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The SEC Alleges Software Provider to be a Broker and Underwriter in Continued Crackdown on the Crypto Industry

By [Eric Sibbitt](#), [Kristofer Readling](#), [Dana Syracuse](#), [Josh Boehm](#) & [Lisa Rubin](#)

On June 28, 2024, the Securities and Exchange Commission ("**SEC**") filed a complaint alleging that Consensys Software, Inc. ("**Consensys**"),[1] the developer of the MetaMask self-hosted wallet, acted as an unregistered broker through MetaMask's interface with respect to its swaps and staking "services." The SEC also alleged that Consensys engaged in unregistered offers and sales by acting as an "underwriter" of liquid staking programs alleged by the SEC to be investment contract securities.[2]

Some key takeaways to consider are:

- *Software as a Broker*? The SEC alleged that Consensys acted as an unregistered broker through MetaMask Swaps by facilitating trades, providing curated pricing, advising on trades, routing orders via its smart contract, and charging transaction-based compensation. It similarly alleged that Consensys acted as a broker through MetaMask Staking by soliciting investors to participate in the alleged Lido and Rocket Pool "investment contracts," holding itself out as a place to buy them and recommending those with the highest rewards, and, through the role of MetaMask Staking software, transferring assets through its smart contract to other smart contracts. In another recent case involving a self-hosted wallet, a court held that Coinbase Wallet was not a broker based on the facts alleged in the case (which included a 1% commission, marketing to users, price comparisons without recommendations, minimal order routing participation, and a lack of control over user assets).[3]

- *Liquid Staking Tokens Alleged Securities*. The SEC identified Lido and Rocket Pool liquid staking tokens as investment contracts, highlighting factors such as their *pro rata* ownership and rewards, and Lido and Rocket Pool marketing their staking expertise. This marks the SEC's first public targeting of liquid staking tokens.

- *Software Interface as Underwriter*? The SEC also alleged that MetaMask acted as an underwriter for Lido and Rocket Pool liquid staking investment contracts by participating in key points in the distribution from the issuer and characterizing its staking services as the "offer and sale" of these tokens. The Consensys case suggests that the SEC may expansively view any software that somehow potentially facilitates ultimate transactions in securities as underwriter activity.

- *SEC Advocates for the "Ecosystems" Theory for Investment Contracts*. In rehashing digital assets the SEC previously alleged to be securities and newly applying to Lido and Rocket Pool, the SEC pushed what is sometimes referred to as the "ecosystems" theory, suggesting that while tokens in isolation may not necessarily be securities, the overall context of their sale, marketing, and distribution can form an investment contract. The SEC focused, in particular, on the statements of issuers and promoters regardless of when or how the tokens were acquired by a purchaser.

- *Marketing and Contracting Discipline Remain Essential*. The SEC frequently cited tweets, blog posts, terms of service, and user guides as evidence for its claims against Consensys. Firms must carefully consider how their marketing and contractual materials might inadvertently appear to regulators in an enforcement context.

- *Evolving Enforcement Strategy.* The SEC appears to have updated its regulation by enforcement litigation strategy based on partial losses in other cases, rather than through rulemaking or guidance (in a recent decision,[4] the court notably criticized the SEC's oversight through litigation strategy). For example, possibly in response to its loss against Coinbase Wallet, the SEC appears to have included more details on MetaMask's transactions and emphasized Consensys' alleged role in directing how those transactions should be executed.

Although the complaint only reflects the SEC's allegation and interpretation of facts and not the countervailing facts or positions that could be asserted, including those implied by recent judicial decisions, crypto firms should take note of these developments and adjust their product strategies as appropriate.

I.   SEC's Lawsuit

MetaMask is a self-hosted wallet that allows users to manage and interact with blockchains via user-friendly software, enabling self-custody of crypto, decentralized application integration, and disintermediation of transactional activities. Users can manage crypto keys, broadcast transactions, and trade Ethereum-based tokens through its MetaMask Swaps feature, comparing decentralized exchanges for the best price, lowest fees, and least slippage.

