

The SEC’s crypto crackdown: Why Bitcoin remains the outlier

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The battle lines are drawn in the fight over one of the most hotly contested legal questions facing the world of cryptocurrency today: Should the ever-expanding class of crypto tokens and related digital assets be classified as securities under applicable American law?¹

What started out as one obscure and initially valueless project called “Bitcoin: A peer-to-peer electronic cash system,”² has spawned an asset class that at its peak boasted a combined market cap of over \$3 trillion³ and continues to add new—though often incredibly similar—crypto tokens and digital assets to the space.⁴ And while this growth has gradually broadened the ecosystem to encompass more mainstream users, cryptocurrency has its roots in the pseudo-anarchic ethos of the “cypherpunks” from the late 20th century⁵ and has not traditionally been overly concerned with regulatory compliance.

Nevertheless, a modest flow of more regulation-minded clients hoping to build on the historic success of Bitcoin began trickling into law offices roughly a decade ago. A critical threshold issue for them was determining how to launch their own Bitcoin-like tokens and digital assets without drawing undue scrutiny from the Securities and Exchange Commission (“SEC”). Over time, more clients turned up seeking similar guidance as the space rapidly expanded beyond what anyone could have initially imagined. But this expansion brought into law offices another type of client: the (often disgruntled) token investor.

Year after year, an increasing number of hopeful investors initially met with enticing promises from highly effective marketers and technologists were often wildly misled.⁶ From the beginning and persisting to this day, investors’ initial moments of expectation frequently ran headlong into the sobering reality that the broader crypto space has a penchant for making promises it simply cannot deliver.⁷

¹ In the United States, the term “security” is defined in Section 2(a)(1) of the Securities Act of 1933 (the “Securities Act”), Section 3(a)(10) of the Securities Exchange Act of 1934, Section 2(a)(36) of the Investment Company Act of 1940, and Section 202(a)(18) of the Investment Advisers Act of 1940.

² Satoshi Nakamoto, Bitcoin: A peer-to-peer electronic cash system, BITCOIN.ORG, <https://bitcoin.org/bitcoin.pdf> (last visited October 12, 2022).

³ Joanna Ossinger, *Crypto World Hits \$3 Trillion Market Cap as Ether, Bitcoin Gain*, BLOOMBERG, (November 9, 2021, 4:06 AM EST) <https://www.bloomberg.com/news/articles/2021-11-08/crypto-world-hits-3-trillion-market-cap-as-ether-bitcoin-gain>.

⁴ See generally, CoinMarketCap.com (last accessed October 12, 2022) (Showing market prices for 21,293 distinct cryptocurrencies).

⁵ Steve Fiorillo, *Bitcoin History: Timeline, Origins and Founder*, <https://www.thestreet.com/investing/bitcoin/bitcoin-history-14686578> (last updated Jan. 2, 2020).

⁶ See, Shaanan Cohny, et al., *Coin-Operated Capitalism*, 119 Col. L. Rev. 591, 597-98 (2019) (“Article built around a survey of the 50 ICOs that raised the most capital in 2017,” and finding “that ICO code and ICO disclosures often do not match.”)

⁷ See, e.g., Wayne Duggan, *Celsius Crypto Meltdown: A crypto lender in crisis*, FORBES, <https://www.forbes.com/advisor/investing/cryptocurrency/what-is-celsius/> (last updated Oct. 4, 2022).

Whether looking at it from the perspective of the token issuer or the token investor, the trouble for most cryptocurrency projects is that their success hinges on the creation and distribution of a financial instrument that looks an awful lot like the sale of an investment contract under the *Howey*⁸ test. And this matters because if these tokens are “investment contracts,” as the SEC generally believes them to be,⁹ then their issuers and promoters become subject to a difficult and often expensive regulatory regime that most crypto projects are either unable or unwilling to comply with.¹⁰ As a result, both eager investors and intrepid entrepreneurs should exercise caution before getting swept up in the emotion and promise of what feels like a once-in-a-lifetime opportunity.

While there are many prudent questions worth asking when experimenting in the cryptocurrency space, the salient one this article addresses is determining whether a given crypto token or digital asset is likely to be deemed a security by the SEC. Of course, each individual token must be independently analyzed to get a definitive answer to this question. But this article endeavors to provide the reader with a generalized framework likely to be applied when conducting such an analysis.

To do this, we must first understand how crypto tokens are usually created and distributed. This—along with how they are used—is where these assets generally intersect with the American securities law framework. The article devotes only passing attention to the often overused and largely misunderstood term, “blockchain,” which today is so weighed down by marketing ambiguity and venture capital pitch decks that it no longer lends itself to easy or meaningful definition.

