should be classified and which regulatory regime should be responsible for regulating them.[1] Further, the Securities and Exchange Commission (SEC or Commission) is taking an inconsistent regulatory approach concerning digital assets.[2] Recently, the Commission argued that XRP constitutes a "security" pursuant to the Securities Act of 1993 (Securities Act) while maintaining that similar digital assets, such as ether, are not securities.[3] This article addresses the current SEC lawsuit against Ripple Labs, Inc. (Ripple) concerning its distributions of XRP. Section 1 provides a background of the Securities Act and its registration requirements. Section 2 provides an overview of the SEC's complaint and its allegations against Ripple. Section 3 discusses what constitutes an "investment contract" under the *Howey* test. Section 4 summarizes Ripple's response to the Commission's allegations. Part B analyzes why XRP should not constitute a security under *Howey* and explains that the sphere of securities regulation is ill-suited to regulate digital assets.

1. Background of the Securities Act

Following the stock market crash of 1929, Congress enacted the Securities Act and the Securities Exchange Act of 1934 (Exchange

---

[1] Ephrat Livni, *What's Next for Crypto Regulation*, N.Y. TIMES (Jan. 30, 2021), https://www.nytimes.com/2021/01/30/business/dealbook/crypto-regulation-blockchain.html (noting that the U.S. law is "outdated and unfit to address the inventions that blockchain technology has created").

[2] J.W. Verret, *It's Time for the SEC to Overhaul Cryptocurrency Regulation*, LAW360 (Feb. 2, 2021, 5:13 PM), https://www.law360.com/securities/articles/1349629/it-s-time-for-the-sec-to-overhaul-cryptocurrency-regulation ("It does however demonstrate that the SEC's regulatory approach to crypto-currency has been haphazard and inconsistent over the last four years").

[3] *Id.* ("[W]hy is XRP considered a security by the SEC, but other crypto-currencies like Ethereum and Bitcoin are not?").

Act) in an attempt to protect investors.[4] The Securities Act's main focus is governing the primary issuance of securities, or public offerings, while the Exchange Act's main focus is governing companies' ongoing periodic disclosure requirements in the secondary market of securities.[5] The primary purposes of the Securities Act were to ensure greater transparency in the disclosure of corporations' financial statements and to establish uniform federal legislation to protect against misrepresentation and fraudulent activities in the securities markets.[6]

The Securities Act regulates the public offering and sale of securities in interstate commerce.[7] Absent a qualifying exemption, Section 5 of the Securities Act requires every company to file a registration statement with the SEC containing information about its financial state, the securities that it is offering, and the offering itself before offering to sell any securities.[8] Further, a company's registration statement must be deemed "effective" before it can be used to complete the sale and delivery of securities to investors.[9] Section 12 of the Securities Act provides any purchaser of securities sold in violation of Section 5's registration requirements the legal remedy to rescind the

---

[4] The Acts established the Securities Exchange Commission to enforce the regulation. *See* Larry Bumgardner, *A Brief History of the 1930s Securities Laws in the United States—And the Potential Lesson for Today,* 4 J. GLOB. BUS. MGMT. 1 (2008) (discussing the history of U.S. securities law); *see also* SEC. & EXCH. COMM'N, FEDERAL SECURITIES LAWS, https://www.sec.gov/page/federal-securities-laws?auHash=B8gdTzu6DrpJNvsGlS1-JY1LnXDZQqS-JgJAgaSXimg [https://perma.cc/YH3T-YJPA] (providing an overview of the Securities Act and the Exchange Act).

[5] The Exchange Act is beyond the scope of this article. SECURITIES REGULATION: CASES AND MATERIALS 9–10 (James D. Cox et al. eds., 9th ed. 2019) (discussing generally the Securities Act and the Exchange Act).

[6] Will Kenton, *Securities Act of 1933*, INVESTOPEDIA (Oct. 20, 2020), https://www.investopedia.com/terms/s/securitiesact1933.asp [https://perma.cc/D8MF-9EVX] ("Prior to this legislation, the sales of securities were primarily governed by state laws").

