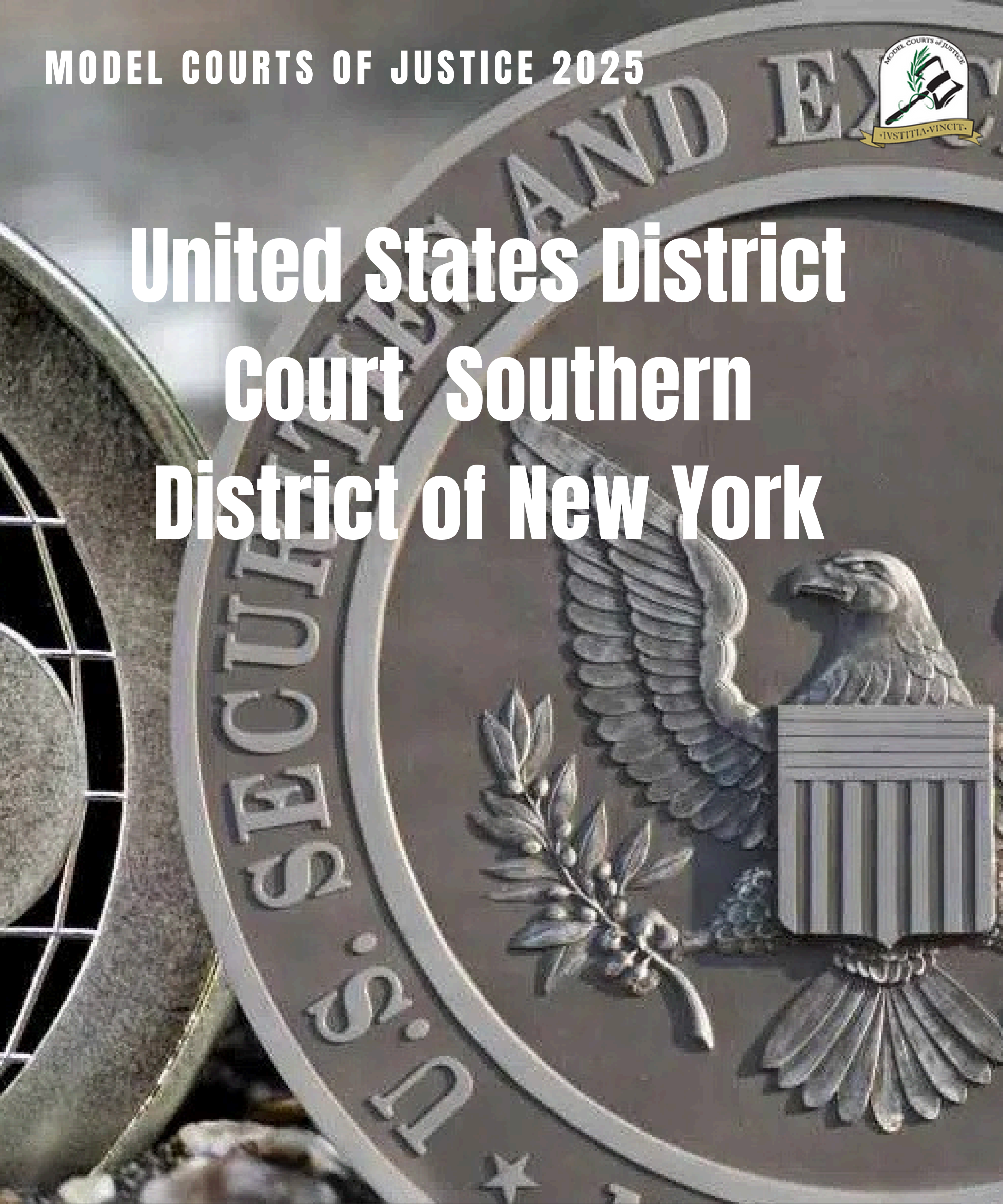

MODEL COURTS OF JUSTICE 2025

IVSTITIA·VINCIT

United States District Court Southern District of New York

Written by Sena Ateş & Mert Halil Bölükbaşı
Supervised by Aydan Seyidaliyeva

8 DECENT WORK AND ECONOMIC GROWTH
9 INDUSTRY, INNOVATION AND INFRASTRUCTURE
16 PEACE, JUSTICE AND STRONG INSTITUTIONS

LETTER FROM THE SECRETARY-GENERAL

Highly Esteemed Participants,

It is my pleasure to welcome you all to the 13th Edition of the Model Courts of Justice as the Secretary-General. My name is Aydan Seyidaliyeva and I am a junior law student at Ankara University, currently on her Exchange Program at Utrecht University Law School.

The participants of the Model Courts of Justice 2025 will be focusing on the fields of finance and technology law with a particular focus on the role of cryptocurrency in modern sectors.The case that will be simulated this year is *'SEC v. Ripple'*. In this regard, the participants, will have the opportunity to practice their subjects and improve their written and oral skills in the above-mentioned fields.

I would first like to express my gratitude to Mr Mert Halil Bölükbaşı and Miss Sena Ateş for excelling in the writing of the entire academic material for this court with their unmatched harmony and coordination fuelled with endless dedication. Second, I appreciate the trainee of the United States District Court Miss İlayda Kara for her dedication to Academic Team of the Model Courts of Justice 2025. Last, I would like to thank the Director-General of the Model Courts of Justice 2025 and the most valuable source of our motivation throughout the entire preparation process, Miss Elfin Selen Ermiş for enduring organizational excellence and professionalism with her wonderful organization team despite uncountable obstacles and the given conditions.

Before attending the sessions, I highly recommend that all the participants read the Study Guide and Rules of Procedure and prepare the printed versions of these documents with them to refer to during the Conference.

If you have any questions or hesitations about the Conference, please do not hesitate to contact me at secretarygeneral@modelcj.org

Sincerely,

Aydan Seyidaliyeva

Secretary-General of the Model Courts of Justice 2025

LETTER FROM THE UNDER-SECRETARY-GENERAL

Highly Esteemed Participants,

My name is Sena Ateş and I am currently a junior at Ankara University, Faculty of Law. As the Under-Secretary-General of the United States District Court more precisely Southern District of New York, it is of utmost honour for me to welcome you all to the 13th edition of the Model Courts of Justice, the leading international law conference in Turkey.

This year, the United States District Court will be simulating the case between United States Securities and Exchange Commission v Ripple. This case will determine whether XRP is classified as a security, which would subject it to stricter regulations under U.S. law. The case touches many complex issues such as definition of a security, regulatory clarity and precedent setting. Ultimately, the case will provide greater clarity on cryptocurrency regulation, impacting investors, businesses, and legal frameworks globally.

Before concluding my remarks, I would like to express my sincerest gratitude to each and every member of the both academic and organization team, who made the 13th edition of Model Courts of Justice possible. I would to extend my appreciation to our dear Secretary-General Aydan Seyidaliyeva, for giving me the opportunity to be a part of this conference and for her great effort and for encouraging and supporting me in every step. I would also like to thank our dedicated Director-General Elfin Selen Ermiş for making Model Courts of Justice come true. Importantly, I extend my deepest gratitude to Under Secretary General of United States District Court, Mert Bölükbaşı, for being the best partner. He has consistently demonstrated understanding and provided unwavering support. Lastly, I would like to deliver my gratitude to our trainee İlayda Kara, for her dedication and diligence.

Please do not hesitate to contact us at usdcsny@modelcj.org for any inquiries you may have regarding the document or proceedings.

Yours faithfully,

Sena Ateş

Under-Secretary-General for the United States District Court

LETTER FROM THE UNDER-SECRETARY-GENERAL

Highly Esteemed Participants,

My name is Mert Halil Bölükbaşı and I am currently a sophomore at Ankara University, Faculty of Law, as the Under-Secretary-General of the United States District Court for the Southern District of New York. It is a great honor to present our work as a guide and meeting with you will be an unforgettable experience for me. I am confident, this conference will always be a success in Türkiye for law but this one will be the greatest one.

This year, the United States District Court will be simulating the case between United States Securities and Exchange Commission v Ripple. This case will check the standards of securities and financial law regulations for their adaptability to the market and technology. Cutting-edge technological developments will face old-guard investor protections and regulations. This outcome is anticipated to offer critical clarity on cryptocurrency regulation, shaping the law for investors, businesses, and global legal frameworks.