Indeed, most potential investors seem to view it as a kind of un-hackable database. But the reality is that a “blockchain” is only as good as the network and underlying incentive mechanisms that support it. More importantly, from a securities perspective, the fact that some asset purports to utilize a blockchain—however one might define it—is not really all that significant except to the extent it confuses many into thinking they are beyond the reach of traditional legal systems.¹¹

⁸ The *Howey* test arose out of the seminal Supreme Court case, *Securities and Exchange Commission v. W.J. Howey, Co.*, 328 U.S. 293 (1946), which established a four-factor inquiry for determining whether a transaction constituted an investment contract subject to the regulatory authority of the SEC. Under the *Howey* test, a transaction is an investment contract if 1) it constitutes an investment of money (or other thing of value); 2) there is an expectation of profit from the investment; 3) the investment of money is in a common enterprise; and 4) any profit comes from the efforts of others.

⁹ See, Emily Graffeo, *SEC chief Gary Gensler says many crypto tokens are securities and fall under the agency's jurisdiction*, BUSINESS INSIDER (Aug. 4, 2021 at 1:04pm), <https://markets.businessinsider.com/news/currencies/sec-chief-gary-gensler-many-crypto-tokens-securities-commodities-bitcoin-2021-8?op=1>.

¹⁰ Being classified as a security creates a series of onerous and ultimately expensive reporting and disclosure requirements for numerous actors within the space, including promoters, creators/issuers, and exchanges. See, e.g. Lydia Beyoud and Allyson Versprille, *Why the Crypto World Flinches When the SEC Calls Coins Securities*, THE WASHINGTON POST (July 30, 2022), https://www.washingtonpost.com/business/why-the-crypto-world-flinches-when-the-sec-calls-coins-securities/2022/07/29/7caa05d8-0f5c-11ed-88e8-c58dc3dbae2_story.html.

¹¹ Both the SEC and the courts look to the “economic realities underlying a transaction,” *United Housing Found., Inc. v. Forman*, 421 U.S. 837, 849 (1975), so merely stating that your token “uses a blockchain” will not, without more, save it from SEC scrutiny. See also *Reves v. Ernst & Young*, 494 U.S. 56, 61 (1990) (“Congress’ purpose in

Once we establish how token creation and issuance generally occurs today, focus shifts to the world's first decentralized cryptocurrency, Bitcoin, to contrast critical elements of the Bitcoin story from the tens of thousands of alternative cryptocurrencies that followed. In so doing, several unique attributes surrounding the formation and operation of Bitcoin are explained. Considering these attributes against the backdrop of the *Howey* test, which remains the standard-bearer for determining whether an economic relationship constitutes an "investment contract" under the United States securities framework,¹² we can see how Bitcoin is demonstrably distinct from the more than 20,000 currently circulating cryptocurrencies. Perhaps more importantly, we can identify what potential token issuers and prospective token buyers need to consider when deciding whether a particular cryptocurrency project suits them.

Cryptocurrency token creation

Although Bitcoin first emerged in 2009, there was lengthy period where the cryptocurrency scene remained relatively modest. Prior to 2015, creating a new cryptocurrency token usually required the arduous task of spinning up an entirely new distributed database.¹³ And while some sporadic experimentation of building tokens "on top of" existing blockchains like Bitcoin had occurred,¹⁴ the launch of Ethereum in 2015 following an initial coin offering ("ICO")¹⁵ radically changed the cryptocurrency landscape.¹⁶

Not long after Ethereum launched, developers leveraged its relatively robust programming language and ruleset to advance what became known as the ERC-20 protocol.¹⁷ This dramatically streamlined the process of token creation and made it possible for even those with comparatively rudimentary technical experience to quickly launch a token of their own.¹⁸ With just a few simple steps, these tokens could use the persisting Ethereum protocol in order to

enacting the securities laws was to regulate investments, *in whatever form they are made and by whatever name they are called,*" (emphasis added)).

¹² See *supra* note 8

¹³ The XRP Ledger, for example, launched in 2012 using its own native Ripple Consensus Ledger, and underlying token, XRP. The Ripple ledger is entirely separate and distinct from Bitcoin. See, e.g., <https://xrpl.org/history.html>

¹⁴ An early secondary layer token, Mastercoin, was built on top of Bitcoin in 2013 and led by J.R. Willett, who had been pitching the idea to the Bitcoin community with limited success. See Laura Shin, Here's The Man Who Created ICOs And This Is The New Token He's Backing, FORBES, (Sep. 21, 2017, 12:06 PM), <https://www.forbes.com/sites/laurashin/2017/09/21/heres-the-man-who-created-icos-and-this-is-the-new-token-hes-backing/?sh=7b3b44591183> (last visited August 11, 2022).

