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February 21, 2025

Hon. Hester Peirce, Commissioner
Crypto Task Force
U.S. Securities and Exchange Commission
100 F Street NE, Washington, D.C. 20549
Cupertino, CA 95014

Re: Amendments Regarding the Definition of "Exchange" (Release No. 34-97309, File No. S7-02-22), RIN 3235–AM45

Commissioner Peirce:

Consensys Software Inc. ("Consensys") writes to respectfully propose that the SEC's newly formed Crypto Task Force consider removing from the SEC's rulemaking agenda a pending rulemaking which amends the definition of "exchange" under U.S. securities laws. Our view is that the rule reflects an unduly broad assertion of regulatory authority over blockchain technology, and that the comments the SEC has received through the notice and comment period, which initially opened in Spring 2022, persuasively establish the basis to set aside the amendments. We attach as appendices two letters that Consensys submitted to the Commission in April 2022 and June 2023, respectively. They outline the major problems with the proposed amendments as we see them, and we summarize these views below for your convenience. We would be pleased to discuss our arguments with the Task Force further, as it is critical that the Commission understands precisely why the amendments go beyond its statutory mandate, are violative of the Administrative Procedure Act, and even violate the U.S. Constitution. We thank you for your consideration.

1. The amendments exceed the SEC's statutory authority

The amendments expand the regulatory definition of "exchange" beyond what the statutory definition permits. They are predicated on the first part of the '34 Act's definition, namely that exchanges are entities that "provide[] a market place or facilities for bringing together purchasers and sellers of securities." 15 U.S.C. § 78c(a)(1). But the amendments sweep beyond this definition in two ways.

First, the '34 Act definition contemplates only entities that play an active role in "bringing together" purchasers and sellers. But the amendments reach not just entities that play this intermediating role, but also entities whose tools can be more passively used by purchasers and sellers. Indeed, the Staff recognizes in their discussion of the amendments that the broader "makes available" language may cover systems that merely "take[] a more passive role in providing to their participants the means and protocols to interact, negotiate, and come to an

agreement"). 87 Fed. Reg. 15496, 15506 (Mar. 18, 2022). Second, the '34 Act definition refers only to those *actually engaged* in purchasing or selling securities. In contrast, the amendments broaden the regulatory definition to cover those with potential, non-firm interest. *Accord, e.g.*, 63 Fed. Reg. 70844, 70850 (Dec. 22, 1998) (previously recognizing that exchanges bring together "firm indication[s] of a willingness to buy or sell a security," which may also support an APA challenge for failure to distinguish prior reasoning). Because the proposed amendments only appear to rely on the first part of the '34 Act definition, they cannot belatedly invoke the second part ("otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood"). 15 U.S.C. § 78c(a)(1). Regardless, it is not a traditional function of a stock exchange to offer passive support or to bring together those with non-firm trading interest.

Beneath these concerns is the amendments' fatal conceptual flaw: failing to acknowledge that blockchain-based systems are meaningfully different than the exchanges the '34 Act was drafted to regulate. Interpretation of the '34 Act must reach only those methods of "bringing together purchasers and sellers" that are consistent with the traditional functions of a stock exchange. 15 U.S.C. § 78c(a)(1) (emphasis added); *see Villarreal v. R.J. Reynolds Tobacco Co.*, 839 F.3d 958, 964 (11th Cir. 2016) (en banc). As understood in 1934, stock exchanges were fundamentally centralized entities with market-setting capabilities, in stark contrast to the decentralized operations of most blockchain-based systems. Arguments that the statute's use of "otherwise" permits a broader application are incorrect. As the Supreme Court instructed in *Fischer v. United States*, the "way to discern the reach of an 'otherwise' clause is to look for guidance from whatever examples come *before it*." 144 S. Ct. 2176, 2183 (2024) (emphasis added). This "'avoid[s] ascribing to one word a meaning so broad that it is inconsistent with' 'the company it keeps.'" *Id.* at 2183-84. Permitting "otherwise" to swallow blockchain technology 90 years after the passage of the '34 Act would be inconsistent with appropriate statutory construction.

2. The amendments are arbitrary and capricious under the APA

The amendments violate the APA, first, because they improperly expand the applicability of broker dealer regulations rather than exchange regulations. The 2023 supplemental release indeed assumes that no "New Rule 3b-16(a) Systems" would actually register as exchanges, so it analyzed only the purported costs and benefits of broker-dealer registration and Regulation ATS compliance. *See, e.g.*, 88 Fed. Reg. at 29465-66, 29469, 29475-90.

But a more serious problem is the latent purpose of the amendments: to chill blockchain innovation in the U.S. Numerous comments submitted in response to the amendments explained that it would be impossible for a decentralized exchange (assuming it facilitated transactions in securities and met the Commission's proposed revised definition of exchange) to comply with the existing requirements for a national securities exchange, and therefore be

banned from the U.S. market. The proposed amendments indeed acknowledge this and all but admit that the goal is not to register new exchanges but instead to force decentralized exchanges to "exit the market for crypto asset security trading services rather than continue operations." 88 Fed. Reg. at 29484 n.368. This is not a permissible aim. An agency may not consider "factors which Congress has not intended it to consider," *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983), and may not adopt regulations for pretextual or predetermined reasons, *see, e.g.*, *Dep't of Com. v. New York*, 139 S. Ct. 2551, 2575-56 (2019); *Rural Cellular Ass'n v. FCC*, 588 F.3d 1095, 1101 (D.C. Cir. 2009).