[7] COX ET AL, *supra* note 5 at 5 ("The Federal Securities Act of 1933 … regulates the public offering and sale of securities in interstate commerce.").

[8] FEDERAL SECURITIES LAWS, *supra* note 4; *see also* COX ET AL, *supra* note 5, at 150 ("Section 5(c) prohibits any offer to sell or offer to buy prior to the filing of a registration statement.").

[9] FEDERAL SECURITIES LAWS, *supra* note 4 (outlining the Securities Act's requirements for offers to sell securities in the United States); *see also* COX ET AL, *supra* note 5, at 150 ("Under Section 5(a), no sales or deliveries of registered securities can occur until the registration statement is effective").

purchase.[10] More importantly, the Commission may issue administrative cease-and-desist letters pursuant to Section 8A of the Securities Act and may bring civil prosecutions against companies that fail to comply with Section 5 pursuant to Section 20.[11]

2. *SEC Complaint Against Ripple*

On December 20, 2020, the SEC exercised its Section 20(b) authority and filed a civil complaint (The Complaint) against Ripple in the United States District Court for the Southern District of New York alleging that the company "engaged in and [is] currently engaging in the unlawful offer and sale of securities in violation of Sections 5(a) and 5(c) of the Securities Act."[12] The Commission alleges that Ripple, an American technology company that provides a global open source payments network through the use of blockchain technology,[13] has engaged in illegal securities distributions from 2013 through the present.[14] The Complaint avers that Ripple has "sold over 14.6 billion units of a digital asset security called 'XRP,' in return for cash or other consideration worth over $1.38 billion U.S. Dollars" without properly registering the offering with the SEC and that no exemption applies to the alleged offering.[15]

The complaint further alleges that two Ripple executives, Bradley Garlinghouse, the company's current chief executive officer (CEO), and Christian Larsen, the company's co-founder, initial CEO from September 2012 through December 2016, and current chairman of the Board of Directors, "orchestrated these unlawful sales and personally profited by approximately $600 million from their unregistered sales of XRP."[16] The SEC seeks to enjoin Ripple from engaging in the alleged offering and selling of unregistered securities pursuant to

---

[10] COX ET AL., *supra* note 5, at 6 ("Section 12 imposes civil liability upon those who sell securities in violation of Section 5's registration requirement as well as upon anyone who sells any security in a public offering by means of a materially misleading statement").
[11] *Id.* at 6.
[12] First Amended Complaint & Demand for Jury Trial at 3, Sec. & Exch. Comm'n v. Ripple Labs Inc., (S.D.N.Y. Dec. 22, 2020) (No. 1:20-cv-10832-AT) [hereinafter "The Complaint"].
[13] RIPPLE, FREQUENTLY ASKED QUESTIONS, https://ripple.com/faq/ [https://perma.cc/A8DP-8FZ4].
[14] The Complaint, *supra* note 12, at 1.
[15] *Id.* at 1–2.
[16] *Id.* at 1–2, 4, 14.

Section 20(b) of the Securities Act.[17] Further, the Commission seeks to disgorge the defendants of any gains derived from the alleged offerings pursuant to Section 21(d)(5) of the Securities Act as well as to pay civil monetary penalties pursuant to Section 20(d) of the Securities Act.[18]

3. Investment Contract and Howey Test

Essentially, the Commission believes that the way Ripple marketed and continues to market XRP constitutes an "investment contract" with purchasers, and thus a security that must be registered with the SEC before it can be offered to investors.[19] As the complaint explains, the XRP Ledger is a software code that "operates as a peer-to-peer database, spread across a network of computers, that records data respecting transactions, among other things."[20] In essence, the XRP Ledger can be thought of as a digital network for sending and receiving value.[21] Of course, however, such transfers require some sort of asset or conductor to hold said value.[22] For this purpose, Ripple created XRP, a software code, to serve as its ledger's digital asset and native token.[23] XRP was originally called "Ripple Credits" and is commonly referred to as "Ripples" by participants in the cryptocurrency market.[24] Although the technical intricacies of blockchain technology are beyond the scope of this paper, digital tokens, such as XRP, can be traded on a digital distributed ledger in exchange for other digital assets or fiat currency.[25]