Before concluding my remarks, I wish to express my gratitude to every member of the academic and organization teams who worked for the 13th edition of the Model Courts of Justice for a long time. I extend my sincere appreciation to our esteemed Secretary-General, Aydan Seyidaliyeva, for always supporting me without hesitation in the whole process. My thanks also go to our committed Director-General, Elfin Selen Ermiş, whose efforts were instrumental in bringing the Model Courts of Justice to life. I am particularly grateful to the Under-Secretary-General of the United States District Court, Sena Ateş who has been an exceptional pair, and a disciplined worker who does everything with perfection.

Finally, I would like to acknowledge and thank our trainee, İlayda Kara, for her remarkable dedication and hard work throughout this journey.

Please do not hesitate to contact us at usdcsny@modelcj.org for any inquiries you may have regarding the document or proceedings.

Yours faithfully,

Mert Halil Bölükbaşı

Under-Secretary-General for the United States District Court

INDEX

I. INTRODUCTION TO THE LAW OF FINANCE

1. History of the Financial Law

Throughout history, human society's complex character has invariably required transactional and managing systems to facilitate interactions among different peoples and institutions including states, religious communities and companies. The endeavors undertaken by humans and cultural needs caused by institutions have to save, invest and exchange their resources for new sources with minimum consumption. The emergence of money provided a solution for value exchange among humankind. As a consequence, it also led to the establishment of a specialized branch of law, known as financial law.

a) Early Development of the Financial Law

The practice of finance could be said to have started thousands of years ago alongside the origin of trade and commerce in ancient civilizations. Agriculture and the erection of the first cities were major starters in trade and finance. Before them, an exchange trade existed to a minimal degree but their complexities were more inclusionary for civilization.[1] For instance, in ancient Mesopotamia, a sort of credit system was put in place as a form of trade, extending between city-states. Merchants and landowners would provide farmers with the resources they needed, such as grain, pledging to repay them with more grain after the harvest. Deposits on clay tablets chronicle such transactions and point to the fact that there were certain dismissible works and pledges in due course around 3000 BCE.[2] According to other sources, before agriculture and primitive urban life, religious sites had been created with a side purpose of trade.[3] Göbekli Tepe[4] changed the perspective in history by a more religious centered perspective from seeing agriculture as the starting point for civilization. The adoption of precious metals as currency simplified trade and secured payments and resulted in an underutilization of insufficient barter trade. Currency created a store of value and unit of account for cost and price in trade.

[1] Semple, E. (1921) 'Geographic factors in the ancient Mediterranean Grain Trade', *Annals of the Association of American Geographers*, 11, pp. 47–74. doi:10.2307/2560853.

[2] Squitieri A and Altaweel M, 'Long-Distance Trade and Economy before and during the Age of Empires. ', In Revolutionizing a World: From Small States to Universalism in the Pre-Islamic Near East (UCL Press 2018) https://www.jstor.org/ accessed 1 November 2024.

[3] Bahattin Çelik and Orhan Ayaz, *'rise of göbekli tepe culture: "hunting ground economy" and the role of speculative "knowledge"'* [27.12.2022] 56(1) *Karadeniz Uluslararası Bilimsel Dergi* 143 - 160.

[4] An archaeological site.

Centralized administration regulated mints for quality but often engaged in debasement by altering weight or mixing inferior metals. These actions always caused inflation and an economic crisis.[5]

In ancient times, the systems of lending and interest were not only tethered to tangible property or real estate but were also relevant to the farming calendar. Farmers frequently needed to borrow seeds to plant, but later returned the seeds in the form of produced crops. In these early societies, personal bonds significantly influenced commerce, and trust and reputation were the main ways of securing loans.[6] *The Code of Hammurabi* was a remarkable ancient legal advancement that set forth one of the most significant basic principles in financial law. This code was developed in the vision of King Hammurabi and dealt with property laws, commerce, and also finance by means of an eye for an eye. An example from Hammurabi codes is as follows:

" If a merchant entrust money to an agent (broker) for some investment, and the broker suffer a loss in the place to which he goes, he shall make good the capital to the merchant.

If a merchant give an agent corn, wool, oil, or any other goods to transport, the agent shall give a receipt for the amount, and compensate the merchant therefor. Then he shall obtain a receipt form the merchant for the money that he gives the merchant.

If the agent accept money from the merchant, but have a quarrel with the merchant (denying the receipt), then shall the merchant swear before God and witnesses that he has given this money to the agent, and the agent shall pay him three times the sum."[7]

The differences between these religious approaches have created distinct economic landscapes between the East and the West.[8] In this regard difference between understanding of financial practices gave a huge advantage for Italian peninsula states that traded with the East for Western

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[5] Peter Bernholz, 'The Evolution of Financial Law: Ancient to Modern' in *Monetary Regimes and Inflation: History, Economic and Political Relationships* (2nd edn, Edward Elgar Publishing 2003) 41 53.

[6] Van Minnen, Peter. *"Agriculture and the 'Taxes-and-Trade' Model in Roman Egypt." Zeitschrift Für Papyrologie Und Epigraphik*, vol. 133, 2000, pp. 205–20. JSTOR, <http://www.jstor.org/stable/20190766> . Accessed 31 Oct. 2024.

[7] LW King, 'The Code of Hammurabi' (The Avalon Project, 2008) <https://avalon.law.yale.edu/ancient/hamframe.asp> accessed 31 October 2024.

[8] Kuran, Timur. *"Islam and Underdevelopment: An Old Puzzle Revisited." Journal of Institutional and Theoretical Economics (JITE) / Zeitschrift Für Die Gesamte Staatswissenschaft*, vol. 153, no. 1, 1997, pp. 41–71. *JSTOR*, <http://www.jstor.org/stable/40752985.> Accessed 31 Oct. 2024.

hemisphere. Their increasing trade also created a need for accounting and funding systems thus city states witnessed a new system named banking differentiated from mints and usury by creating imaginary personalities in banks accounts called legal entities.[9]

The expansion of banking in the North Italian city-states from the late medieval period in particular at places like Genoa, Venice and Florence established new concepts such as commercial trade within banks, double-entry bookkeeping, bills of exchange, and credit instruments and created laws on matters of risk, liability and interest.[10] This development was very unique since this expansion created laws that were all about standardizing and making secure transactions to make people accountable and to set legal precedents for financial practices within European nations. This laid the foundation for modern banking. [11]

b) Modern Understanding of Financial Law

When the age of discovery started in Europe, the desire of exploitation in new lands and resources gave rise to needs for new institutions. Companies for extraction and commerce emerged and they needed new markets and capitals. Crisis and booms in markets and flows of money shaped the law and civilizations. Central banking became an essential tool for financial policy and stock markets became absolute for corporate economies. However when the discovery of the world ended. For centuries new fields in finance and money took shape with more legal handwork.

The foundation of the Bank of England in 1694 represents the start of modern intervention in the history of financial law.[12] The new institution was capable of managing government debt, regulating interest rates and issuing notes as a reliable currency.[13] This Foundation changed monetary policies by creating a tool for ensuring stability and setting legal standards that other

[9] Timur Kuran, 'The Absence of the Corporation in Islamic Law: Origins and Persistence' (2005) 53 American Journal of Comparative Law 785.

[10] Meir Kohn, 'Risk Instruments in the Medieval and Early Modern Economy' (2001) 8(2) Financial History Review 165.

[11] Edwin S Hunt, 'The Medieval Super-Companies: A Study of the Peruzzi Company of Florence' (1971) 31(1) The Journal of Economic History 170.