Second, the amendments ignore the problems of broadly capturing blockchain-based systems, particularly the SEC's limited legal authority over digital assets. For instance, the amendments cryptically explain that "[a] digital asset may or may not meet the definition of a 'security' under the federal securities laws." 88 Fed. Reg. at 29450 n.26. But no meaningful analysis is put forward as to why many or most digital assets are believed to be securities. *See, e.g.*, 88 Fed. Reg. at 29450-51; *see also* Mark T. Uyeda, *Statement on Supplemental Information and Reopening of Comment Period for Amendments to Exchange Act Rule 3b-16 Regarding the Definition of "Exchange,"* SEC (Apr. 14, 2023) (suggesting that the supplemental release was a "paper exercise" to finalize the SEC's predetermined conclusion that "nearly all crypto assets are securities"). The failure to describe or quantify the conclusory assertion that most crypto assets are "securities"—which depends on whether they are "investment contracts" under *Howey*—underscores critical analytical flaws. Absent a definition or coherent framework regarding whether and when digital assets are subject to federal securities law, neither the Commission nor regulated entities have a rational means of determining the scope of the rule, the number of entities it regulates, the rule's benefits, or the costs of compliance. When a digital asset is a security is a fundamental question that must be clearly answerable for these amendments to be workable, and these amendments dodge the question entirely.

These amendments also unfortunately belie a deficient understanding of digital assets and blockchain more generally, which are admittedly complicated topics. The amendments concede the "Commission has limited information regarding crypto asset securities." 88 Fed. Reg. at 29470. *See alos id.* at 29471, 29476, 29480, 29482-83 (acknowledging various information the SEC is "unable to provide"). Particularly notable is the casual but unsubstantiated assurance that all blockchain-based systems can come into compliance, ignoring technological nuance, *see id.* at 29457, 29485, and ignoring the autonomous nature of many protocols which have no current group constituting, maintaining, or providing the exchange. This approach would threaten liability for parties that are no longer involved (such as software developers, *id.* at 29456) or only tangentially involved (such as miners, validators, and DAO members, *id.* at 29483-84), without regard for their practical capabilities. The amendments dodge these issues, too.

Third, every policy discussion, whether in the securities context or otherwise, concerning blockchain technology must take account of its global phenomenology. Blockchain software development and on-chain communities are global, so when are foreign communities impacted by this rule? It's impossible to know for sure, so the chilling effect of these amendments would extend out from our borders and into the blockchain technology space worldwide.

3. The required cost-benefit analysis is facially insufficient to withstand scrutiny

Both the initial notice of proposed rulemaking and supplemental release make no effort to show that the amendments' benefits outweigh their costs. *Cf.* 88 Fed. Reg. at 29484 (noting only that the "costs are not impossible to pay"). Indeed, the vagueness of the amendments makes it difficult to meaningfully do so. But whether the benefits outweigh the costs is of course the relevant question for cost-benefit analysis. *See, e.g.*, *Md. People's Counsel v. FERC*, 761 F.2d 768, 779 (D.C. Cir. 1985); *City of Centralia v. FERC*, 213 F.3d 742, 750 (D.C. Cir. 2000). It is unclear what the benefits of the amendments even are, other than a basis to expand the Commission's regulatory purview. *See, e.g.*, 88 Fed. Reg. at 29475 (suggesting that expanded regulatory oversight is necessarily beneficial). The amendments identify not a single real-world example of why they are necessary, and the purported analysis of benefits in the releases is conclusory overall.

The amendments also fail to meaningfully estimate costs, and the assessment it does do is clearly inadequate and under-inclusive. This shortfall is all too obvious to blockchain industry members like Consensys who instantly appreciate the devastating costs the amendments would impose on the market. As an initial matter, the number of entities that would be affected by the amendments is substantially undercounted: we are told that there would be only 35 to 46 New Rule 3b-16(a) Systems, between 15 and 20 of which trade digital assets. 88 Fed. Reg. at 29465, 29474. That number is far too low when, especially given the amendments' expansive but amorphous scope, when we are dealing with an ecosystem with hundreds if not thousands of projects and protocols. *Cf. All Protocols*, Messari, https://bit.ly/3J3WKQm (identifying hundreds of "Decentralized Exchanges"); *Top Decentralized Exchanges Ranked*, Coin Gecko, https://tinyurl.com/4h89ybph (cataloging 875 decentralized exchanges). This incongruity with the reality of the industry and these comparatively miniscule figures has never been explained.