---

[17] *Id.* at 3 (stating the relief sought by the SEC).
[18] *Id.* at 3, 79 (stating relief sought by the SEC).
[19] *Id.* at 40 ("At all relevant times during the Offering, XRP was an investment contract and therefore a security subject to the registration requirements of the federal securities laws.").
[20] *Id.* at 8.
[21] XRP LEDGER, XRP'S ORIGIN, https://xrpl.org/history.html [https://perma.cc/D299-L8H8] (outlining the timeline of how XRP was developed).
[22] Luke Conway, *Blockchain Explained*, INVESTOPEDIA (Nov. 17, 2020), https://www.investopedia.com/terms/b/blockchain.asp [https://perma.cc/B4X3-SQV2] (explaining the storage function of blockchain in the context of cryptocurrencies).
[23] The Complaint, *supra* note 12, at 9.
[24] *Id.*
[25] *Id.* at 7 ("A blockchain or distributed ledger is a peer-to-peer database spread across a network of computers that records all transactions in theoretically unchangeable, digitally recorded data packages.").

Pursuant to Section 2(a)(1) of the Securities Act, the definition of "security" includes investment contracts.[26] Although the Securities Act leaves the term "investment contract" undefined, the Supreme Court established in *S.E.C. v. W.J. Howey Co*. that

> an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.[27]

Thus, pursuant to the *Howey* test, an investment contract exists whenever there is (1) an investment of money (2) in a common enterprise with (3) reasonable expectation of profits (4) to be derived from the efforts of others.[28] The *Howey* Court stressed that Congress intended the definition of security to embody a "flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits."[29]

In the Complaint, the Commission notes that novel and unique investment vehicles, such as interests in orange groves, animal breeding programs, railroads, mobile phones, and strictly web-based enterprises, have been held to be investment contracts.[30] The Complaint points to a 2007 report, in which the Commission concluded that digital assets or "digital tokens" may be considered investment contracts and therefore deemed securities, and further advised "those who would use … distributed ledger or blockchain-enabled means for capital raising[] to take appropriate steps to ensure compliance with the U.S. federal securities laws."[31] Accordingly, the Commission alleges

---

[26] Securities Act of 1933, 15 U.S.C. § 77b(a) (defining the term "security").
[27] S.E.C. v. W.J. Howey Co., 328 U.S. 293, 298–99 (1946).
[28] *Id.* at 298–99; *see also* The Complaint, *supra* note 12, at 6–7.
[29] *Howey*, 328 U.S. at 299.
[30] The Complaint, *supra* note 12, at 6–7.
[31] U.S. SEC. & EXCH. COMM'N, Release No. 81207, REPORT OF INVESTIGATION PURSUANT TO SECTION 21(A) OF THE SECURITIES EXCHANGE ACT OF 1934: THE DAO, (July 25, 2017), https://www.sec.gov/litigation/investreport/34-81207.pdf [https://perma.cc/N578-VMVU].

that "[a]t all relevant times during the Offering, XRP was an investment contract and therefore a security subject to the registration requirements of the federal securities laws" and that Ripple failed to register with the SEC in violation of Section 5 of the Securities Act.[32]

Essentially, the Commission argues that the manner in which Ripple "promoted and marketed XRP to potential purchasers, the motivation of such purchasers, and Ripple's other activities with respect to XRP," constitutes an "investment contract," and therefore a security.[33] The Commission avers that Ripple's private internal communications evidences that the company was aware that the principal reason for purchasing XRP was for investors' speculative purposes.[34] The complaint alleges in 2013, a Ripple Agent forwarded an internal memorandum titled "XRP Distribution Framework," which was forwarded to at least one member of Ripple's Board of Directors and stated that "[s]peculators are speculating on Ripple Labs" and that "[i]f you are holding xrp you should want [Ripple Labs] to retain xrp for business development."[35]