[12] F Capie and G Wood, '*The Development of Central Banking'* (2001) 17(4) *Oxford Review of Economic Policy.*

[13] Note: There were paper money use or imaginary entities back in the day but in this paper we followed development of financial law customs by looking into modern financial laws history that result of western world culture.

states would later embrace to develop a global banking system.[14] The Industrial Revolution represented the enlargement of financial law as the rapid expansion of industry established the stock markets as an essential part of the Commercial sector by public funding with new laws for governing corporate structures, shareholder rights, and financial disclosure.[15] The *Joint Stock Companies Act of 1844* allowed companies to merge and work without a royal charter, making the corporate structure independent from any crown or state intervention. This law, followed by the *Limited Liability Act of 1855*, presented limited liability for shareholders, limiting their losses to the amount invested and reducing personal financial risk.[16]

Financial crises have historically acted as a stimulus for major finance law reforms, reshaping legal frameworks to address emerging vulnerabilities. The establishment of institutions like the International Monetary Fund and World Bank after the Bretton Woods Conference in 1944 was an early start of financial globalization and a measure against global economic crises and in this way stopping wars.[17] After World War II, there were ideas that economic incorporations and resource competition caused the Issues such as the Great Depression that provoked World War II in this regard encouraging economic corporations and granting financial plans should have solved the world peace problem.[18] Cold War politicians from both sides made decisions from this viewpoint but also during this time period a lot of financial and legal frameworks that were influenced by their contesting ideologies came into legislation.[19] Over time, additional legal frameworks appeared to solve specific failings such as The Basel Accords that setted global standards for capital requirements and risk management in banks influenced by Soviet risk management politics. After the Cold War, the world saw significant deregulation, because of the rise in neoliberal policy support, particularly with the repeal of the Glass-Steagall Act in

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[14] W Bagehot, *Lombard Street: A Description of the Money Market* (1873)< https://www.gutenberg.org/ > accessed 1 November 2024.

[15] R E Cameron, 'The Rise of Financial Capitalism: International Capital Markets in the Age of Reason' (1972) The Journal of Economic History 899.

[16] *Joint Stock Companies Act 1844* (7 & 8 Vict c 110) and Limited Liability Act 1855 (18 & 19 Vict c 133).

[17] Bordo, MD, and Eichengreen, B. *"Bretton Woods and the Great Inflation" (2013) 3 NBER Working Paper Series 98* and Burak Sayın, 'The Birth and Peculiarities of the Bretton Woods Institutions and the Main Features of the International Financial System They Brought About' (2011) 40(57) Annales De La Faculté De Droit d'Istanbul 155.

[18] B Eichengreen, 'Global Imbalances and the Lessons of Bretton Woods' (2010) 48(4) Journal of Policy Modeling 711

[19] Stiglitz, JE. "Globalization and Its Discontents" (2002) W W Norton & Company 121

the U.S., that created a divide between commercial and investment banking, leading to complex financial instruments which needed new legal frameworks.[20]

The 2008 financial crisis was a huge shock for markets. Expectations on the market's endless growth caused by the bloom of production, globalization and increase of variation in financial assets and instruments were broken. This started a more economical interventionism trend in policy making such as prompting laws like the *Dodd-Frank Act* in the U.S., which introduced stringent rules on bank capitalization, systemic risk monitoring, and consumer protection through the creation of the Consumer Financial Protection Bureau (CFPB).[21] In the modern age, the increasing awareness of environmental, social, and governmental topics started to initiate new standards for financial law, as companies are now required to be transparent about their environmental impact and social responsibility.[22] The Emergence of cryptocurrencies, digital assets, data privacy and cybersecurity concerns incite the world into creation and revision of legal frameworks as changing definitions, determining new rights and answering legal questions around ownership, transparency, and transaction security with new technological reality.

2. Sources of the financial law

a) International Conventions

International agreements in the area of banking and finance are the natural by-product of the dismantling of quantitative restrictions on domestic financial markets and international capital flows. Each convention seems to have one of three purposes. First, they may serve to facilitate the conduct of cross-border business. Second, international agreements may have as one of their objectives the deliberate expansion of cross-border competition in banking and finance. Lastly, the third purpose of international agreements is to promote or maintain financial

[20] Matthew Sherman, A Short History of Financial Deregulation in the United States (Center for Economic and Policy Research, July 2009) <www.cepr.net>.

[21] Financial Stability Oversight Council, 2019 Annual Report (2019) https://home.treasury.gov/system/files/261/FSOC2019AnnualReport.pdf

[22] Mark S. Bergman, Ariel J. Deckelbaum and others, '*Introduction to ESG*'(1 August 2020) <https://corpgov.law.harvard.edu/2020/08/01/introduction-to-esg/> .

stability. Agreements reached by various standing committees which meet at the Bank for International Settlements, under the aegis of the Governors of the Group of Ten, have been particularly important in this regard.[23]

In terms of bank regulation, few international agreements address the matter. Treaties, however, may contain provisions that impact the regulation of banks indirectly. For example, the Articles of Agreement that establish the IMF provide, inter alia, that the it shall oversee each member's compliance with its general obligations.

Perhaps the most important international agreements regarding bank regulation were formed with the establishment of the European Communities and the European Union. Because much of the impetus for a unified Europe has been economic, the treaties and other agreements leading up to and establishing the European Union have had a direct impact on bank regulation at the national level and have prompted extensive examination of bank supervision from a supranational perspective. One of the objectives of the European Communities has been to create a unified internal market, including a single European market in financial services. Thus, a substantial body of European Law has developed to ensure uniform regulatory standards among Member States.[24]

b) International Custom

Customary law is the set of customs, practices and beliefs that are accepted as obligatory rules of conduct by a community.[25] International Customary Law refers to obligations that arise from established state practice and opinio juris[26] rather than from formal agreements such as treaties. Customary law is often administered at the local level in accordance with tradition and dispute resolution mechanisms. However, in some countries, it is enforced within the modern court system. Some national court systems require that customary law principles be proven as a

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[23] International Agreements In the Area of Banking and Finance: Accomplishments and Outstanding Issues William R. White October 1996.

[24] Sources of Financial Regulation, Uni Wuppertal,https://welfens.wiwi.uni-wuppertal.de/fileadmin/welfens/daten/Skripte/SS12/Sources_of_Financial_Regulation.pdf accessed October 27, 2024.

[25]World Intellectual Property Organization, Customary Law and Property Law, https://www.wipo.int/tk/en/indigenous/customary_law/index.html accessed November 4, 2024.

[26] Opinio juris is a shortened form of the Latin phrase "opinio juris sive necessitatis," which means "an opinion of law or necessity.".

question of fact, whereas others permit proof through written documents or prior legal decisions. Many countries that formally recognize customary law require that its enforcement not in conflict with any statute, public policy, or enumerated values and principles.[27]

International customary law was superseded to a large extent by the proliferation of investment treaties in the late 1980s and early 1990s. However, many experts claim that customary law is still a significant source of international investment law and has had a resurgence with the basic rules of the investment protection regime achieving customary status. These basic rules include International Minimum Standard, Fair and Equitable Treatment, Protection against Expropriation, Standards of Compensation, Denial of Justice, and Due Process[28].[29]

c) General Principles

i. National Treatment

National treatment, often thought of as a principle of non-discrimination, is a standard trope of trade treaties. In financial regulation, national treatment is designed to ensure that domestic financial institutions are treated in the same manner as foreign ones. Article III of the General Agreement on Tariffs and Trade (GATT) offers perhaps the best-known public law articulation of this principle:

"The contracting parties recognize that . .. regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products,... should not be applied to imported or domestic products so as to afford protection to domestic production."[30]

In international financial regulation, national treatment drives harmonization efforts a diverse as the capital adequacy requirements across countries to the efforts to develop a single set of

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[27] Judiciaries Worldwide, Customary Law, https://judiciariesworldwide.fjc.gov/customary-law , accessed November 4, 2024.

[28] Due process of law is application by the state of all legal rules and principles pertaining to a case so all legal rights that are owed to a person are respected. Due process balances the power of law of the land and protects the individual person from it.

[29] Jean d'Aspremont, 'International Customary Investment Law: Story of a Paradox' in Tarcisio Gazzini, Eric De Brabandere (eds) International Investment Law: the Sources of Rights and Obligations ,Martinus Nijhoff, 2012.

[30]General Agreement on Tariffs and Trade, art. III(1), Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S.

