

**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION**

CRYPTO FREEDOM ALLIANCE OF TEXAS and
BLOCKCHAIN ASSOCIATION,

Plaintiffs,

-against-

SECURITIES AND EXCHANGE COMMISSION and
GARY GENSLER, in his official capacity as Chairman
of the Securities and Exchange Commission,

Defendants.

Civil Action No. 4:24-cv-00361-O

BRIEF OF *AMICUS CURIAE* PARADIGM OPERATIONS LP

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INTERESTS OF *AMICUS CURIAE*

Paradigm Operations LP (“Paradigm”) is an American investment firm that invests in crypto and related technologies at the frontier of innovation. It provides expertise that ranges from technical (mechanism design, smart contract security, and engineering) to operational (recruiting and regulatory strategy). Paradigm believes this litigation could significantly impact the entrepreneurs it backs, as well as many others who seek to use and develop innovative new technology.

As set forth in detail below, the SEC’s final rule *Further Definition of “As Part of a Regular Business” in the Definition of Dealer and Government Securities Dealer in Connection with Certain Liquidity Providers*, 89 Fed. Reg. 14938 (Feb. 06, 2024) (the “Dealer Rule”) seeks to expand greatly the definition of the term “dealer” as used in the Securities Exchange Act of 1934 (the “Exchange Act”), far beyond what the weight of the statutory language can bear. The Dealer Rule explicitly states that it applies to digital assets, yet fails to grapple with the ways in which the poorly-defined rule affects participants in the digital assets industry, not least in the burgeoning field of decentralized finance (“DeFi”). Paradigm is concerned about the real-world chilling effect that the Dealer Rule will have on innovation in an exciting and transformative developing sector that is likely to be – unless squashed by overbearing regulation – the future of finance.¹

¹ Plaintiffs Crypto Freedom Alliance of Texas and Blockchain Association (“Plaintiffs”) are both industry member organizations; Blockchain Association in particular has nearly 100 members. Paradigm is a member of both. Additionally, a Paradigm employee is on the Board of Plaintiff Crypto Freedom Alliance of Texas. However, Paradigm and its counsel drafted this *amicus* brief themselves; neither Plaintiffs nor their counsel authored this *amicus* brief in whole or in part. Likewise, Plaintiffs and their counsel did not contribute money that was intended to fund preparing or submitting the brief. Further, no person – other than the *amicus curiae*, its members, or its counsel – contributed money that was intended to fund preparing or submitting the brief.

INTRODUCTION AND SUMMARY OF ARGUMENT

The Dealer Rule is the latest example of the SEC exceeding its authority in an attempt to regulate the digital assets industry out of existence. The Dealer Rule purports to solve a problem that does not exist, in turn creating inordinate uncertainty for digital assets industry participants.

As Plaintiffs describe in their motion for summary judgment filed on May 17, 2024 (ECF Nos. 28-30, the “SJ Motion”),² a “dealer” as defined in the Exchange Act is a person that holds him or herself out to customers as willing and able to buy and sell securities as part of a regular business.

The Dealer Rule seeks to rewrite that definition by decreeing that a person is engaged in buying and selling securities for their own account “as part of a regular business” (and thus is a dealer) if that person “[e]ngages in a regular pattern of buying and selling securities that has the effect of providing liquidity to other market participants.” The Dealer Rule flies in the face of ninety years of market understanding, and contradicts statements and guidance by the SEC itself.

In this *amicus* brief, Paradigm provides industry context about how the Dealer Rule’s many ambiguities might be used to sweep into the statutory definition of “dealer” all sorts of digital asset market participants that have not been considered dealers under the Exchange Act. The Dealer Rule leaves a bevy of potential open questions that may be abused by an SEC that is aggressively seeking to stifle the digital assets industry:

- Non-securities digital assets are not within the rule, but when is a digital asset trading in the secondary market a security? How would a market participant know?

² All references to “A.R. ___” are to the relevant tabs in Plaintiffs’ Appendix in Support of Their Motion for Summary Judgment. ECF No. 30. The final Dealer Rule is A.R. 2.