The complaint further alleges that, consistent with Ripple's internal understanding that investors were purchasing XRP for speculative purposes, the company publicly offered and sold XRP, purporting it an investment into a common enterprise with promises to assume significant entrepreneurial and managerial efforts to help create a liquid market for XRP, which would increase the digital token's demand, and thus its price.[36]

The Complaint alleges that, from the digital asset's creation, Ripple publicly and privately promised to undertake significant efforts to build value for XRP.[37] That as early as 2014, Ripple, in a publicly distributed promotional document, explained that its business model was predicated on the belief that demand for XRP would increase if

---

[32] The Complaint, *supra* note 12, at 40, 68 ("Defendants have never filed a registration statement with the SEC with respect to any XRP they have offered or sold or intend to offer or sell, and no registration statement has ever been in effect with respect to any offers or sales of XRP").

[33] *Id.* at 10–11 (Ripple "offered, sold and promoted XRP as an investment—precisely the type of conduct [the] Legal Memos had warned could lead to a determination that XRP was a security.").

[34] *Id.* at 40 ("[Ripple] understood and acknowledged in non-public communications that the principal reason for anyone to buy XRP was to speculate on it as an investment.").

[35] *Id.*

[36] *Id.* at 41.

[37] *Id.* at 43.

the company's protocol, the idea of an Internet-for-value exchange, became widely adopted.[38] The Commission avers that the "Ripple protocol" predicated on increasing demand for XRP through speculative investing and improving its liquidity.[39] The Complaint alleges that Ripple "encouraged reasonable investors to view the purchase of XRP as something from which they could profit by persistently touting increases in XRP's price."[40] The complaint further alleges that

> Ripple did not limit its touting of XRP purchases as a potential means for investors to profit only to increases in XRP prices in the abstract. Frequently, Ripple explicitly tied actual or potential XRP investment returns to Ripple's completed or upcoming efforts—both with respect to developing demand for XRP and to protecting the XRP markets themselves.[41]

The Commission avers that Ripple "held itself out as the key party who would make these efforts with respect to XRP and the Ripple protocol" and highlighted the company's "business development efforts" in various promotional materials.[42] The Complaint alleges that emails sent to shareholders and interviews given by Ripple executives prove that Ripple promised not only to undertake significant efforts to build value for XRP but also to undertake significant efforts to develop and maintain a secondary market for XRP investors to resell their XRP in.[43]

The Commission avers that beginning in at least late 2015, Ripple undertook "extensive efforts" to persuade digital asset trading

---

[38] *Id.*
[39] *Id.* at 43–45 (detailing Ripple's efforts to increase XRP's liquidity and price).
[40] *Id.* at 58.
[41] *Id.* at 59.
[42] *Id.* at 43.
[43] The Complaint alleges that as early as 2014, Ripple's then CEO, Larsen, explained in a public interview, that one of the company's goals was to make sure it distributed XRP in a broad manner that added as much liquidity as possible, stating "[Ripple's] incentives are very well aligned [with investors] … that for Ripple Labs to do well we have to do a very good job in protecting the value of XRP and the value of the network, and that really is the guiding principle here in our distribution of XRP." *Id.* at 46–47.

platforms to allow for XRP to be traded on their exchanges.[44] And that Ripple maintained such distribution strategy and promise to increase investor value throughout the years, and therefore that "[t]he very nature of XRP in the market—as constructed and promoted by Ripple—compels reasonable XRP purchasers to view XRP as an investment," and therefore a "security" pursuant to the Section 2(a)(1) of the Securities Act.[45]

4. Ripple's Answer to the Complaint

Ripple's Answer to the Complaint accurately identifies that "the most consequential and overarching issue" is "whether Ripple's *current* distributions of XRP are 'investment contracts' under existing U.S. securities laws."[46] Ripple maintains that "[t]he answer is a resounding no, and reaching that determination quickly is urgently needed to provide clarity to the market."[47] Ripple avers that it did not sell nor distribute XRP as an investment contract, asserting that