194.

global accounting principles, as the tax information disclosures required of banks. National treatment is about the creation of a "level playing field" for international banks and was one of the stated goals of the Basel process[31]. In both trade and finance, the international rule is directed at domestic regulators, requiring them not to discriminate against foreign institutions.[32]

ii. Most Favored Nation

While an *Most Favored Nation* (MFN) principle is slightly less obvious in financial regulation, it also characterizes the way the financial networks operate. The Word Trade Organization (WTO) defines its own MFN principle as follows:

Under the WTO agreements, countries cannot normally discriminate between their trading partners. Grant someone a special favour (such as a lower customs duty rate for one of their products) and you have to do the same for all other WTO members. [33]

iii. Rulemaking

If national treatment and a *de facto* MFN principle are the two institutional pillars of global financial regulation on which the particular substantive commitments of the genre are built, the third principle of the process is a procedural one. International financial regulation proceeds through rulemaking rather than adjudication. Regulation through rulemaking classically involves the promulgation of standards of general applicability that apply prospectively.

The U.S. Supreme Court has characterized rulemaking as a regulatory version of legislation. It is the mechanism that has produced the Basel Capital Accords[34], with each of the three iterations having been promulgated after increasingly elaborate notice and comment periods, as well as the principles that guide the interstitial work of International Organization of

[31] The Basel Process refers to the way in which the Bank for International Settlements (BIS) promotes international cooperation among monetary authorities and financial supervisory officials.

[32] Thomas Cottier & Markus Krajewski, What Role for Non-Discrimination and Prudential Standard.

[33] Principles of the Trading System, WTO, http://tinyurl.com/yfe7z2v , accessed October 28, 2024.

[34] The Basel Accords are a series of three sequential banking regulation agreements (Basel I, II, and III) set by the Basel Committee on Bank Supervision (BCBS).

Securities Commissions (IOSCO), the international securities regulator, the international insurance regulator.

Conventionally, the alternative procedural vehicle for regulators seeking to implement policy is adjudication [35] Just as happens through the judge-made common law, it is perfectly possible to create and elaborate a body of law through precedent; domestic agencies such as the National Labor Relations Board have operated through adjudication almost exclusively.[36] International financial regulators, however, have no dispute settlement process, and there is little prospect of one arising in the future. Unlike in domestic administrative law, where agencies can usually choose between one or the other, adjudication is not an alternative to rulemaking. Internationally, rules are the only sort of regulation available.

iv. Subsidiarity

If financial rulemaking has gone global and is now conducted through international networks, enforcement and application of the rules is handled very differently. This principle of subsidiarity has been embedded within the structure of the networks themselves, given their lack of executive or judicial functions. Tiny secretariats oversee international financial regulation through networks, and none of them purport to be able to deal with cross-border transactions or multijurisdictional insolvencies, or any of the areas that the networks assert to regulate. Additionally, there is no dispute resolution process, as there is with the WTO, in which agencies who shirk or violate their financial regulatory responsibilities might be sued into compliance by aggrieved parties.[37]

v. Peer Review

The subsidiarity approach has been paired with a unique form of oversight over domestic application of the soft international law of finance namely: peer review. Sometimes, this review is contracted out, as a business might do with a consultant. The regulators occasionally use international organizations like the World Bank or the IMF to monitor their peers, but often it

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[35] Jeffrey Rachlinski, Rulemaking Versus Adjudication:A Psychological Perspective, 32 FLA. ST. U. L. REV. 529, 529-30 (2005).

[36]Charles H. Koch, Jr., Policy making by the Administraive judiciag, Spring 2004.

[37] David Zaring, 'Finding Legal Principle in Global Financial Regulation' (2012) 52 Va J Int'l L 683.

is conducted by the other members of the regulatory networks themselves. The Financial Stability Board (FSB) exemplifies how this peer review system works. Once its members pass rules that the FSB, or the networks under it, presumably for their prospect of promoting financial stability, the Board conducts regular reviews of both the membership, on a country-by- country basis, and of particular issues for all the FSB members at once.

Peer review makes particular sense for international financial regulation, where much of the point is to ensure that the same sort of work is being done in the same sort of way. It encourages regulators to learn from one another, and in this way, it incentivizes the search for best practices that is a popular goal of good governance mavens.[38] But peer review, as a compliance mechanism, has obvious disadvantages as well. Enforcement subsidiarity, even if bolstered by peer review, is certainly not a recipe for perfect compliance; it leaves, at least in theory, the decision of whether or not to do what the network has asked its members to do up to those members and simply makes violation clear.

vi. Network Governance

Networks exhibit *"patterns of regular and purposive relations among like government units working across the borders that divide countries from one another and that demarcate the 'domestic' from the 'international' sphere."*[39] These transgovernmental arrangements began, at least in the modern, most successful variant, with the Basel Committee in 1974; their subsequent spread across many different areas of regulation have made them research darlings of the legal academy for the past decade and a half. For financial regulation, networks are the vehicles through which the principles of subsidiarity and national treatment, and the forms of rulemaking and peer review, find expression.[40]

[38] See David Zaring, Best Practices,81 N.Y.U. L. REV. 294 (2006).

[39] Slaughter, supra note 32, at 14.

[40] David Zaring, 'Finding Legal Principle in Global Financial Regulation' (2012) 52 Va J Int'l L 683.

3. Basic Principles of the Financial Law

a) Principle of Free Market and Competition

Adam Smith, known as the father of modern economics, defined markets as a place where everybody's actions for individual self-interest in total contribute to the overall good of society and any intervention to this market dynamics harms the society. According to him, an invisible hand of the market is regulates and renovates itself against changes and crises. From his ideas a philosophy named classical liberalism started in western world and over the centuries. John Stuart Mill argued that people should have the freedom to make economic and personal decisions without interference, as long as their actions did not harm others but also said he believed governments could step in to prevent monopolies, protect consumers. Friedrich Hayek, an economist who worked on price and free market, argued that extensive government intervention would lead to economic inefficiency and, ultimately, the loss of individual freedoms and argued that financial laws should encourage competition and protect property rights rather than seek to control or direct market outcomes expanded upon these principles. Classical Liberals advocated for minimal government intervention and highlighting the role of competition in enhancing social welfare and fostering economic advancement. State policies and public interest of some social class sometimes crashed with the liberal ideas such as market freedom, competitive practices, and individual liberties so classical liberal demands restricted by needs and ambitions of them.

b) Principle of Regulation and State Intervention

During periods of economic crisis, classical liberals accused the state intervention for crises, and challenged the values of classic liberals as the times of major economic downturns that exposed unpleasant sides in markets. Politicians and thinkers highlighted the need for government intervention to stabilize the economy and protect public welfare. This shift was influenced by the ideas of economist John Maynard Keynes who argued that during times of crisis, government intervention is essential to stimulate demand and reduce unemployment. Keynes claimed that efficient markets sometimes need guidance and involvement to stabilize the economy. According to interventionists, to prevent new crises and protect the public interest, the state could take a step into the market and define the standards and rules. The Cold War period saw a rise in interventionist politics with welfare state ideas but in the end of the

Cold war, globalization kept the classical liberal value of competition as consideration for policy makers.

c) Principle of Investor and Consumer Protection

Globalization of markets invoked new problems with investors and consumers. After the Cold War, the opening of new markets in former Eastern Bloc countries, advancements in technology, and the cost-reducing impact of East Asian production altered stock and commerce markets globally. Alteration also introduced risks, such as corruption, limited public awareness, and challenges in adapting to new economic realities, health and safety risks from lower-standard products. These realities force the policy makers and global institutions to have stronger legal frameworks to protect public interest globally. In the past the welfare state idea protected the citizens from domestic issues with its domestic legal frameworks but new institutions or demand for new economical instruments also come along with fraud and market manipulation. Inside trading, money laundering[41] and frauds force the states to take measures against them with more regulations.

d) Principle of Transparency and Disclosure

The markets generally operate by bilateral contracts such as the buyer and the seller or the lessee and the lessor but the policy makers have not to choose a side in their politics as the nature of the market could causes issues or unfairness. From the classic liberal school, the rights of ownership or means of production have been regulated and checked by the institutions and the state in regard of public interest. Business in the stock market is more regulated and checked than the others as not just producing value but being a value brings potentials for fraud and manipulations in the market. Any true, false or hidden knowledge on business's future value or plan could affect the value of business with limited public access on that information that could hurt public investors is a contradiction with fair market ideas. For protection of the market and investors, the state and institutions have to ensure transparency and disclosure.

[41] Money laundering is a criminal concept as money or financial assets that came from illegal sources go through a process for legalization. For a example, Look into Arthur Budovsky case.