- A user who deposits cryptocurrency into a software protocol’s liquidity pool may have the “effect” of providing liquidity under the Dealer Rule; is that person “regularly” expressing trading interest by doing so? How would he or she know?
- Are the liquidity tokens received for depositing tokens into a pool “incentives” as set forth in the rule?
- Can algorithmic software or “bots” count as dealers?
- Could open-source DeFi software code itself be considered a dealer? Or the individuals who originally wrote the code?
- What is the scope of the “catch-all” in the rule, and what prevents it from being weaponized against digital assets industry participants?

Numerous industry participants raised these concerns in comment letters to the proposed rule, but were ignored in the final rule.

These industry concerns are not academic. A digital asset market participant that might be a dealer under these ambiguous questions must either rely on traditional market understandings that it is not a dealer, and risk SEC enforcement if the SEC disagrees; or attempt to register as a broker-dealer when the registration process and ongoing requirements are fundamentally incompatible with digital assets and decentralized protocols. And it could take years, if registration is ever approved at all. For the many digital asset market participants, these questions create intolerable ambiguities.

Because the SEC has refused to provide sufficient answers to the questions raised in the comment letters, market participants will be forced to play guessing games, where guessing wrong has severe consequences. That uncertainty will lead to a chilling effect on innovation and investment, and might cause more industry participants to move outside the United States to escape

the SEC's guessing-game regime. The Dealer Rule is devastating to exciting and groundbreaking innovation and risks abdication of American leadership in the financial technology sector.

STATEMENT OF FACTS

A. The Exchange Act Definition of “Dealer” and the Dealer Rule

The Exchange Act requires “dealers” to register and defines “dealer” as “any person engaged in the business of buying and selling securities . . . for such person’s own account through a broker or otherwise.” 15 U.S.C. §§ 78o(a)(1), 78c(5)(a). However, the Exchange Act exempts from the definition of “dealer” a “person that buys or sells securities . . . for such person’s own account, either individually or in a fiduciary capacity, but not as part of a regular business.” 15 U.S.C. § 78c(5)(b).

On April 18, 2022, the SEC promulgated a proposed rule that purported to define “as part of a regular business,” as that term is used in 15 U.S.C. § 78(c)(5)(b) (A.R. 1, the “Proposed Rule”). Numerous market participants and other stakeholders, in the digital assets space as well as traditional finance, issued public comments on the Proposed Rule.

On February 6, 2024, the SEC issued the final Dealer Rule. The Dealer Rule provides:

(a) A person that is engaged in buying and selling securities for its own account is engaged in such activity “as a part of a regular business” as the phrase is used in section 3(a)(5)(B) of the Act (15 U.S.C. 78c(a)(5)(B)) if that person:

(1) Engages in a regular pattern of buying and selling securities that has the effect of providing liquidity to other market participants by:

(i) Regularly expressing trading interest that is at or near the best available prices on both sides of the market for the same security and that is communicated and represented in a way that makes it accessible to other market participants; or

(ii) Earning revenue primarily from capturing bid-ask spreads, by buying at the bid and selling at the offer, or from capturing any incentives offered by trading venues to liquidity-supplying trading interest.”

Dealer Rule (A.R. 2) at 15009.

The Dealer Rule also states that a person is not engaged in buying and selling securities for its own account “as part of a regular business” if that person “has or controls total assets of less than \$50 million,” along with other, less relevant, exceptions. *Id.*

B. Registering as a Dealer

To register as a dealer, an applicant must, *inter alia*, fill out Form BD,³ have the SEC grant its registration; become a member of a self-regulatory organization (like FINRA); become a member of the Securities Investor Protection Corporation; comply with state requirements; and have officers and “associated persons” who satisfy qualification and licensure requirements.⁴

Once registered, dealers “must meet certain financial responsibility requirements,”⁵ which include maintaining “minimum net capital levels based upon the type of securities activities they conduct and based on certain financial ratios.”⁶ Dealers must also “make and keep current books and records detailing, among other things, securities transactions, money balances, and securities positions [Dealers] also must file with the SEC periodic reports, including quarterly and annual financial statements . . . [that] must be certified by an independent public accountant.”⁷

FINRA independently assesses whether the applicant can comply with various rules, including but not limited to maintaining certain net capital requirements, “financial controls to ensure compliance with the federal securities laws,” “compliance, supervisory, operational, and

³ *Form BD, Uniform Application for Broker-Dealer Registration*, SEC, <https://www.sec.gov/files/formbd.pdf>.