¹⁵ ICO's, like their traditional finance namesake, IPOs, "entail the issuance of assets whose value depends on the success of a business venture, and... are offered to so-called retail investors." Cohney, et al., *supra* note 6, at 609.

¹⁶ The History of Ethereum, <https://ethereum.org/en/history> (last updated August 9, 2022); See also, Camilla Russo, Sale of The Century: The Inside Story of Ethereum's 2014 Pre-Mine, COINDESK, Jul. 11, 2020 <https://www.coindesk.com/markets/2020/07/11/sale-of-the-century-the-inside-story-of-ethereums-2014-premine/> (last accessed Oct. 11, 2022)

¹⁷ See Fabian Vogelsteller & Vitalik Buterin, ERC-20 Token Standard, GitHub, <https://github.com/ethereum/EIPs/blob/master/EIPS/eip-20.md> [https://perma.cc/4GZA-EFMP] (last visited August 10, 2022). The acronym "ERC" means "Ethereum Request for Comment." Chris Dannen, *Introducing Ethereum and Solidity: Foundations of Cryptocurrency and Blockchain Programming for Beginners* 106 (2017). The Ethereum community uses these requests to develop standards for smart contract design. *Id.* at 111.

¹⁸ Cohney, et al., *supra* note 6, at 605.

enforce their own discrete cryptocurrency ruleset.¹⁹ Around the same time, appetite grew among some developers and investors for leaving Bitcoin behind, which they argued had stagnated and failed to remain valuable in the fast-paced and dynamic world of cryptocurrency.²⁰ The phrase “blockchain, not Bitcoin” became relatively commonplace, particularly in the corporate and venture capital spheres and, unsurprisingly, an explosion in cryptocurrencies promising to be the “next Bitcoin” followed suit.²¹

From 2017-2018, alongside a strong Bitcoin bull market, a new investor “boom” found its footing, with the ICO forming its backbone.²² Over that period, more than a thousand projects offered early investment opportunities to buy their “native token.” A speculative fervor around the blockchain space grew and an eager public wanting to avail itself of the “new internet” gold rush was happy to oblige project founders pitching blockchain ideas and accompanying token offerings for everything from supply chain management²³ to dental visits.²⁴ Speculation swelled and, perhaps due to the sheer number of tokens being created, it seemed the SEC had given tacit permission for these offerings through its perceived inaction.²⁵

But over time, the SEC began ramping up enforcement actions against token issuers²⁶ and those who promote them.²⁷ Perhaps the most noteworthy and potentially impactful of these actions is the SEC’s ongoing enforcement lawsuit against Ripple, Inc. and its co-founders in federal court

¹⁹ *Id.*, (describing how the ERC-20 standard “establishes a simple template to create... and operate entirely new crypto assets within the Ethereum system.”)

²⁰ *See, e.g.*, Alex Hern, Bitcoin’s Forked: Chief Scientist Launches Alternative Proposal For The Currency, THE GUARDIAN, (Aug. 17, 2015, 6:57 AM) <https://www.theguardian.com/technology/2015/aug/17/bitcoin-xt-alternative-cryptocurrency-chief-scientist> (last visited August 11, 2022). *See also*, Camila Russo, *The Infinite Machine: How an army of crypto-hackers is building the next internet with Ethereum*, 37-48 (New York: HarperBusiness 2020) (describing the early efforts to build more functionality on top of the Bitcoin blockchain and contemporaneous cryptocurrency projects entirely separate from Bitcoin).

²¹ *See*, Cohny, et al., *supra* note 6, at 594-95 (“In 2017—the year that ICOs entered popular consciousness—453 ICOs raised an estimated \$6.58 billion. By July 1, 2018, an additional 684 ICOs had raised an estimated \$17.47 billion.”). *See also*, Camila Russo, *The Infinite Machine: How an army of crypto-hackers is building the next internet on Ethereum*, 37-48 (New York: HarperBusiness 2020) (describing the initial projects built on top of Bitcoin as well as other contemporaneous efforts to create cryptocurrencies unrelated to Bitcoin).