I. INTRODUCTION TO THE UNITED STATES OF DISTRICT COURT

1. History

The United States District Courts were established as a part of the federal judiciary system by the *Judiciary Act of 1789*. This act introduced the first federal courts across the country to enforce federal laws and handle federal cases.

The Judiciary Act of 1789, officially titled "An Act to Establish the Judicial Courts of the United States," was principally authored by Senators Oliver Ellsworth and William Paterson and signed into law by Pres. George Washington on September 24, 1789. The act's creators, by essentially all accounts, viewed it as a work in progress. Although indeed amended throughout the years, the basic outline it provided has remained largely intact.[42]

The act established a three-part judiciary made up of district courts, circuit courts and the Supreme Court and outlined the structure and jurisdiction of each branch.

2. Structure

The federal court system has three main levels: district courts (the trial court), circuit courts which are the first level of appeal, and the Supreme Court of the United States, the final level of appeal in the federal system. There are 94 district courts, 13 circuit courts, and one Supreme Court throughout in the country.

Courts in the federal system work differently in many ways than state courts. The primary difference for civil cases , as opposed to criminal cases, is the types of cases that can be heard in the federal system. Federal courts are courts of limited jurisdiction, meaning they can only hear cases authorized by the United States Constitution or federal statutes. The federal district court is the starting point for any case arising under federal statutes, the Constitution, or treaties. This type of jurisdiction is called "original jurisdiction." Sometimes, the jurisdiction of state courts will overlap with that of federal courts, meaning that certain cases can be brought in both courts. The plaintiff has the initial choice of bringing the case in state or federal court. However, if the plaintiff chooses state court, the defendant may sometimes choose to "remove" the matter to federal court.

[42]National Archives, The Judiciary Act of 1789, https://www.archives.gov/milestone-documents/federal-judiciary-act , accessed October 26, 2024.

The district courts are the general trial courts of the federal court system. Each district court has at least one United States District Judge, appointed by the President and confirmed by the Senate for a life term. District courts oversee trials within the federal court system – both civil and criminal. The districts are the same as those for the U.S. Attorneys, and the U.S. Attorney is the primary prosecutor for the federal government in his or her respective area.

District court judges are responsible for managing the court and supervising the court's employees. They are able to continue to serve so long as they maintain "good behavior," and they can be impeached and removed by Congress. There are over 670 district court judges nationwide.[43]

Some tasks of the district court are given to federal magistrate judges. Magistrates are appointed by the district court by a majority vote of the judges and serve for a term of eight years if full-time and four years if part-time, but they can be reappointed after completion of their term. In criminal matters, magistrate judges may oversee certain cases, issue search warrants and arrest warrants, conduct initial hearings, set bail, decide certain motions (such as a motion to suppress evidence), and other similar actions. In civil cases, magistrates often handle a variety of issues such as pre-trial motions and discovery.

Federal trial courts have also been established for a few subject-specific areas. Each federal district also has a bankruptcy court for those proceedings. Additionally, some courts have nationwide jurisdiction for issues such as tax (United States Tax Court), claims against the federal government (United States Court of Federal Claims), and international trade (United States Court of International Trade).[44]

3. Jurisdiction

The jurisdiction of the U.S. District Courts is provided under *United States Code* as follows:

1329: The district courts of the United States shall have jurisdiction of all causes, civil and criminal, brought by the United States that arise under the provisions of this subchapter. It shall be the duty of the United States attorney of the proper district to prosecute every such suit

[43]Introduction to The Federal Court System, U.S. Department of Justice,https://www.justice.gov/usao/justice-101/federal-courts accessed October 27, 2024.

[44] Ibid.

when brought by the United States. Notwithstanding any other law, such prosecutions or suits may be instituted at any place in the United States at which the violation may occur or at which the person charged with a violation under section 1325 or 1326 of this title may be apprehended. No suit or proceeding for a violation of any of the provisions of this subchapter shall be settled, compromised, or discontinued without the consent of the court in which it is pending and any such settlement, compromise, or discontinuance shall be entered of record with the reasons therefor. Nothing in this section shall be construed as providing jurisdiction for suits against the United States or its agencies or officers.[45]

As part of their general jurisdiction, state courts have concurrent jurisdiction to hear most cases that raise issues under the Constitution or federal law. Congress may enact legislation providing that certain claims arising under federal law may be heard only in federal court. However, unless Congress expressly or implicitly provides for exclusive federal court jurisdiction, a case raising federal law claims may proceed in either state or federal court. The role of state courts in applying federal law dates back to the Founding.[46]

4. Applicable sources of law

a) Procedural Sources

United States district courts and courts of appeals often prescribe local rules governing practice and procedure. Such rules must be consistent with both Acts of Congress and the Federal Rules of Practice and Procedure, and may only be prescribed after notice and an opportunity for public comment. A court's authority to prescribe local rules is governed by both statute and the Federal Rules of Practice and Procedure. Section 205 of the E-Government Act of 2002[47] requires that federal courts post local rules on their websites.[48]

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[45] United States Code, 8 USC 1329: Jurisdiction of district courts, From Title 8-Part VIII-General Penalty Provisions.

[46] Congressional Research Service, Federal and State Courts: Structure and Interaction August 2, 2023.

[47] Pub. L. No. 107-347.

[48] Current Rules of Practice & Procedure,https://www.uscourts.gov/rules-policies/current-rules-practice-procedure accessed October 27, 2024.

b) Substantive Sources

State courts are authorized to apply federal law in many types of cases and are required to apply federal law when it governs a dispute. While state courts may interpret and apply federal law, the Supreme Court is the final authority on the meaning of federal law. Decisions of the Supreme Court interpreting the Constitution and federal laws and treaties are binding on state courts as well as on the lower federal courts.[49]

III. INTRODUCTION TO BLOCKCHAIN

1. History of Blockchain Technology

a) Before the Bitcoin Era

In 1979, one of the early pre-blockchain technologies is the Merkle tree[50], named after computer scientist and mathematician Ralph Merkle. He described an approach to public key distribution and digital signatures called tree authentication in his PhD thesis for Stanford University. Merkle eventually patented this idea as a method for providing digital signatures.

In 1982, in his PhD dissertation for the University of California, Berkeley, David Chaum described a vault system for establishing, maintaining and trusting computer systems among mutually suspicious groups. The system embodied many of the elements that comprise a blockchain. Another important development is the beginning of the *Proof of Work*[51] (PoW) concept were published in a paper by Cynthia Dwork and Moni Naor to provide "a computational technique for combatting junk mail, in particular, and controlling access to a shared resource, in general."[52] In 1997, Adam Black introduced hashcash, a PoW algorithm that provided denial of service countermeasures.

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[49] See generally Cong. Rsch. Serv., Overview of Supremacy Clause, CONSTITUTION ANNOTATED, https://constitution.congress.gov/browse/essay/art VI-C2-1/ALDE_00013395/ accessed November 2, 2024.

[50] The Merkle tree provides a data structure for verifying individual records.

[51] Proof-of-work (PoW) is a blockchain consensus mechanism that incentivizes network validation by rewarding miners for adding computational power and difficulty to the network. It is a lottery system where miners increase their likelihood of receiving the reward the more power they add.

[52] A Timeline and History of Blockchain Technology, TechTarget, accessed November 21,2024.

Markus Jakobsson and Ari Juels published the term proof of work. Also, the peer- to- peer (P2P)[53] network was popularized by the now defunct peer-to-peer file sharing application Napster in 1999. Some argued that Napster was not a true P2P network because it used a centralized server. But the service still helped breathe life into the P2P network, making it possible to build a distributed system that could benefit from the compute power and storage capacity of thousands of computers. In 2000, Stefan Konst introduced the concept of cryptographically secured chains in his paper "Secure Log Files Based on Cryptographically Concatenated Entries." His model, which showed that entries in the chain can be traced back from the Genesis block[54] to prove authenticity, was the basis for today's blockchain models. Subsequently, Hal Finney introduced reusable PoW, a mechanism for receiving a non-exchangeable hashcash token in return for a Rivest-Shamir-Adleman (RSA)[55]-signed token. The PoW approach today plays a vital role in Bitcoin mining. Cryptocurrencies like Bitcoin and Litecoin use PoW, and Ethereum shifted to the proof-of-stake protocol to secure a network using a fraction of the energy that PoW uses.