MetaMask enables wallet users to stake compatible assets to secure the Ethereum blockchain. Because staking on Ethereum requires locking up a substantial minimum of 32 ETH and the ETH cannot be used during staking, liquid staking programs such as those from Lido and Rocket Pool have emerged that batch user tokens for staking with validators, issue tradeable receipt tokens (stETH and rETH), and collect a percentage of the staking rewards.

A.   Unregistered Broker Claims

The SEC alleged that Consensys violated the Exchange Act and that MetaMask Swaps acted as an unregistered broker by facilitating trades in crypto assets that the SEC previously claimed were securities. The Securities Exchange Act of 1934 defines a "broker" as "any person engaged in the business of effecting transactions in securities for the account of others." 15 USC § 78c(a)(4).

The SEC also alleged that Consensys acted as a broker with respect to the Lido and Rocket Pool staking programs. The SEC alleged Lido and Rocket Pool's liquid staking programs are investment contracts because users deposit ETH for receipt tokens representing a *pro rata* interest, with rewards also paid

pro rata after fees. The SEC highlighted the staking providers' marketing, including public remarks on using "expert knowledge" to simplify and secure the staking process.

In addition to the existence of transaction-based compensation, there are several factors the SEC mentioned to support their unregistered broker allegations, including:

▪ *Solicitation and Holding Out*: The SEC alleged that MetaMask Swaps presented itself as a broker by soliciting potential investors in digital asset securities (including assets the SEC has previously alleged to be securities), holding itself out to be a place to buy and sell crypto asset securities, promoting its trading experience and efficiency, and enabling "more trades more efficiently" with an optimized path for every trade. The SEC focused on claims of achieving best execution and cited promotional content, highlighting MetaMask's "ease of use" due to its actions. The SEC also alleged that MetaMask Staking presented itself as a broker by soliciting potential investors, holding itself out as a place to buy and sell the "investment contracts," and recommending which of the two investment contracts would offer the highest rewards.

▪ *Effecting Transactions*: The SEC alleged MetaMask Swaps effects transactions by providing a trading interface, curating pricing information, advising on the "best" trades, and routing orders. The SEC highlighted statements about MetaMask's "behind the scenes" efforts, calling it "the secret ingredient in making MetaMask Swaps the cheapest and best swapping service out there." The SEC also pointed to MetaMask's user guide, indicating that it acts on users' behalf to "lessen [user] exposure to potentially hackable or malicious smart contract code." The SEC also alleged that MetaMask Staking effects transactions by removing assets from the user's MetaMask wallet, transferring the assets to the staking smart contract, and transferring the acquired liquid staking token back into the user's MetaMask wallet.

   – *Providing a Trading Interface*: The SEC focused on MetaMask Swaps' clickable menus and order types, highlighting that users do not need to know or enter public blockchain addresses to trade crypto assets. The SEC emphasized that Consensys does "all the work" to effect transactions, using its own market knowledge and discretion in displaying information and selecting DEXs and market makers. The SEC compared this to traditional securities brokers seeking the best execution for their customers and quoted the MetaMask Swaps User Guide stating "[MetaMask] Swaps enables you to trade tokens on any Ethereum-compatible network … without having to interface directly with third-party platforms."

   – *Discretion in Providing Pricing Information and Recommendations*: The SEC alleged that MetaMask Swaps provides quotes to users from various third-party liquidity providers, some under contract with Consensys. The SEC highlighted that MetaMask does not pull pricing from all sources but exercises discretion in selecting providers, noting that some share trading fees with Consensys. The SEC also considered MetaMask's features for seeking the best prices or value for Metamask Swap or the best rewards for MetaMask Staking. In a moment of irony, the SEC alleged that Consensys' attempts to screen out fraudulent or "regulated" tokens (*e.g.*, securities) indicates that MetaMask Swaps acts in a brokerage capacity by advising users of the best value transactions.