²² *Id.*

²³ Stephen Laaper & Joseph Fitzgerald, Using blockchain to drive supply chain transparency, DELOITTE, <https://www2.deloitte.com/us/en/pages/operations/articles/blockchain-supply-chain-innovation.html> (last visited August 11, 2022)

²⁴ Dentacoin, the blockchain solution for oral health, <https://dentacoin.com/assets/uploads/dentacoin-company-introduction.pdf> (last visited August 11, 2022).

²⁵ There was also confusion about the actions the SEC *did* undertake related to unregistered securities in the blockchain space. For example, the SEC issued the “DAO Report,” investigating a massive token sale involving the creation of a Decentralized Autonomous Organization (“DAO”) built using smart contracts on the Ethereum blockchain. *See*, Securities and Exchange Commission, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Release No. 81207 (Jul. 25, 2017). Though the report found the token issued was an unregistered security, the project failed in spectacular fashion and the Commission chose at the time not to pursue any action against the issuers. *Id.*

²⁶ *See*, Alex Sunnarborg, *The Incoming Wave of ICO Regulation (Yes, It’s Coming)*, COINDESK (Nov. 2, 2018), <https://www.coindesk.com/the-incoming-wave-of-ico-regulation-yes-its-coming> (last visited Aug. 11, 2022)

²⁷ *See*, Kimberly Kardashian, Exchange Act Rel. No. 11116 (Securities and Exchange Comm’n October 3, 2022) (Order) (Detailing a settlement and Order before the SEC finding that media personality Kim Kardashian violated Section 17(b) of the Securities Act, “which makes it unlawful for any person to promote a security without fully disclosing the receipt and amount of [any] consideration from an issuer.”)

for allegedly violating securities laws.²⁸ XRP, the cryptocurrency native to Ripple’s distributed ledger, was at one time the third largest cryptocurrency by market cap trailing only Bitcoin and Ethereum, and it remains a Top 10 digital asset today.²⁹ A decision in the case has not yet been reached but the parties are now at the summary judgment phase after two years of litigation.³⁰ And while settlement is always a possibility, the considerable resources of Ripple and its founders uniquely position this action to proceed to a final opinion from the trial court and perhaps an appeal beyond that.

Similar actions have been filed against relatively small token issuers and sellers as well,³¹ suggesting that the SEC is intent on curbing the *practice* of unregistered ICOs and digital token offerings generally rather than simply punishing those who are unusually successful. Ultimately, these actions must make their way through the courts and adjudicatory bodies of administrative agencies before we can hope for a satisfactory and lasting resolution. But the wheels of industry grind on, exposing investors and entrepreneurs to the risk of falling under the watchful eye of the SEC.

To understand why the cryptocurrency landscape is broadly vulnerable to SEC enforcement actions—even those with unusually deep pockets—it helps to compare the core attributes of Bitcoin against those of a typical alternative cryptocurrency.

What makes Bitcoin different under *Howey*?

The Supreme Court’s *Howey* test established a four-factor inquiry for determining whether a transaction constituted an “investment contract” subject to the regulatory authority of the SEC. A transaction is an investment contract if 1) it constitutes an investment of money (or other thing of value); 2) there is an expectation of profit from the investment; 3) the investment of money is in a common enterprise; and 4) any profit comes from the efforts of others.³² For several reasons, Bitcoin is perhaps the only—or at least the clearest—exception to the current securities conundrum faced by most of the cryptocurrency industry.^{33 34}

²⁸ *Securities and Exchange Commission v. Ripple Labs, Inc., et al.*, No. 1:20-cv-10832 (S.D.N.Y. Dec. 20, 2020)

²⁹ See generally, CoinMarketCap.com (last accessed October 12, 2022).

³⁰ Timmy Shen, *SEC, Ripple seek summary judgment in attempt to speed lawsuit*, YAHOO! FINANCE (Sep. 19, 2022), <https://finance.yahoo.com/news/sec-ripple-seek-summary-judgment-091525925.html>.

³¹ *Securities and Exchange Commission v. Ishan Wahi, Nikhil Wahi, and Sameer Ramani*, No. 2:22-cv-01009 (S.D.N.Y. Jul. 21, 2022)

³² See *supra* note 8

³³ The Bitcoin network has been “hard forked” on multiple occasions, a process that maintains the original coin distribution as it existed at the time of the fork, but ultimately changes the network rules in a way that is incompatible with the broader Bitcoin network. These forks, to the extent they still exist, at least initially enjoy many of the attributes that shield Bitcoin from a securities classification and so they, too, might not be securities. But that depends on how the network operates going forward, and merely forking from Bitcoin will not guarantee a non-security classification in perpetuity.