⁴ *Guide to Broker-Dealer Registration*, SEC (Apr. 2008), <https://www.sec.gov/about/reports-publications/investor-publications/guide-broker-dealer-registration#III>.

⁵ *Id.*

⁶ *Id.* See also 17 C.F.R. § 240.15c3-1 (setting forth dealers’ net capital requirements).

⁷ *Guide to Broker-Dealer Registration*, SEC (Apr. 2008), <https://www.sec.gov/about/reports-publications/investor-publications/guide-broker-dealer-registration#III>. See also 17 C.F.R. § 240.17a-3; 17 C.F.R. § 240.17a-4; 17 C.F.R. § 240.17a-5 (setting forth requirements).

internal control practices and standards,” a recordkeeping system and a training plan, and “a supervisory system . . . designed to prevent and detect . . . violations of the federal securities laws, the rules and regulations thereunder, and FINRA rules.”⁸

Before the promulgation of the Dealer Rule, there was no requirement for traders engaged in buying and selling securities for their own account to undertake this burdensome registration and compliance process. And there certainly has never been a requirement for software, or a software protocol like an “automated market maker,” to be registered as a dealer.

C. The Basic Mechanics of DeFi

The SJ Motion contains a detailed explanation of DeFi and liquidity pools. ECF No. 29 at 9-11. As a brief refresher, liquidity pools are crucial elements of the functionality of certain types of decentralized exchanges (“DEXes”), in which users can trade one cryptocurrency for another without the need for an intermediary. To do so, the user deposits their token to a “pool,” and receives some quantity of another token, based on the current “price ratio” of the tokens in the pool. The price of assets in the liquidity pool is calculated by open-source, automated market maker software (“AMMs”) and after each transaction, the AMM re-calculates the prices of the remaining assets in the pool.

In this model, common in the DeFi world, there is no need for a dealer. No person needs to stand in the middle of the trades to set prices or “match” trades for execution.

⁸ FINRA, Rule 1014(a), *available at* <https://www.finra.org/rules-guidance/rulebooks/finra-rules/1014>.

ARGUMENT

I. THE AMBIGUITIES OF THE DEALER RULE MIGHT IMPROPERLY SWEEP PARTICIPANTS IN THE DIGITAL ASSETS INDUSTRY INTO THE DEFINITION OF “DEALER”

A. The SEC’s Refusal to Elucidate the Circumstances Under Which Digital Assets Are Securities Results in an Ambiguous Rule

The Dealer Rule “appl[ies] to the buying and selling of all securities, including crypto assets that are securities” Dealer Rule at 14960. Yet, the SEC has repeatedly failed to articulate clear guidance establishing the circumstances under which digital assets transactions are securities. For example, the SEC has argued at various times that digital assets themselves are not securities;⁹ that digital assets themselves are securities;¹⁰ or that digital assets are sometimes securities based on a facts and circumstances test.¹¹

The SEC could have used the Dealer Rule to provide additional clarity as to when digital assets are securities. The SEC chose not to. The Dealer Rule provides no guidance as to under what circumstances a cryptocurrency transaction might be a securities transaction, except to merely recite that the “analysis is governed by the test first articulated by the Supreme Court in *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946).” Dealer Rule at 14950 n.134.

⁹ See William Hinman, *Digital Asset Transactions: When Howey Met Gary (Plastic)*, Remarks at the Yahoo Finance All Markets Summit: Crypto, SEC (June 14, 2018), <https://www.sec.gov/news/speech/speech-hinman-061418>. See also *SEC v. Coinbase, Inc.*, 2024 WL 1304037, at *13 (S.D.N.Y. Mar. 27, 2024) (“[t]he SEC does not appear to contest that tokens, in and of themselves, are not securities”); *SEC v. Ripple Labs Inc.*, 682 F. Supp. 3d 308, 324 (S.D.N.Y. 2023) (“XRP, as a digital token, is not in and of itself a ‘contract, transaction, or scheme’ that embodies the *Howey* requirements of an investment contract.”) (brackets omitted); *SEC v. Terraform Labs Pte. Ltd.*, 684 F. Supp. 3d 170, 194 (S.D.N.Y. 2023) (“the original UST and LUNA coins, as originally created and when considered in isolation, might not then have been, by themselves, investment contracts”).