> Ripple has never offered or sold XRP as an investment. XRP holders do not acquire any claim to the assets of Ripple, hold any ownership interest in Ripple, or have any entitlement to share in Ripple's future profits. Ripple never held an "ICO" (initial coin offering); never offered or contracted to sell future tokens as a way to raise money to build an ecosystem; never explicitly or implicitly promised profits to any XRP holder; and has no relationship at all with the vast majority of XRP holders today, nearly all of whom purchased XRP from third parties on the open market.[48]

---

[44] *Id.* at 57 ("Ripple undertook extensive efforts—starting in at least late 2015—to persuade digital asset trading companies to permit investors to buy and sell XRP on their platforms, especially those that would make XRP tradable against the USD ….").
[45] *Id.* at 62.
[46] Answer of Defendant Ripple Labs, Inc. to Plaintiff's First Amended Complaint at 8, Sec. & Exch. Comm'n v. Ripple Labs Inc., (S.D.N.Y. Dec. 22, 2020) (No. 1:20-cv-10832-AT) [hereinafter "The Answer"].
[47] *Id.*
[48] *Id.* at 5.

While Ripple concedes that it did enter into a limited number of contracts with "sophisticated, institutional counterparties," it maintains that these agreements were "standard purchase and sale agreements with no promise of efforts by Ripple or future profits."[49] Ripple avers that it "has no explicit or implicit obligation to any counterparty to expend efforts on their behalf; proceeds of XRP sales are not pooled in a common enterprise; and holders of XRP cannot objectively rely on Ripple's efforts."[50]

The Answer further avers that the mere fact that Ripple owns a large percentage of XRP, and therefore may have some aligned interests with certain XRP purchasers, cannot alone render its sales of XRP as investment contracts.[51] Ripple argues that many corporations own large amounts of the commodities that they sell as well as heavily participate in the markets of those commodities, pointing out that "Exxon holds large quantities of oil, De Beers owns large quantities of diamonds, Bitmain and other Chinese miners own a large percentage of outstanding bitcoin."[52] The Answer contends that it is inevitable that such large commodity owners will have aligned interests with some purchasers of the underlying asset, "[b]ut there is no credible argument that substantial holdings convert those commodities or currencies into securities, nor has any case so held."[53]

Ripple avers that if the company were to "cease to function tomorrow" that "XRP would continue to survive and trade in its fully developed ecosystem."[54] And that

> [t]o that end, the Complaint mischaracterizes, misunderstands or ignores the economic realities of XRP, including: (i) that the XRP Ledger is entirely open-source, decentralized, and operates on an enormous scale (more than 1.4 billion transactions globally since 2013) outside of Ripple's control; (ii) that XRP is and long has been a digital asset with a fully functional ecosystem and utility as a bridge currency and other types of currency uses; and (iii) that XRP's price is not and has not been determined by Ripple's activities

---

[49] *Id.*
[50] *Id.*
[51] *Id.* at 5–6.
[52] *Id.*
[53] *Id.*
[54] *Id.* at 5.

> —instead, the market has for many years priced XRP in correlation with other virtual currencies, most notably bitcoin and ether (which the SEC has publicly stated are not investment contracts).[55]

Ripple argues that the Complaint "read[s] the word 'contract' out of 'investment contract,' and stretch[es] beyond all sensible recognition the Supreme Court's test for determining investment contracts in [*Howey*]."[56] The Answer maintains that "[a]s a matter of economic substance, XRP categorically differs from the various instruments and business arrangements that Congress authorized the SEC to regulate—all of which, unlike Ripple's relationship to XRP holders, involve 'schemes devised by those who seek the use of the money of others on the promise of profits.'"[57] The Answer asserts that every case in which courts have held that a transaction involving digital assets constituted an investment contract involved either an issuer's ICO or agreement to provide future tokens in exchange for money to develop a digital-asset product, which involved a contractual relationship between the issuer and purchasers.[58] Ripple avers that it "never held an ICO, never offered future tokens to raise money, and has no contracts with the vast majority of XRP holders."[59] Therefore, the company "did not violate Section 5 of the Securities Act because XRP is not a security or 'investment contract,' and Ripple's distributions or sales of XRP are not 'investment contracts.' No registration was required in connection with any distribution or sales of XRP by Ripple."[60]