³⁴ This article does not attempt to divine what might come from a more favorable regulatory regime. It only attempts to describe the regulatory reality as it exists today, and why most cryptocurrencies—even with their perceived complexity—likely fail to comply with it.

First, Bitcoin had what has been described as a “fair launch,” meaning there was no pre-launch sale of Bitcoin to an investing public. This makes it difficult for regulators to allege under *Howey* that Bitcoin was conceived and offered to the public with the “expectation of profit.”

Second, there is no identifiable Bitcoin leadership team because the person or persons responsible for its creation disappeared more than a decade ago³⁵ and because those who enable and enforce the protocol rules do so on a voluntary basis with no commitment to continuing in such a role.³⁶ This makes regulators unlikely to find that any profit resulting from acquiring bitcoin comes from “the efforts of others,” as the *Howey* test requires.

Third, Bitcoin enjoyed an extended period following its launch in which it freely circulated among enthusiasts without having any monetary value at all.³⁷ Again, this suggests there was no “expectation of profit” at the time of launch.

Finally, Bitcoin has a high degree of decentralization, meaning that there are users running the software all around the world.³⁸ Because of this, there are no top-down directives from a privileged class within the Bitcoin network that might exercise outsized influence over the protocol.³⁹ This both creates practical enforcement problems and further diminishes any claim that pecuniary gains associated with Bitcoin are secured through “the efforts of others” or the result of an identifiable “common enterprise” under *Howey*.

The fair launch

When pseudonymous creator, Satoshi Nakamoto, “mined” the first Bitcoin block—known as the Genesis Block⁴⁰—the Bitcoin White Paper describing the structure of the protocol had already been circulating for several months.⁴¹ Moreover, unlike most cryptocurrency launches today, no tokens were created in advance of the launch to be sold to eager investors or hoarded by founders with the goal of bootstrapping the project. To the contrary, bitcoin is exclusively created through the Bitcoin mining process, with just a handful being released each time a new block of transactions is added to the chain. And the first fifty bitcoins generated by the Genesis Block—as well as many tens of thousands generated thereafter—had *no market value* when they entered

³⁵ Sophie Bearman, *Bitcoin’s creator may be worth \$6 billion—but people still don’t know who it is*, CNBC <https://www.cnbc.com/2017/10/27/bitcoins-origin-story-remains-shrouded-in-mystery-heres-why-it-matters.html>

³⁶ Satoshi Nakamoto, *Bitcoin: A peer-to-peer electronic cash system*, p. 8 (2008) (“The network is robust in its unstructured simplicity. Nodes work all at once with little coordination... Nodes can leave and rejoin the network at will, accepting the proof-of-work chain as proof of what happened while they were gone.”)

³⁷ Benjamin Wallace, *The Rise and Fall of Bitcoin*, WIRED, (Nov. 23, 2011, 2:52 PM) <https://www.wired.com/2011/11/mf-bitcoin/> (last visited August 9, 2022).

³⁸ See, Bitnodes, <https://bitnodes.io>. *Note*: These are users that go beyond merely opening a wallet on Coinbase or some other public exchange and trading the underlying token. These are users that run “full node” software, personally downloading and independently verifying the state of the Bitcoin blockchain in real time, as well as enforce the Bitcoin ruleset and agree to (or deny) periodic upgrades to the rules. It is also difficult to determine the exact number of nodes operational on the Bitcoin network at any given time because, for a variety of reasons, users may be utilizing techniques to mask the appearance of their node.

³⁹ See generally, Jonathan Bier, *The Blocksize War: The Battle Over Who Controls Bitcoin’s Protocol Rules* (2021)

⁴⁰ See Blockchain.com, Block 1, <https://www.blockchain.com/btc/block/1> (last visited August 11, 2022)

⁴¹ Satoshi Nakamoto Institute, *Bitcoin: A Peer-to-Peer Electronic Cash System*, <https://nakamotoinstitute.org/bitcoin/> (last visited, August 11, 2022)

circulation.⁴² Instead, they essentially operated as a proof-of-concept. But the network their issuance started persists to this day, with each new block adding more (though progressively fewer⁴³) bitcoin to the network.⁴⁴ And while today it may be difficult to imagine a bitcoin circulating freely with no price, that’s exactly what these early bitcoin did.⁴⁵

As the network of computers utilizing the Bitcoin protocol grew, new blocks continued to generate new bitcoin. Thus, a steady stream of initially valueless bitcoin slowly seeped into the world, largely sent among hobbyists or collected among the initial miners.⁴⁶ Unfortunately, many of these early bitcoin were lost forever through carelessness or neglect precisely because they had no initial value.⁴⁷

This “fair launch” is very different from what occurs with the launch of a typical cryptocurrency.