¹⁰ *SEC v. Payward, Inc.*, No. 23-cv-06003, ECF No. 26-2 at 92:14-15 (N.D. Cal. Feb. 22, 2024) (Hearing Tr. from *SEC v. Binance Holdings Ltd.*, No. 23-cv-1599 (D.D.C Jan. 22, 2024)).

¹¹ *Framework for “Investment Contract” Analysis of Digital Assets*, SEC (Apr. 3, 2019), <https://www.sec.gov/files/dlt-framework.pdf>.

B. The Profound Ambiguities in the Dealer Rule May Result in Digital Assets Market Participants Being Deemed Dealers

Market participants raised numerous questions about the Dealer Rule’s applicability to DeFi participants and open-source, autonomous software in comment letters responding to the Proposed Rule, but the SEC declined to answer, or gave unclear responses that did not address the substantive questions asked, continuing to leave industry participants in limbo. We have highlighted just a few of the litany of unanswered questions below.

1. Does Staking Tokens to a Liquidity Pool Make You a Dealer?

Users who stake their assets to a liquidity pool might be considered dealers under the Dealer Rule. These users are not “dealers” in the traditional understanding of the term; they are merely traders who want to receive a return on certain tokens that are not otherwise being used. But such users’ activities have the “effect of providing liquidity to other market participants,” even if that is not the user’s principal intent, because assets deposited to the liquidity pool are available to be traded by other users at the pool’s prevailing rate calculated by an AMM. Moreover, because users who deposit assets to a liquidity pool typically receive liquidity provider tokens in return, and may receive a portion of the fees earned on transactions in the pool, those users might be considered to be “[e]arning revenue . . . from capturing any incentives offered by trading venues to liquidity-supplying trading interest.” Dealer Rule at 15009.

Numerous comment letters responding to the Proposed Rule pointed out how under the SEC’s expansive definition, users providing their tokens to a pool could be considered dealers.¹²

¹² See, e.g., William C. Hughes, Consensys Software Inc., Comment Letter on Proposed Further Definition of the Dealer Rule at 7 (May 26, 2022) (A.R. 3, the “Consensys Letter”) (“[A]s the proposal seems to indicate on its face—many of the *individual liquidity providers* that participate in DEXes would be required to register as dealers too.”); Miller Whitehouse-Levine, DeFi Education Fund, Comment Letter on Proposed Further Definition of the Dealer Rule at 8 (May 27, 2022) (A.R. 7, the “DeFi Education Fund Letter”) (“All participants in a liquidity pool are, by leaving their assets in the pool, exposing those assets to sale at the pool’s prevailing exchange rate. Does this translate to all participants expressing a ‘trading interest?’”).

The SEC declined to engage with those concerns when it announced the Dealer Rule, instead unhelpfully stating that “[w]hether a particular activity in the crypto asset securities market, including the so-called DeFi market, gives rise to dealer activity requires an analysis of the totality of the particular circumstances against all elements of the expressing trading interest factor.” Dealer Rule at 14950. The SEC also stated that “whether there is a dealer involved in any particular transaction or structure (whether or not referred to as so-called DeFi) is a facts and circumstances analysis. There is nothing about the technology used, including the distributed ledger technology-based protocols using smart contracts, that would preclude crypto asset securities activities from falling within the scope of dealer activity.” Dealer Rule at 14960. The Dealer Rule cryptically and unhelpfully adds that “certain persons engaging in crypto asset securities transactions may be operating as dealers as defined in the Exchange Act.”

It is inappropriate to subject market participants to such a “facts and circumstances, maybe” test. There must be at least an attempt to draw clear lines before disrupting the ability of everyday users to be able to use and benefit from new technology. The SEC sets the rules of the road; it does not have the power to enforce its authority arbitrarily amid a vague fog of power.