In addition to arguing that Ripple's distributions of XRP do not constitute "investment contracts," and therefore XRP cannot be classified as a "security" pursuant to the Securities Act, Ripple avers that the Commission failed to provide the company and the market with fair notice that "transactions in XRP violated the law or that the SEC would later claim XRP itself to be an investment contract."[61] Ripple argues that due process requires that the law give a person of ordinary intelligence a reasonable opportunity to know that their conduct is prohibited, which the Commission could have done

---

[55] *Id.* at 6.
[56] *Id.*
[57] *Id.* at 6–7.
[58] *Id.* at 7.
[59] *Id.* at 7.
[60] *Id.* at 96.
[61] *Id.* at 97.

concerning Ripple's distributions of XRP, but failed, for years, to do so.[62] Ripple avers that the lack of fair notice to Ripple and market participants was "exacerbated" when the Commission remained silent following a 2015 settlement between Ripple, the U.S. Department of Justice, and FinCEN, which described XRP as a "convertible virtual currency" and expressly permitted future sales and distributions of XRP as long as they were registered with FinCen as money services business and "in compliance with federal laws and regulations applicable to money service businesses."[63] The Answer avers that the Commission "provided neither [Ripple] nor the broader market with clear notice that, in [the Commission's] view, [Ripple's] prospective XRP sales as permitted by the settlement agreement would nevertheless constitute a violation of another federal law."[64]

Ripple argues that the lack of fair notice was "further exacerbated" when the SEC's then-Director of Corporation Finance, William Hinman, publicly stated that the Commission did not consider bitcoin or ether, two other popular virtual currencies that utilize blockchain technology, to be securities, in a 2018 speech.[65] In the speech, Hinman noted that although ether engaged in an ICO and may have constituted a security at the time of its initial offering, it was no longer a security and would be a waste of the Commission's resources to pursue an action against Ethereum, the company responsible for developing ether's code.[66]

B. Analysis

The Commission's allegation that Ripple sold XRP as an investment into a common enterprise with the promise to engage in

---

[62] *Id.* at 97–99 ("In short, there was no fair notice to the market that the transactions in XRP violated the law or that the SEC would later claim XRP itself to be an investment contract").
[63] *Id.* at 97.
[64] *Id.*
[65] *Id.* at 98.
[66] William Hinman, Director, Division of Corporation Finance, Remarks at the Yahoo Finance All Markets Summit: Crypto (June 14, 2018) *in Digital Asset Transactions: When Howey Met Gary (Plastic)*, SEC. & EXCH. COMM'N, https://www.sec.gov/news/speech/speech-hinman-061418 [https://perma.cc/7S8Q-TCRP] ("[P]utting aside the fundraising that accompanied the creation of Ether … current offers and sales of Ether are not securities transactions. And, as with Bitcoin, applying the disclosure regime of the federal securities laws to current transactions in Ether would seem to add little value.").

significant managerial efforts to increase XRP's value, and therefore constitute an "investment contract" would require an expansive reading of *Howey*. Chris Giancarlo, former Commodity Futures Trading Commission (CFTC) chairman, and Conrad Bahlke, counsel at Willkie Farr & Gallagher LLP, also do not believe that XRP constitutes a security under *Howey*.[67] The two securities law experts explain that "[e]ven if XRP was to satisfy one or two of the prongs of the *Howey* test, it does not satisfy all the factors such that XRP is an investment contract subject to regulation as a security."[68] They argue that "under a fair application of the *Howey* test and the SEC's presently expanding analysis, XRP should not be regulated as a security, but instead considered a currency or a medium of exchange, consistent with interpretations offered by other federal regulators."[69] The two securities law experts further argue that the fact

> That market participants recognize the separation between XRP and Ripple is evidenced by the fact that the price of XRP is generally unresponsive to developments regarding Ripple and instead follows the movement of other cryptocurrencies. Though Ripple maintains a sizable stake of the XRP supply and certainly has a pecuniary interest in the value of its holdings, it is not enough to suggest that a mutual interest in the value of an asset gives rise to an expectation of profits as contemplated by *Howey*.[70]