For example, as earlier mentioned, Ethereum founders opted for the now-commonplace technique of a pre-launch ICO, in which the initial developers and investors staged a “pre-mine”⁴⁸ event resulting in a privileged allocation of a large amount of the platform’s native token, Eth, accruing to select investors before or immediately after launch. These tokens were either allocated back to the project founders to retain or distribute at their discretion, or sold to the investing public.⁴⁹ This initial pre-mine represented the vast majority of tokens circulating at the time of launch and for a long time thereafter.⁵⁰

When we compare these two launches in the context of the *Howey* test, it’s relatively clear that the launch path taken by Ethereum and the many similarly situated crypto tokens potentially run afoul of the four-prong test, while Bitcoin does not. This is not to say that all cryptocurrencies that did not exactly mirror Bitcoin’s launch necessarily *will* be classified as a security. In fact,

⁴² See, *infra*, Section on “Valueless Circulation”

⁴³ The Bitcoin block reward gradually decreases over time in what can be compared to an atomic half-life. Every 210,000 blocks (approximately four years), the reward is programmatically cut in half. This process—colloquially termed the “halving” or “halvening”—continues with each roughly four-year epoch, eventually reaching zero sometime around the year 2140. Because of Bitcoin’s half-life, the block reward has already been diminished from the original 50 bitcoin to just 6.25 bitcoin per block at the time of publication.

⁴⁴ For an in-depth but still non-technical explanation on the process of Bitcoin mining, see Bryan F. Jacoutot, Understanding Bitcoin Mining, (Nov. 29, 2020), <https://jacoutotonlaw.com/2020/11/understanding-bitcoin-mining/> (last visited August 11, 2022).

⁴⁵ There is some uncertainty about when a price for Bitcoin was first established. In October of 2009, about nine months after the Genesis Block, a now defunct entity known as the New Liberty Exchange calculated a proposed price for a bitcoin based on the energy expenditure and computing power necessary to mine a block. <https://web.archive.org/web/20100427033445/http://newlibertystandard.wetpaint.com/page/Exchange+Rate>. But many people credit the purchase of two Papa John’s pizzas for 10,000 bitcoin on May 22, 2010 as the date in which a market price for bitcoin was truly established. See, Francisco Memoria, The First Bitcoin Transactions: From a Test to the Famous Pizza Purchase, CRYPTOCOMPARE (Oct. 7, 2021), <https://www.cryptocompare.com/coins/guides/the-first-bitcoin-transactions-from-a-test-to-the-famous-pizza-purchase-1/>.

⁴⁶ *Id.*

⁴⁷ Jeff John Roberts and Nicholas Rapp, Exclusive: Nearly 4 Million Bitcoins Gone Forever, New Study Says, FORTUNE, Nov. 25, 2017 <https://fortune.com/2017/11/25/lost-bitcoins/> (last accessed Aug. 11, 2022).

⁴⁸ Russo, *supra* note 16.

⁴⁹ *Id.*

⁵⁰ *Id.*

individual members of the SEC have indicated (unofficially) at various times that Ethereum may enjoy a non-security designation alongside Bitcoin.⁵¹ Nevertheless, the question becomes more complicated and the risk of an enforcement action by the SEC increases the more a protocol deviates from these attributes. At least for now.⁵²

Valueless circulation

The time between 2009 and early 2010 when Bitcoin circulated freely and with absolutely no value is perhaps one of the most unique aspects of Bitcoin as compared to the now-crowded cryptocurrency space. And it would be difficult for a new cryptocurrency to replicate this grace period without exercising a measure of control over the protocol that would render the use of a blockchain somewhat counterintuitive.⁵³ But because Bitcoin was the first leaderless cryptocurrency and there was no pre-sale on the open-market,⁵⁴ early users faced the thorny question of how to value it. In those first months and years, it required comparatively trivial computing power to mine and operated mostly as a kind of science project for the intellectually curious. Despite this phase of tinkering, Satoshi's code promised to eliminate the need for a central currency issuer, a characteristic long possessed by commodity monies like gold or silver but never quite replicated by synthetic or fiat monies. And while Austrian and Keynesian economists continue to grapple with the origins of the value of commodity money,⁵⁵ the value of Bitcoin needed to come from a more abstract source: consensus. This has proven difficult.