2. When Is Someone “Regularly” Expressing Trading Interest?

It is unclear whether a user who deposits tokens into a liquidity pool is “regularly” expressing trading interest, a word the Dealer Rule uses to “distinguish[] persons engaging in isolated or sporadic expressions of trading interest from persons whose regularity of expression of trading interest demonstrates that they are acting as dealers.” Dealer Rule at 14948. But the term “regularly” provides little clarity for DeFi users.¹³ A user might deposit tokens into a pool, and

¹³ The Proposed Rule used the word “routinely” instead of “regularly,” and the word “routinely” was roundly criticized as ambiguous. *See, e.g.*, Michelle Bond, Association for Digital Asset Markets, Comment Letter on Proposed Further Definition of the Dealer Rule at 16 (May 27, 2022), <https://www.sec.gov/comments/s7-12-22/s71222-20129901-296061.pdf> (“[T]hat ‘routinely’ . . . standard is extremely vague and will lead to inconsistent application across market participants.”); Consensus Letter

those tokens are locked there for some period of time. Does that activity satisfy the “regularly” standard? The Dealer Rule can only offer, unhelpfully, that “[w]hether a person’s activity is ‘regular’ will depend on the liquidity and depth of the relevant market for the security.” Dealer Rule at 14948.

3. Can Arbitrage Bots Be Dealers?

Arbitrage bots are software that identify and execute trades when there is a price difference between the same assets in different liquidity pools (*i.e.*, they buy an asset in the pool containing the lower price and sell the asset in the pool containing the higher price). Such bots provide liquidity and price discovery to the market, but in an entirely automated, non-discretionary, and non-discriminatory way. Are these bots dealers? If not the software itself, could individuals who funded those bots be considered to be engaged in activities that have the effect of providing liquidity to market participants? The SEC summarily and capriciously ignored these concerns, which raise a critical flaw in the Dealer Rule, particularly given the increasing automaticity of trading markets both for traditional equities as well as for digital assets.

4. When Does the \$50 Million “Safe Harbor” Actually Convey Safety?

The Dealer Rule states that a person is not engaged in buying and selling securities for its own account “as part of a regular business” if that person has or controls total assets of less than \$50 million. But that rule leads to even more questions for digital assets industry participants. Some liquidity pool users hold a significant amount of cryptocurrency, some of which cannot easily be valued, or whose value is volatile. How often should those assets be valued to determine whether they fall above or below the threshold? Daily? Weekly? Monthly? Quarterly? In periods

at 18 (“[T]he decisive question for traders is *how much* more frequent than occasional and *how much* less than continuous—and on this question the proposal has nothing to say.”) (emphasis in original). But the word “regularly” is no better.

of volatility, does a person's dealer status change daily? What if a user owns illiquid assets without an easily ascertained market price? Moreover, when a user stakes tokens to a liquidity pool, those tokens may be locked for some period of time; do locked assets count in the determination of the \$50 million figure? The SEC leaves traders in the dark about whether they are supposed to register.

The Dealer Rule's \$50 million safe harbor also does not account for what percentage of assets are actually being used for buying and selling securities as part of a regular business. As one industry participant pointed out, this leads to the absurd result that a person owning or controlling over \$50 million but only trading a small portion of that amount might have to register as a dealer, but a person owning, controlling, and trading \$49 million would not have to register.¹⁴

Worse, the Dealer Rule's \$50 million threshold is not even a real threshold. It "is not an exclusion from the 'dealer' definition for all purposes, but only for purposes of the final rules, which focus on *de facto* market making. Outside of the context of these rules, the question of whether any person, including a person that has or controls less than \$50 million in total assets, is acting as a dealer, as opposed to a trader, will remain a facts and circumstances determination." Dealer Rule at 14956. Thus, the SEC might determine that under some amorphous "facts and circumstances" standard, a person with less than \$50 million of assets still might be a dealer.

5. Can Software or Smart Contracts Be Dealers?

There is risk that the Dealer Rule could be interpreted aggressively to encompass an AMM, DEX, or even a "smart contract" itself, because those products might have the "effect" of "providing liquidity to other market participants."

¹⁴ See Consensus Letter at 19 ("Under the proposal's framework, a trading firm managing \$50 million that employs \$50,000 of it in playing both sides of the market would be a dealer while a firm that employs all of its \$49 million under management in the same strategy would not.").

To be clear, such products are just software – and more than that, they are open-source and autonomous software. They are not “persons” for purposes of the Exchange Act and the Dealer Rule. The Exchange Act defines “person” as a “natural person, company, government, or political subdivision, agency, or instrumentality of a government.” Software, of course, is none of those things.