In 2008, Satoshi Nakamoto, thought to be a pseudonym used by an individual published a white paper introducing the concept of cryptocurrency and blockchain and helped develop the first Bitcoin software. Blockchain infrastructure, according to the white paper, would support secure P2P transactions without the need for trusted third parties such as banks or governments. The Bitcoin/blockchain architecture was introduced and built on technologies and concepts from the previous three decades. Nakamoto's design also presented the concept of a "chain of blocks," making it possible to add blocks without requiring them to be signed by a trusted third party. Nakamoto defined an electronic coin as a "chain of digital signatures," in which each owner transfers the coin to the next owner by *"digitally signing a hash of the previous transaction and the public key of the next owner and adding these to the end of the coin."*[56]

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[53] Peer-to-peer (P2P) is a decentralized communications model in which each party has the same capabilities and either party can initiate a communication session.

[54] A genesis block is the first block of a block chain. Modern versions of Bitcoin number it as block 0, though very early versions counted it as block 1. The genesis block is almost always hardcoded into the software of the applications that utilize its block chain.

[55] The Rivest-Shamir-Adleman (RSA) encryption algorithm is an asymmetric encryption algorithm that is widely used in many products and services.

[56] A Timeline and History of Blockchain Technology, TechTarget, accessed November 21, 2024.

In 2009, Cryptocurrency was launched during the Great Recession[57], when the government pumped large amounts of money into the economy. Bitcoin was worth less than a penny then. Nakamoto mined the first Bitcoin block, validating the blockchain concept. The block contained 50 bitcoins and was known as the Genesis block namely block 0. Nakamoto released Bitcoin v0.1 to the web service SourceForge as open - source software. The first Bitcoin transaction took place when Nakamoto sent Hal Finney 10 bitcoins in block 170. The first Bitcoin exchange, Bitcoin Market, was established, enabling people to exchange paper money for bitcoin. Nakamoto launched the Bitcoin Talk forum to share Bitcoin-related news and information.

b) After Bitcoin Era

In 2013, Bitcoin's upward trajectory continued. In February, Coinbase reported selling $1 million worth of bitcoin in a single month at more than $22 each. By the end of March, with 11 million bitcoins in circulation, the currency's total value exceeded $1 billion. In October, the first reported bitcoin ATM launched in a Vancouver, B.C., coffee shop but it wasn't entire good news for digital currency. Both Thailand and China banned cryptocurrencies. The U.S. Federal Court seized Mt. Gox's[58] funds in the U.S. for transmitting money without a license and the FBI shut down the dark web marketplace Silk Road, confiscating about 144,000 bitcoin worth more than $1 billion.

In 2014, despite setbacks, one of the more important milestones in blockchain's history occurred when Bitcoin Magazine co-founder Buterin published a white paper[59] proposing a decentralized application platform, leading to the creation of Ethereum and the Ethereum Foundation. Ethereum paved the way for blockchain technology to be used for applications other than cryptocurrency. It introduced smart contracts and provided developers with a platform for building decentralized applications. Financial institutions and other industries began to recognize and explore blockchain's potential, shifting their focus from digital currency to the development of blockchain technologies. The Mt. Gox Bitcoin exchange filed for

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[57] The Great Recession was the sharp decline in economic activity that started in 2007 and lasted several years, spilling into global economies.

[58]Mt. Gox was a bitcoin exchange based in Shibuya, Tokyo, Japan. Launched in 2010, it was handling over 70% of all bitcoin transactions worldwide by early 2014, when it abruptly ceased operations amid revelations of its involvement in the loss/theft of hundreds of thousands of bitcoins, then worth hundreds of millions in US dollars.

[59] A whitepaper is a persuasive, authoritative, in-depth report on a specific topic that presents a problem and provides a solution. Marketers create whitepapers to educate their audience about a particular issue, or explain and promote a particular methodology.

bankruptcy. The Bitcoin Foundation vice chairperson was arrested for money laundering and the U.K. tax authority classified bitcoin as private money. Yet several companies accepted bitcoin by year's end, including the Chicago Sun-Times, Overstock.com, Microsoft, PayPal and Expedia. Bitcoin's acceptance only added fuel to blockchain's fire. In 2015, The Ethereum Frontier network launched, enabling developers to write smart contracts and decentralized apps that could be deployed to a live network. Ethereum was on its way to becoming one of the biggest applications of blockchain technology. It drew in an active developer community that continues to this day. After a year, the term blockchain gained acceptance as a single word, rather than being treated as two concepts, as they were in Nakamoto's original paper. Bitcoin hit a record high of nearly $20,000 ,in 2017. Japan recognized bitcoin a legal currency. Seven European banks formed the Digital Trade Chain Consortium to develop a trade finance platform based on blockchain. In 2019, Amazon announced the general availability of its Amazon Managed Blockchain service on Amazon Web Services to help users build resilient Web 3.0 applications on public and private blockchains. Ethereum network transactions exceeded one million per day. Blockchain research and development took central stage stage as organizations embraced blockchain technology and decentralized applications for a variety of use cases.

Ultimately , the bad news for cryptocurrency continued as the Securities and Exchange Commission (SEC) indicted executives at the Coinbase and Binance exchanges and filed charges against crypto-asset entrepreneur Justin Sun and three of his wholly owned companies for the unregistered offer and sale of crypto-asset securities. Businesses are still moving ahead with blockchain, but they're proceeding with greater caution. While blockchain technology has been mostly applicable to finance services and banking, other viable applications include gaming, media and entertainment, real estate, healthcare, cybersecurity, smart contracts, non-fungible token (NFT)[60], transportation, supply chain management and the government.[61]

There are four types of blockchains. Public blockchains embody the essence of decentralization, offering every participant an equal footing in the network. Public blockchains excel in trust and security. Private Blockchain operates within restricted environments such as closed networks or under single-entity control. Furthermore, these blockchains are smaller and

[60] A non-fungible token (NFT) is a unique digital identifier that is recorded on a blockchain and is used to certify ownership and authenticity. It cannot be copied, substituted, or subdivided.

[61] A Timeline and History of Blockchain Technology, TechTarget, accessed November 21, 2024.

offer a more controlled setting than their public counterparts, earning them designations like permission or enterprise blockchains.[62] Hybrid Blockchain a significant innovation in blockchain types, merges the characteristics of private and public blockchains. This type of blockchain allows organizations to set up a unique framework where a private, permission-based system coexists with a public, unauthorized one. Consortium Blockchain is a sophisticated category in the diverse types of blockchain, combines elements of both private and public blockchains. This type of blockchain is distinguished by the collaboration of multiple organizational members on a decentralized network. [63]

2. The Functioning of Blockchain

"Commerce on the Internet has come to rely almost exclusively on financial institutions serving as trusted third parties to process ***electronic payments****... These costs and payment uncertainties can be avoided in person by using physical currency, but no mechanism exists to make payments over a communications channel without a trusted party.*

What is needed is an electronic payment system based on ***cryptographic proof*** *instead of trust, allowing any two willing parties to transact directly with each other* ***without the need for a trusted third party****. Transactions that are computationally impractical to reverse would protect sellers from fraud, and routine escrow mechanisms could easily be implemented to protect buyers. In this paper, we propose a solution to the* ***double-spending problem*** *using a* ***peer-to-peer distributed timestamp server*** *to generate computational proof of the chronological order of transactions. The system is secure as long as honest nodes collectively control more* ***CPU power*** *than any cooperating group of attacker nodes."*[64]

Blockchain Technology begins with Satoshi Nakamato's words as the reasons for the need of the present technology and basic principles explained by the founder. Costs of transfers,

[62] Ibid.

[63] Ibid.

[64] Nakamoto, S. (2008) Bitcoin: A Peer-to-Peer Electronic Cash System. https://bitcoin.org/bitcoin.pdf .

dependence on centralized institutions for transaction verification and trustability of trade in the digital sphere, created a block and chain system with decentralized but reliable nodes for transactions. Blockchain offered increased transparency, reduced costs, and enhanced security for industries. To understand blockchain technology, we have to look into Satoshi's paper.

a) Original Structure of Blockchain Technology

Satoshi Nakamoto described the new distributed digital ledger's (DLT) structure[65] as blocks[66] and chains[67] that operate by digitally signing hashes[68] for transactions.[69] Coins or chain of

digital signatures' ownership are transferred by digitally signing a hash of the previous transaction and the next owner's public key, appending them to the coin, which can be verified by the payee.