Even now, Bitcoin's seemingly insurmountable price volatility is proof the market continues to grapple with this question. Nevertheless, during the first year and a half of its life, Bitcoin circulated with no price.⁵⁶ To date, no other cryptocurrency has replicated this free circulation

⁵¹ William Hinman, Remarks at the Yahoo Finance All Markets Summit: Crypto (June 14, 2018), <https://www.sec.gov/news/speech/speech-hinman-061418> (last visited Aug. 12, 2022) (“If the network on which the token or coin is to function is sufficiently decentralized – where purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts – the assets may not represent an investment contract.”)

⁵² While caselaw has developed over the years indicating that the courts often agree with the SEC that most cryptocurrencies are securities (*See, e.g.* settlements and decisions involving Kik, Telegram, etc.), a bright line rule remains elusive. The SEC's ongoing litigation against Ripple, Inc. and its founders may provide this rule at the conclusion of the case. Alternatively, Congress always retains the right to define or redefine securities laws to embrace or reject cryptocurrencies.

⁵³ The original rationale for using a “blockchain” was one of pure necessity. It was the least bad option available for Satoshi Nakamoto to create a peer-to-peer digital monetary protocol without needing to install gates and gatekeepers. If we add gatekeepers or privileged access to a blockchain, it raises the question why one is being used in the first place.

⁵⁴ Even if we accept that Bitcoin had a founder in Satoshi Nakamoto, this individual was only ever the protocol's nominal “leader.” Because as a practical matter, Satoshi exercised only as much influence over the protocol as his computers had the power to generate, and his ideas had the power to persuade.

⁵⁵ *Compare*, Ludwig von Mises, *The Theory of Money and Credit* (J.E. Batson trans., Yale U. Press 2d prtg.1954), pp. 29-37 (1912) (describing the origins of money in accordance with Mises' Regression Theorem, in which the early monies resulted organically from indirect exchange of useful commodities when direct-exchange through barter proved lacking), *with* Stephanie Kelton, *The Deficit Myth: Modern Monetary Theory and the Birth of the People's Economy* (New York: PublicAffairs 2020) (advocating for the Chartalist Theory of money, in which early monies were a creation of the state once humans organized themselves into primitive but functioning versions of governments).

⁵⁶ *See, supra* note 45.

period. And it may not even be possible at this stage because there are now throngs of willing speculators hoping for privileged early access to anything claiming to be “the next bitcoin.”

No leadership team

The vast majority of cryptocurrencies today have a clear leader or leadership team. And these leaders are often supported by seed investors, or venture capitalists and hedge funds, who in turn hope to raise money and profit on a secondary market from increasing token value. Ethereum, for example, has been helmed by Vitalik Buterin and Joseph Lubin since its inception, as well as the Ethereum Foundation and other key players.

These identifiable leaders create potential problems for cryptocurrency projects under *Howey*, because their contributions to the project may be deemed the “efforts of others” and “common enterprise” with which the SEC and courts concern themselves when making a securities determination.⁵⁷

To be sure, Bitcoin has a founder but it has no leader. And that distinction is crucial. Today, while there are many influential persons in the Bitcoin space, it exists exclusively on its own inertia and on a participatory basis. Moreover, those who become apparent thought leaders typically do not long stay in that capacity. Many of the once-heralded figureheads of Bitcoin have been cast down by the users or moved aside of their own accord. The same cannot be said for the vast majority of cryptocurrency projects.

Genuine decentralization

As a corollary of there being no leadership team in Bitcoin, there also exists a high degree of decentralization, which results from a combination of factors. Through hard fought “fork wars”⁵⁸ and other conflicts within the ecosystem—Bitcoin has remarkably retained the (arguably) highest level of decentralization of any so-called blockchain.⁵⁹ Even after 13 years of data production, the cost of running a node is relatively trivial.⁶⁰ This stands in direct contrast to Ethereum and other popular blockchains, which effectively close off the opportunity for most people because the extreme amounts of data processed on those platforms make running a node impractical.⁶¹ Thus, only highly sophisticated individuals or wealthy entities are typically able to run nodes that enforce protocol rules.

⁵⁷ *W.J. Howey, Co.*, 328 U.S. 293.

⁵⁸ Bier, *supra* note 39.

⁵⁹ At bottom, “decentralization” is an elastic concept open to interpretation. The author views decentralization as a proxy for control—or more precisely, lack of control—over the network. This concept deserves its own separate discussion and is outside the scope of this article.