But, based on recent statements and activities, the SEC or its Enforcement Division Staff might take a contrary position, and assert that the software itself is a dealer, or that the individuals who originally programmed the software, or the individuals involved in governing that software (even if those people are completely decentralized and diffuse) are an “organized group of persons” for purposes of the definition of “dealer.” SEC Commissioner Hester M. Peirce raised these concerns in her dissent, noting that a “crypto automated market maker might have to register as a dealer under the final rules. How can a software protocol register as a dealer?”¹⁵ Commissioner Peirce added, “given that an AMM is a software protocol, who will have to register?”¹⁶

6. Does the Catch-All at the End of the Dealer Rule Give the SEC Unbounded Power?

The Dealer Rule contains an undefined “catch-all”: “[n]o presumption shall arise that a person is not a dealer within the meaning of section 3(a)(5) of the Act solely because that person does not satisfy paragraph (a) of this section.” In other words, even if a person is not buying and selling securities for its own account as part of a regular business under the Dealer Rule, that person might still be considered a dealer under some amorphous criteria. The Dealer Rule explains that this clause is meant to encompass those persons that “engage in a regular business of buying and selling securities for its own account, even if it does not meet the conditions set forth in the

¹⁵ A.R. 9.

¹⁶ *Id.*

proposed rules.” Dealer Rule at 14964. But that language is simply the definition of proprietary traders, who have been excluded from the dealer definition since inception. This catch-all is an impermissible attempt to arrogate all future powers to determine dealer status, under any criteria the SEC may later decide, to an administrative agency with immense powers. The APA forbids such a power grab.

II. DEALER REGISTRATION IS IMPOSSIBLE FOR THE DIGITAL ASSETS INDUSTRY

Even if an entity determines that it might be a “dealer” based on the Dealer Rule, registering as a dealer is impossibly unworkable for digital assets market participants.

The registration process is burdensome and expensive, even for “traditional” dealers. For digital assets industry participants, however, the Final Rule’s cost estimates are wildly understated,¹⁷ and the time it would take to undertake the registration process would be extreme.¹⁸ Worse, all that money and time would be expended on a registration application that would almost certainly be denied,¹⁹ and even if (by some miracle) registration were approved, a digital assets

¹⁷ See DeFi Education Fund Letter at 13-14 (cost estimates were “highly suspect given that so few firms conducting digital asset activities have been able to register as broker-dealers, and typically only after multi-year processes.”); Perianne Boring, Chamber of Digital Commerce, Comment Letter on Proposed Further Definition of the Dealer Rule at 7 (June 13, 2022) (A.R. 8) (“That estimate is significantly deficient, especially for market participants that have previously not been deemed to be dealers and provides no reasonable estimate of the cost and time associated with the preparation of the initial filing, required technology build, hiring requisite registered personnel, net capital requirements, or annual costs and time burden that would be associated with compliance with the Proposals.”).

¹⁸ See Gabriella Kusz, Global Digital Asset and Cryptocurrency Association, Comment Letter on Proposed Further Definition of the Dealer Rule at 3 (May 27, 2022) (A.R. 4) (“While FINRA is expected to approve registrations within six months, in the best circumstances that is often not the case. For firms with unusual or complex business plans, such as digital asset focused firms, this process could take years.”). To date, only one firm has registered as a “crypto securities platform”; it was granted approval in 2021, and as of this writing four years later, still has not been able to list a single digital asset for trading. See Jesse Hamilton, *Prometheum, the Only U.S.-Registered Crypto Platform, Picks Ether as Its First Product*, CoinDesk (Feb. 7, 2024), <https://www.coindesk.com/policy/2024/02/07/prometheum-the-only-us-registered-crypto-platform-picks-ether-as-its-first-product/>.

¹⁹ As of August 3, 2023, FINRA stated that several firms were approved “solely to engage in crypto asset securities business,” but there is no clear understanding of what that phrase means, or when any digital

dealer would be forced to comply with unworkable rules, given the impossibility of applying the existing regulations to cryptocurrency assets.

Commissioner Peirce raised these very points: “In light of the difficulties that other would-be crypto registrants have encountered with the SEC and FINRA, will those persons even be able to register?”²⁰ Until the SEC can unambiguously say yes, and explain how, attempts to register are an expensive bridge to nowhere.