The insufficiency of the analysis is admitted when the amendments concede the SEC lacks basic information necessary to analyze the costs and effects of its regulation on the crypto industry. Among other admissions, the agency (1) "has limited information regarding crypto asset securities," 88 Fed. Reg. at 29470; (2) is "unable to reliably determine the number of platforms operating in the crypto asset market," *id.*; (3) cannot "reliably determine the amount of trading in crypto assets that takes place through platforms, or to quantity their share of the market … in crypto assets," *id.* at 29471; and (4) is unable to determine "the entities involved providing New Rule 3b-16(a) Systems in the market for crypto asset securities," *id.* at 29474.

Without that analysis, it is unclear how a cost-benefit analysis could be performed at all, or how one analyzes the rules' effect on "efficiency, competition, and capital formation" as required by the Exchange Act. 15 U.S.C. § 78c(f). With respect to the latter, the amendments only notethat there "could" be benefits. 88 Fed. Reg. at 29485-90. But the SEC must actually make predictive judgments. *See Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 178 (D.C. Cir. 2010).

The SEC also completely ignores other important costs, such as the costs of slowing innovation in the U.S., the cost of regulatory uncertainty, and the outsized burdens for smaller or less sophisticated market participants, of which there are many in this entrepreneurial space. Moreover, the SEC does not analyze the cost of actually complying with the exchange rules (as opposed to Regulation ATS), which is important because commenters have told the SEC that many New Rule 3b-16(a) systems will not be eligible for Regulation ATS (or, for that matter, able to comply). 88 Fed. Reg. at 29457. Relatedly, the SEC entirely fails to consider the downstream economic consequences its proposed rules would have on affiliates and contractors who work for decentralized exchanges and related projects. These amendments may, as the releases admit, force decentralized exchanges out of the market, and along with them, many smaller contractors of technology suppliers. *See* 88 Fed. Reg. at 29484 & n.368. Yet the amendments did not analyze the economic consequences of such actions.

The amendments make an unavailing attempt to get past the lack of basic information on costs by setting an arbitrary cost baseline. Rather than collecting the information necessary to determine the costs of the rules on decentralized exchanges, the amendments assume that the costs the new rules would impose on traditional entities offered an appropriate baseline. *See* 88 Fed. Reg. at 29476. But the rationale behind this assumption is never substantiated, nor are the fundamental differences between traditional exchanges and crypto-related companies recognized or analyzed. *See id.* The many differences between traditional and decentralized exchanges renders the proposed baseline and the economic analysis that flowed from it arbitrary and capricious for failure to "consider an important aspect of the problem." *See State Farm*, 463 U.S. at 43; *Wages & White Lion Investments v. FDA*, 90 F.4th 357, 373 (5th Cir. 2024).

At bottom, if this cost-benefit analysis was enough to pass muster, then this requirement is in effect a meaningless statutory hurdle in rulemaking. The amendments do not substantiate the claim that the updated rule is necessary, nor explain whether the new rules' purported benefits "bear a rational relationship to the … cost imposed." *Mexican Gulf Fishing Co. v. U.S. Dep't of Commerce*, 60 F.4th 956, 973 (5th Cir. 2023). The absence of such analysis renders the resulting rule arbitrary and capricious. *See Chamber of Commerce*, 85 F.4th at 779.

4. The amendments violate the First and Fifth Amendments

Lastly, the amendments impose improper, content-based regulation of speech and violate the Constitution's due process protections. With respect to speech, unlike the existing Exchange Rule, which makes coverage as an exchange turn only on verbal *acts* (*i.e.*, consenting to buy or sell a particular quantity of a security at a stated price), the amendments—in covering "communications protocols" or other mechanisms for those with "trading interest" to communicate—regulate speech that is, at least in part, untethered to action. In singling out securities-focused speech, in contrast with systems that help people communicate about their interest in other matters, the SEC is engaging in content-based regulation. Although one could debate the appropriate level of scrutiny a court would apply when adjudicating its constitutionality, this regulation would fail any level of scrutiny because the amendment does not explain why it is necessary to expand the term "exchange" to reach such systems and otherwise relies on vague concepts such as "communications protocol", which is inherently poorly tailored.

With respect to due process, matters regarding the amendments' scope—*e.g.*, the meaning of "communications protocol", the level of causation required for a group to be deemed to be "[b]ring[ing] together" individuals with trading interest or to be "[m]ak[ing] available" methods for trading, and the level of scienter required for a person to become part of a "group of persons" implicated by the Rule— are entirely unresolved. As such, it leaves "men of common intelligence [to] necessarily guess at [the amendments'] meaning." *FCC v. Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012) (quotation marks omitted). This is impermissible and requires substantial revision of the amendments for them to cure this defect.

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The Task Force's immediate and productive engagement with the blockchain industry has been a very welcome change. We very much appreciate the renewed interest in working with the crypto community on building a sensible regulatory framework to clarify how securities laws apply, and we wish to assist the Task Force in its work going forward as best we can. We respectfully request that our argument concerning this rulemaking be considered and that the amendments be taken off of the regulatory agenda promptly, lest they end up hindering otherwise productive engagement among all parties.

Sincerely,

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