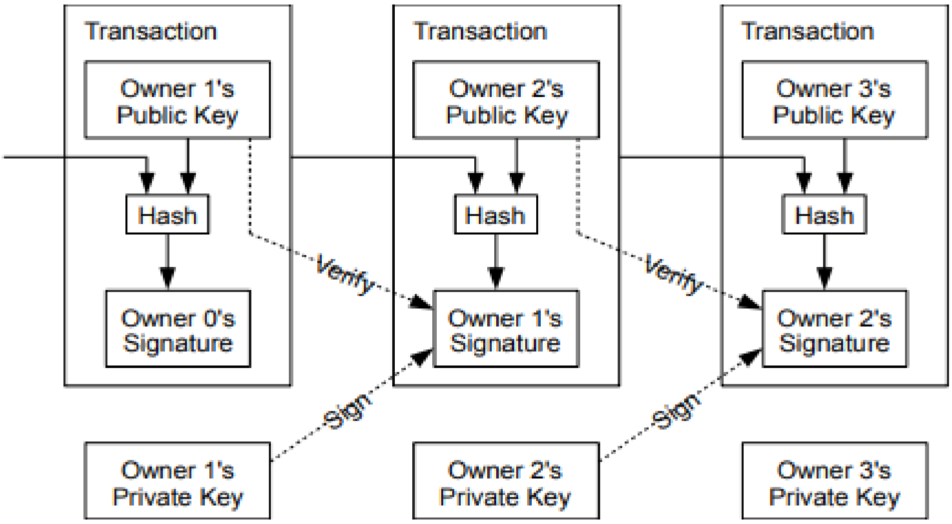

Image I: Structure of Hash System[70]

[65] Distributed digital ledger is a database replicated across multiple nodes without central authority.

[66] A block is a unit of data that contains a list of transactions, a timestamp, and a unique identifier called a hash, which secures the block and links it to previous blocks.

[67] A chain is a connected series of blocks that creates an unbreakable sequence. Every singular link between blocks is a reference.

[68] Hashing is a cryptographic process that converts input data into a fixed-size string of characters, serving as a unique digital fingerprint for the data, ensuring its integrity and security in blockchain technology.

[69] I. Islam et al., *"A critical review of concepts, benefits, and pitfalls of blockchain technology using concept map," IEEE Access* 8 (2020): 68333-68341.

[70] Nakamoto (n 70).

This novelty of blockchain technology started with finding a solution to stop double-spending in coins. The solution starts with a timestamp server that secures data by hashing a block of items, publishing the hash widely, and linking it to previous timestamps in a chain during all procedures; everything has to be publicly announced thus ensuring immutability and transparency.[71] The public can observe that a transaction is occurring between two parties but without any information linking the transaction to specific individuals. This is similar to the stock market where the time and size of trades are publicly available but the information of the traders remains undisclosed.

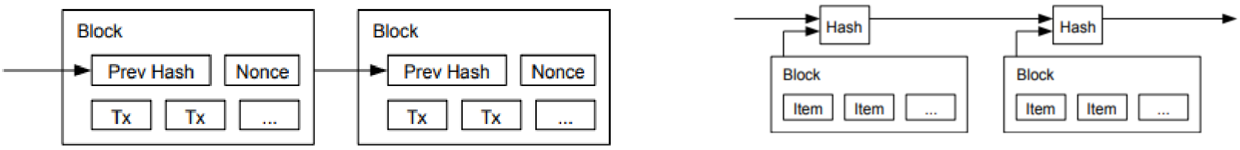

Image II:Nonce and Timestamp Systems of Blockchain.[72]

A (PoW)[73] requires computational effort to find a nonce[74] That number is used only once and produces a specific number of leading zeros. Once a block satisfies the proof-of-work, it becomes difficult to alter as it would necessitate recalculating all subsequent blocks in the chain by stopping a double-spend situation. To implement PoW as a consensus model, the specialized users known as miners compete to solve complex cryptographic puzzles that require substantial computational power. The miner who first solves a puzzle successfully, validates a block of transactions, which is then added to the blockchain. Also, PoW systems create fair representation by aligning decision power with computational effort or central processing unit (CPU) effort, preventing manipulation by those with multiple IP addresses in the creation of

[71] W. Zhao, *"On Blockchain: Design Principle, Building Blocks, Core Innovations, and Misconceptions," IEEE Systems, Man, and Cybernetics Magazine* 8, no. 4 (2022): 6-14, doi:10.1109/MSMC.2022.3192658.

[72] Nakamoto (n 70).

[73] For more details, look into Byzantine General Problem.

[74] A nonce is a random number used to prevent replay attacks in cryptographic protocols. It can be combined with a timestamp to enhance security, but this necessitates synchronized clocks between the communicating nodes.

blockchains. From the genesis block creation, a system given an option for a new block can be created by miners with CPU effort. The network's security came by maintaining a consistent block generation rate. The longest chain is always considered valid, and nodes[75] will switch to the longer chain in case of forks[76]. Transaction and block broadcasts are resilient to network delays and message loss by nodes that missed a block will request it from other nodes.[77] For sustainability, the system gives a coin for the first transaction validation in a block to effort owner miners and by doing this, solves the mint[78] deficit as the system does not have any central operation for controlling and issuing new coins.

For reliability, systems give an opportunity to cheat by taking back the payments or using the cost that is enough for cheating to generate new coins by being a miner. For the verification process, the classic procedure was sending all the data to one central network but the new system works by referencing transactions' position in the blockchain. Users can observe that a network node has added it to the chain by past hashes that are contained and checked by preceding blocks. The following blocks appended to the chain reinforce the network's acceptance of the transaction. According to Nakamoto, systems principal network working can be described step by step:

1) *New transactions are broadcast to all nodes.* (Shared Database for Transparency)

Transaction is done by digitally signing it with a private key, specifying the sender, recipient, and transfer amount.

2) Each node collects new transactions into a block.

3) Each node works on finding a difficult proof-of-work for its block.

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[75] An individual system or user within the blockchain network.

[76] Changes to a blockchain network's protocol and data structures are called forks that can be divided into two categories: soft forks and hard forks. For a soft fork, these changes are backwards compatible with nodes that have not been updated. For a hard fork, these changes are not backwards compatible because the nodes that have not been updated will reject the blocks following the changes.

[77] Yaga, D., Mell, P., Roby, N., & Scarfone, K., *Blockchain Technology Overview (National Institute of Standards and Technology, US Department of Commerce 2018) NISTIR 8202* https://doi.org/10.6028/NIST.IR.8202 accessed 9 November 2024.

[78] Minting is the process by which new tokens or coins are created and introduced into a blockchain network. This can be done as part of a consensus mechanism or by pre-defined rules.

Miners turn the transactions data into a block which contains timestamps and cryptographic hashes of the previous block in the chain.

4) When a node finds a proof-of-work, it broadcasts the block to all nodes.

5) Nodes accept the block only if all transactions in it are valid and not already spent. (Verification)

When two valid blocks are mined at nearly the same time nodes, follow the longest chain.