Giancarlo and Bahlke believe that under a fair application of the *Howey* test XRP cannot constitute a security and should instead be regulated as a currency or a medium of exchange.[71]

---

[67] It is worth noting that Willkie Farr & Gallagher LLP serves as counsel to Ripple on certain matters. Chris Giancarlo & Conrad Bahlke, *Cryptocurrencies and US Securities Laws: Beyond Bitcoin and Ether*, INT'L FIN. L.R. (Jun. 17, 2020), https://www.iflr.com/article/b1m2pm9g4n65mk/cryptocurrencies-and-us-securities-laws-beyond-bitcoin-and-ether [https://perma.cc/P9PU-3HAQ] (discussing Ripple and the application of U.S. securities to XRP).

[68] *Id.*

[69] *Id.*

[70] *Id.*

[71] *Id.* ("XRP should not be regulated as a security, but instead considered a currency or a medium of exchange, consistent with interpretations offered by other federal regulators").

Mary Jo White, former chair of the SEC, shares sentiments similar to those of Giancarlo and Bahlke concerning the regulation of XRP as a security, explaining that "[t]here's no way to sugarcoat it. [The Commission is] dead wrong legally and factually."[72] White points to the timing of the Complaint and the fact that it took the Commission nearly eight years from Ripple's initial distribution of XRP to bring the suit, stating that "[a]s a former U.S. attorney and SEC chair, you know that when it takes that long to figure out a case you probably shouldn't be bringing it" and that the Commission is attempting to "fit a round peg in a square hole."[73]

J.W. Verret, an Associate Professor of corporate and securities law at the Antonin Scalia Law School at George Mason University, also believes that the *Howey* test as well as other SEC regulations are not suited for application to the technological advances of digital tokens.[74] Verret would seem to agree with Ripple's argument that XRP cannot constitute an "investment contract," and therefore a "security" as holders of XRP cannot objective rely on the company's efforts and if the company were to become defunct that XRP would continue to be traded on digital asset exchanges. Verret explains that one of the main difficulties in attempting to administrate the regulation of digital tokens is that

> Cryptocurrency looks a lot like a security at the beginning of its business life cycle, as a central promoter must sell a sufficient critical mass of tokens such that the interactive network takes on a life of its own. Early in the life cycle of the asset, the central activity of the founders, in promoting the asset and in maintaining the code underlying the asset, is central to

---

[72] It is worth noting that White serves as counsel to Ripple. Jeff J. Roberts, *SEC Is 'Dead Wrong': Former Chair Mary Jo White Defends Ripple in Pivotal Crypto Case*, FORTUNE (Feb. 19, 2021, 10:00 AM), https://fortune.com/2021/02/19/ripple-sec-lawsuit-mary-jo-white-crypto-unlicensed-securities-xrp/ [https://perma.cc/ZU5P-P4ZQ].

[73] *Id.*

[74] Verret, *supra* note 2 (discussing the need for an overhaul of cryptocurrency regulation); *see also* Roslyn Layton, *SEC v. Ripple: Mining for Clarity in Regulatory Chaos*, FORBES (Feb. 10, 2021, 9:16 AM), https://www.forbes.com/sites/roslynlayton/2021/02/10/sec-v-ripple-mining-for-clarity-in-regulatory-chaos/?sh=5fc8428e7673 [https://perma.cc/7SXG-QVPH].