Further, even if an entity could be registered as a dealer, the ongoing compliance requirements, designed for traditional securities dealers, are effectively impossible to meet for digital assets participants. For example, registered dealers must maintain a minimum amount of net capital under SEC Rule 15c3-1. But, as stated by the SEC, “[c]rypto assets that are not securities would be subject to a 100% deduction when computing net capital and so affected persons that hold more of such assets would likely need more net capital.” Dealer Rule at 14988. In other words, if a person held over \$50 million worth of digital assets, they may be considered a dealer, but if those assets were not securities (even setting aside the thorny questions of when an entity would know that), those digital assets would not count toward net capital requirements.²¹ Even cryptocurrencies that are securities would “likely contribute to net capital” only if there is a “ready market” and they are “subject to haircuts,” Dealer Rule at 14988 n.573. As a result, there

assets fall into that category. See Jason Foye, *An Inside Look into FINRA’s Crypto Asset Work*, FINRA (Aug. 3, 2023), <https://finra.org/media-center/blog/inside-look-finras-crypto-asset-work>.

²⁰ A.R. 9. For a discussion of the difficulties facing potential digital assets registrants in other contexts, see Rodrigo Seira, Justin Slaughter, Katie Biber, *Due to SEC Inaction, Registration is Not a Viable Path for Crypto Projects*, Paradigm (Mar. 23, 2023), <https://policy.paradigm.xyz/writing/secs-path-to-registration-part-i>; Rodrigo Seira, Justin Slaughter, Katie Biber, *Lessons from Crypto Projects’ Failed Attempts to Register with the SEC*, Paradigm (Mar. 23, 2023), <https://policy.paradigm.xyz/writing/secs-path-to-registration-part-ii>; Rodrigo Seira, Justin Slaughter, Katie Biber, *The Current SEC Disclosure Framework Is Unfit for Crypto*, Paradigm (Apr. 20, 2023), <https://policy.paradigm.xyz/writing/secs-path-to-registration-part-iii>.

²¹ See DeFi Education Fund Letter at 9 (“Market participants do not know the net capital treatment of digital assets.”).

is substantial uncertainty about what cryptocurrencies could ever count toward the net capital requirements, thus making it literally impossible for an entity in the digital assets industry to know if it was in compliance.

Further, dealer recordkeeping requirements are incompatible with digital assets. Dealers registered with the SEC must maintain, among other things, “an itemized daily record of all purchases and sales of securities . . . receipts and deliveries of securities (including certificate numbers) . . . [l]edgers (or other records) reflecting all assets and liabilities, income and expense and capital account,” and a “securities record or ledger reflecting separately for each security . . . all ‘long’ or short’ positions . . . and in all cases the name or designation of the account in which each position is carried.” 17 C.F.R. § 240.17a-3(a)(1), (2), and (5). These requirements were clearly written for centralized entities in traditional finance. For digital assets market participants, these requirements may be both impossible, as well as purposeless. A decentralized project does not maintain these records in a centralized manner; AMMs and other DeFi protocols would have no knowledge of any such transactions or holdings, outside publicly available information on blockchains. But all of that information is publicly available on blockchains, for the SEC (and everyone else) to see.

To the extent that an AMM or a DEX itself is considered a dealer, these requirements would be nonsensical. Software cannot maintain net capital or maintain required records. Very simply, software cannot be a registered dealer.²² But the Dealer Rule suggests – with some ambiguity – that it should be. A regulator cannot require a company to perform that which is not

²² See Consensus Letter at 7 (“[I]t is not even clear (and the Commission certainly has not explained) *how* a decentralized exchange—which after all is not a person or an entity with staff but rather a network and set of protocols—would register in the first place.”) (emphasis in original).

possible as a matter of its business. Just as Congress does not hide elephants in mouseholes, it does not demand the impossible to comply with the law.

CONCLUSION

The ambiguities and impossibilities addressed above render the Dealer Rule, particularly as applied to the digital assets industry, an arbitrary and capricious adoption of a rule governing literally trillions of dollars of assets. Plaintiffs' SJ Motion should be granted, and the Dealer Rule should be vacated.

Dated: Dallas, Texas
May 24, 2024

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