⁶⁰ The author runs a full Bitcoin node, which verifies state of the Bitcoin blockchain and enforces protocols rules at all times. This is one measure of “decentralization” within a crypto network. And he can attest to the low-cost, low-energy nature of the process. Even possessing very little practical computer knowledge beyond the ability to use YouTube and Google, running a node is entirely accessible for most people. If the author can run a node, anyone can run a node.

⁶¹ See, Go Ethereum, <https://geth.ethereum.org/docs/interface/hardware> (last visited October 13, 2022) (“A “full” archive node that keeps all state back to genesis requires more than 12TB of space.”)

Without widespread decentralization, protocols again run into a *Howey* test problem because it becomes increasingly clear that a small and identifiable group is working to improve the value of the underlying token. Thus, even if the tokens were not issued by some sort of leadership team, users are still relying primarily on “the efforts of others” to receive pecuniary gain.

Howey and Bitcoin’s Four Factors

The unique attributes of Bitcoin described here, among others, have led the current Chairman of the SEC, Gary Gensler, and his predecessor, Jay Clayton, to publicly declare that Bitcoin is not a security.⁶² Indeed, it is difficult to see how a widely distributed and ever-changing open protocol like Bitcoin could satisfy the requirement under *Howey* that profits derive from a “common enterprise.”

The fair lunch further insulates Bitcoin because unlike other cryptocurrency projects, the inception and early years of Bitcoin look less like the “investment opportunities” we hear pitched today than an invitation to participate in a science experiment. No riches were initially promised, nor could they have been. To the contrary, the “free circulation” period cuts against any theory that Bitcoin could have been initially pitched as an investment. If anything, early bitcoin required computing power, energy, and time to acquire *despite* there no opportunity for monetary gain.

Finally, the lack of an identifiable leadership team suggests a lack of common enterprise as well. And as a practical matter, the leaderless nature of Bitcoin creates a headache for even unusually fervent regulators that might seek to enforce subpoenas to undermine or rein in the protocol. There is no “CEO of Bitcoin” for overzealous politicians to haul before Congress to publicly chastise for electoral gain. There is not even a person or group that a court could plausibly enjoin in order to alter certain aspects of the protocol. The court would need the obedience or acquiescence of the globally distributed userbase.

Utility: What is it good for? Absolutely nothing?

In the wake of the ICO craze of 2016-2018, many market participants attempted to insulate their crypto token from securities regulations by ascribing certain utility aspects to the token beyond the mere capacity to “buy and sell” in the market. But this strategy was quickly shot down by regulators as somewhat of a parlor trick. In a statement made by then-Chairman of the SEC, Jay Clayton, he made clear his personal⁶³ position:

Following the issuance of the 21(a) Report,⁶⁴ certain market professionals have attempted to highlight utility characteristics of their proposed initial coin offerings in an effort to claim that their proposed tokens or coins are not securities. Many of these assertions appear to elevate form over substance. Merely calling a token a “utility” token or structuring it to provide some utility does not prevent the token

⁶² Kevin Helms, SEC Chair Gensler Affirms Bitcoin Is a Commodity — 'That's the Only One I'm Going to Say' (Jun. 27. 2022), <https://news.bitcoin.com/sec-chair-gensler-bitcoin-is-a-commodity/> (last visited August 9, 2022).

⁶³ Although only made in his personal capacity and not an official position of the agency, it is nevertheless instructive.

⁶⁴ See *supra* note 25.

from being a security. Tokens and offerings that incorporate features and marketing efforts that emphasize the potential for profits based on the entrepreneurial or managerial efforts of others continue to contain the hallmarks of a security under U.S. law.⁶⁵

While not dispositive on the issue, cryptocurrencies that otherwise fail *Howey's* four-factor test are unlikely to find shelter in any purported utility of their token.

Conclusion

Because many cryptocurrency projects remain vulnerable to regulatory scrutiny, the SEC has already begun gearing up for a deluge of actions against the ever-expanding cryptocurrency space.

Of course, each token contains its own unique attributes and history that might insulate it from enforcement in ways similar to Bitcoin. And because more are being created seemingly daily—and not all are definitively subject to the jurisdiction of the United States—caution should be exercised before writing off the entire space as a potential regulatory liability. That said, few projects have followed the admittedly painstaking lead that Bitcoin first set in 2009. And it remains good advice today that projects seeking shelter from the coming securities storm should work to emulate the underlying structure and launch of Bitcoin. If such a strategy conflicts with business goals, you might just be offering or investing in a security.

⁶⁵ Chairman Jay Clayton, Statement on cryptocurrencies and initial coin offerings (Dec. 11, 2017) https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11#_ftnref5.