> the success of the enterprise. The test for a security is easily met.
>
> Then, as the asset takes off, it becomes controlled by a decentralized community of users who can then trade in the asset and maintain and evolve the asset's code. There is no longer a central actor who is key to the asset's value.[75]

Verret believes that the current binary rules regarding securities regulation, in that an underlying asset is either a security and always will be regulated like one or it is not, "are not well tailored to take into account this evolution of cryptocurrency along its transition from centralized to decentralized."[76] Verret believes that the "current application of the *Howey* test represents significant departure from the language in the original case," as the U.S. Supreme court held that the source of an investment's profit must come *solely* from the efforts of the promoter.[77]

In addition to many American securities law experts taking the stance that Ripple's distribution of XRP should not constitute an offering subject to the registration requirement of the Securities Act, some foreign regulators, including the UK's finance ministry and Japan's Financial Service Agency (FSA), have taken the position that XRP is not a security.[78] Regulatory officials in the UK consider XRP to be "exchange tokens"—that is, "tokens that are primarily used as means of exchange" and are unregulated.[79] The UK's Financial Conduct Authority (FCA) explicitly distinguishes exchange tokens from its other two categories of crypoassets, "e-money tokens" and "security tokens," both of which are "within the UK's regulatory

---

[75] *Id.*
[76] *Id.*
[77] *Id.*
[78] Yogita Khatri, *Japan's Top Securities Regulator Says XRP Is Not a Security*, THE BLOCK (Jan. 13, 2021, 3:21 PM), https://www.theblockcrypto.com/post/90922/japan-fsa-xrp-comments-cryptocurrency [https://perma.cc/98VT-V857] (reporting that Japan's security regulator and the U.K.'s finance ministry do not view XRP as a security).
[79] Bitcoin and ether are also classified as exchange tokens in the UK securities regime. *See* UK REGULATORY APPROACH TO CRYPTOASSETS AND STABLECOINS: CONSULTATION AND CALL FOR EVIDENCE, HM TREASURY 5 (Jan. 2021), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/950206/HM_Treasury_Cryptoasset_and_Stablecoin_consultation.pdf [https://perma.cc/S3GG-22N8].

perimeter and therefore subject to FCA regulation."[80] Similarly, the FSA has taken the position that XRP is a cryptocurrency and not a security based on definitions of the country's Payment Services Act.[81] While the Commission has taken a similar approach regarding the regulation of other digital assets, such as bitcoin and ether, the Commission maintains that XRP differs from these two digital assets as it is backed by a knowable and singular body, and therefore that any offering and sale of XRP requires registration with the SEC pursuant to the Securities Act.[82] However, Verret argues, "[t]here are a number of similarities between Ethereum and Ripple," and the Commission's "haphazard and inconsistent" approach to digital assets over the past few years demonstrates that SEC regulations are not suited for application to the technological advances of digital tokens.[83]

C. Conclusion

In closing, the Commission avers that Ripple's distributions of XRP constitute "investment contracts," pursuant to *Howey*, and therefore a "security" that must be properly registered with the SEC before being offered to potential purchasers. However, Ripple argues, and many American securities law experts seem to agree, that the company's current distributions of XRP do not constitute "investment contracts," and that XRP should be regarded as a cryptocurrency rather than a "security," consistent with how the Commission considers ether and bitcoin. While it is largely uncertain how the United States District Court for the Southern District of New York will ultimately rule on this matter of first impression, it is clear that the cryptocurrency market

[80] *Id.*
[81] Yogita, *supra* note 77.
[82] *SEC Says XRP Is Fundamentally Different Than Bitcoin and Ethereum as Legal Battle with Ripple Intensifies*, DAILY DODL (Mar. 21, 2021), https://dailyhodl.com/2021/03/21/sec-says-xrp-is-fundamentally-different-than-bitcoin-and-ethereum-as-legal-battle-with-ripple-intensifies/ [https://perma.cc/U5RH-ZZ28] ("During a hearing in the SEC's case against Ripple in which the regulatory agency accuses the digital payments firm of illegally selling unauthorized securities in the form of XRP, legal counsel Jorge Tenreiro argues that XRP is dissimilar to the two large-cap crypto assets which have already been cleared by the SEC. [*sic*] Today reports that within his case against Ripple, Tenreiro notes that XRP, unlike BTC and ETH, is backed by a knowable and singular body.").
[83] Verret, *supra* note 2.

will benefit in the future from the regulatory guidance that the holding will hopefully provide no matter what way the court comes out.

Dalton Battin[84]

[84] Student, Boston University School of Law (J.D. 2022).