   – *Accepting and Routing Orders*: The SEC argued that MetaMask Swaps effects transactions by accepting and routing orders by performing every step of a crypto asset trade. MetaMask Swaps uses smart contracts on the Ethereum blockchain to (1) read the user's

private key from the user's MetaMask wallet, (2) submit the transaction to a Consensys-operated node, transferring assets to a Consensys controlled "Spender" smart contract; (3) the Spender contract interacts with the Consensys-built "Adapter" smart contracts that then interact with liquidity pools; (4) the Adapter contracts and liquidity pools interact to effect the trade; (5) Consensys takes a percentage-based fee from the Spender contract; and (6) transfers the remaining assets back to the user's wallet address. Similarly, the SEC noted the role of software in facilitating the movement of assets between a customer wallet, a MetaMask Staking smart contract, and a Lido or Rocket Pool smart contract.

B. Unregistered Securities Offering Claims

In addition to the aforementioned broker claims regarding MetaMask Staking, the SEC argued also that MetaMask Staking offered and sold these alleged investment securities by acting as an underwriter by participating in key points in their distribution. The SEC specifically emphasized soliciting investors to participate in staking and acting as an intermediary in the distribution from the liquid staking program to users. MetaMask's interface and ease of use and marketing, including testimony that MetaMask is a key "distribution channel," supported the claim that MetaMask's staking services constitute offer and sale activity by an underwriter under the Securities Act. The SEC notably did not make similar claims against Coinbase Wallet in the Coinbase action, so the SEC may be testing receptiveness to an additional theory in the digital asset context.

The challenges of drawing lines between technologies and services when considering broker status under the Exchange Act is not new. The SEC has issued a number of no-action letters and other guidance that predate blockchain technology, permitting certain technical service providers (based on specific facts and circumstances) to continue providing services without broker registration, even if used in connection with securities. Courts, including the court in the Coinbase Wallet action, have also weighed in on related questions.

The SEC's case against Consensys shows its ongoing efforts to regulate DeFi and software applications and suggests that the regulatory onslaught against crypto firms is far from over. Crypto firms, including software providers, need to be especially careful about assessing their own regulatory profiles and how they structure and market their products.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

New York	San Francisco	Washington D.C.
Dana Syracuse	Eric Sibbitt	Kristofer Readling
1.212.318.6034	1.415.856.7210	1.202.551.1848
danasyracuse@paulhastings.com	ericsibbitt@paulhastings.com	kristoferreadling@paulhastings.com
Josh Boehm	Lisa Rubin	
1.212.318.6033	1.415.856.7027	
joshboehm@paulhastings.com	lisarubin@paulhastings.com	

[1] *SEC v. Consensys Software*, 24 Civ. 4578, Complaint (E.D.N.Y. Jun. 28, 2024) ("Complaint"), *available at* https://www.sec.gov/files/litigation/complaints/2024/comp-pr2024-79.pdf.

[2] Consensys first brought an action against the SEC on April 25, 2024. *Consensys Software v. Gensler,* Complaint, No. 4:24-cv-00369 (N.D. Tex. Apr. 25, 2024).

[3] *SEC v. Coinbase*, 23 Civ. 4738 (KPF), Opinion and Order at 46 (S.D.N.Y. Mar. 27, 2024) ("Coinbase Order"), available at https://storage.courtlistener.com/recap/gov.uscourts.nysd.599908/gov.uscourts.nysd.599908.105.0.pdf.

[4] *SEC v. Binance Holdings Limited,* No. 23-1599, Order at 21 (D.C. Jun. 28, 2024) ("Also, the agency's decision to oversee this billion dollar industry through litigation – case by case, coin by coin, court after court – is probably not an efficient way to proceed, and it risks inconsistent results that may leave the relevant parties and their potential customers without clear guidance.").