6) Nodes express their acceptance of the block by working on creating the next block in the chain, using the hash of the accepted block as the previous hash.[79]

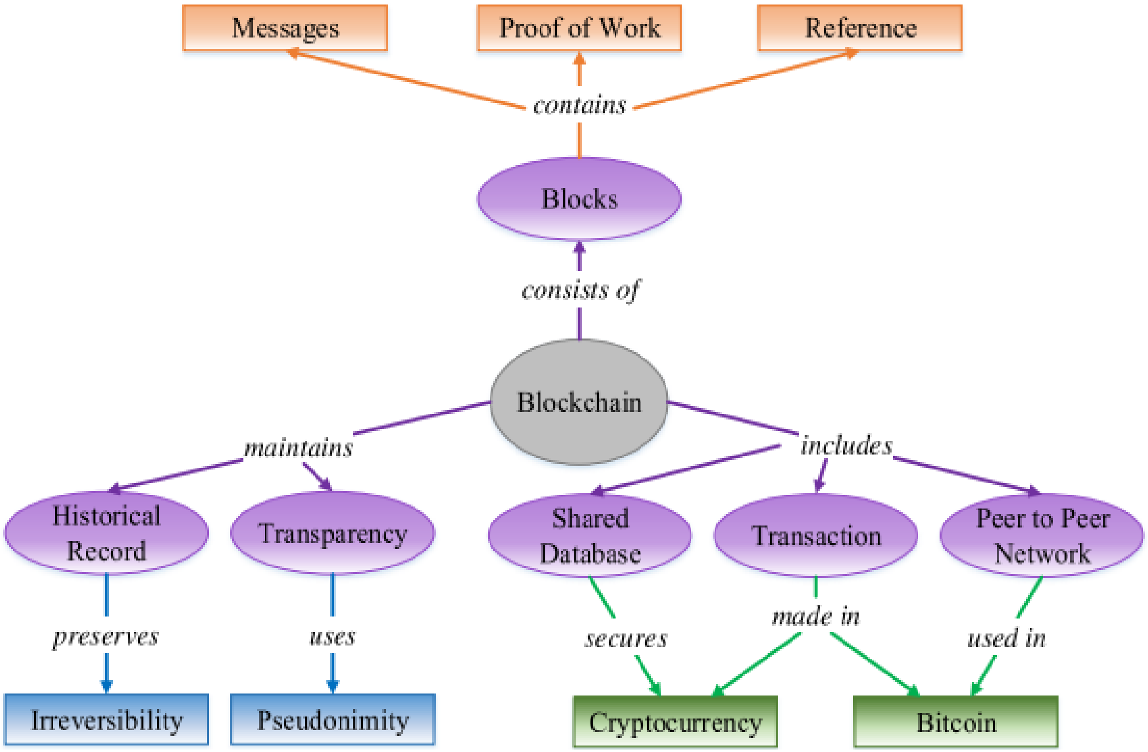

Image III: Concept Map of Blockchain[80]

b) Other Concepts in Blockchain Technology

After Nakamoto, Blockchain's utilization expanded into fields with new innovative models and ideas for security and decentralization. Classical PoW worked well as a consensus model but its high cost issue became a huge problem for other emerging blockchain projects. As an

[79]Nakamoto (n 61).

[80] Islam (n 66).

example, Proof of Stake (PoS) blockchains reward users with the right to validate blocks based on the amount of cryptocurrency they own in their stakes. Round Robin consensus gives turns by predefined order for publishing nodes. It's efficient and energy-friendly however it requires a high level of trust among nodes.[81]

Growth and expansion in use of technology fields also came with automation needs for transactions. The smart contracts dated before the blockchain technology but their active use also expanded with it. They are defined as "*a computerized transaction protocol that executes the terms of a contract. The general objectives of smart contract design are to satisfy common contractual conditions (such as payment terms, liens, confidentiality, and even enforcement), minimize exceptions both malicious and accidental, and minimize the need for trusted intermediaries*" by Nick Szabo.[82] Blockchain technology created an opportunity by its decentralized nature as without any bank or middleman, contracts can be signed when they are needed in the digital world.

Huge transactions, the need for a value storage in digital asset trading and active digital market usage required a new concept. For these requirements, stablecoins are created to facilitate the trading, lending, and borrowing of digital assets without losing value in exchange and reliance on fiat currency. They are fixed-rate currencies. Stablecoins are backed by reserve assets, which involve secure holdings like deposits like U.S. Treasury bills or corporate bonds. There are three asset types: Real-world asset-backed stablecoins are backed by actual assets held in trust or at a bank, and can be redeemed for these assets on a one-to-one basis.[83] Virtual asset-backed type stablecoins are backed by virtual assets, such as a portfolio of cryptocurrencies instead of being backed by real-world assets. Algorithmic stablecoins use algorithms to control the cryptocurrency supply or the supply of the pools of cryptocurrency collateral to maintain a flat value.

Market participants can earn returns on their stablecoin holdings by transferring them to digital asset trading platforms, where they may earn interest or rewards. Additionally, stablecoins can

[81] Yaga (n 70).

[82] Ibid.

[83] United States Government Accountability Office. (2022). *Blockchain: Emerging Technology Offers Benefits for Some Applications but Faces Challenges.* Washington, DC: United States Government Accountability Office. Report to Congressional Requesters. GAO-22-104625.

be used as collateral for loans or margin transactions, allowing users to borrow funds or increase their trading positions while earning interest on their collateral. Stablecoins are reportedly among the most highly traded assets as a percentage of total volume on several large platforms that enable the trading of digital assets. Several existing stablecoin issuers and entities with stablecoin projects have stated plans for goods and services on payment options with stablecoins.[84]

Another important concept is “token and tokenization”. In the classical monetary aspect, the term "token" has been used to describe physical objects representing value which carry symbolic representations of value and could be used to make payments. Ownership of these early tokens was determined solely by physical ownership.

The Ethereum project with its smart contract utilization was an early usage case for digital tokens which are the definition of custom assets that can be created by the user. The Ethereum users introduced a standard named “ERC-20”[85] for fungible units of value termed "tokens" shortly after its public launch.[86] Tokenization is the process of linking reference assets to tokens and by indexing the token’s price to the value of the token’s reference asset. Tokenizations are allow for a crypto token holder to have a legally lawful ownership claim over the token’s reference asset. As an example, this following table shows various tokens who carry a value storage for their assets. There are financial assets such as stocks, bonds, and exchange-traded funds (ETFs) or non-financial reference assets such as soybeans, gold and real estate tokens.[87]

[84] U.S. Department of the Treasury. (2021). *Report on Stablecoins*. Washington, DC: U.S. Department of the Treasury.

[85] There are other standards such as ERC-721, ERC-1155, ERC-2309, ERC-4400, ERC-4907 and others. For more details look into: NIST Internal Report NIST IR 8472 *Non-Fungible Token Security:* https://doi.org/10.6028/NIST.IR.8472 .

[86] Lee, A., Malone, B., & Wong, P. ,*Tokens and Accounts in the Context of Digital Currencies*,(Board of Governors of the Federal Reserve System, 2020).

[87] Federal Reserve, Tokenization: Overview and Financial Stability Implications (Federal Reserve, 2024) https://www.federalreserve.gov accessed 30 November 2024.

Token Issuer	Token Name	Reference Asset	Reference Category
European Investment Bank	Bond-specific tokens	Bonds	Financial asset
Onyx by J.P. Morgan	Repo security-specific tokens	Intraday repo	Financial asset
Obligate	Bond-specific tokens	Corporate Bonds	Financial asset
Franklin Templeton	BENJI	MMMF shares	Financial asset
Ondo Finance	OUSG	iShares Short Treasury Bond ETF	Financial asset
RealT Tokens	Multiple, property specific tokens	Residential properties	Real asset - Real estate
MatrixDock	STBT	Short-term Treasury Bill	Financial asset
Lofty	Multiple, property specific tokens	Residential Properties	Real asset - Real estate
Tangible	Real USD	Real Estate	Real asset - Real estate
Tangible	Item specific Tangible NFTs (TNFTs)	Wine, gold, watches, or real estate	Real asset - Other
Aktionariat	DAKS	Private Equity Investments	Real asset - Other
Agrotoken	SOYA	Soybeans	Real asset - Commodity
Agrotoken	CORA	Corn	Real asset - Commodity
Agrotoken	WHEA	Wheat	Real asset - Commodity
Paxos Trust Company	PAXG	1 fine Troy ounce of gold	Real asset - Commodity
TG Commodities Limited	TXAUT	1 fine Troy ounce of gold	Real asset - Commodity
Toucan Protocol	TCO2	Carbon credits	Real asset - Other
Centrifuge	DROP/TIN	Pools of reference assets	Multiple assets
Goldfinch	Pool-specific tokens	Pools of reference assets	Financial asset

Image VI: Tokenization Examples with Reference Asset[88]

The concept of tokens also created another term named "NFT" which is a unique digital identifier. They are recorded on a blockchain and are used to certify ownership and authenticity. They can not be copied, substituted, or subdivided. NFTs claim to represent ownership of various forms of media, real estate, access rights, and intellectual property, among other uses.

An NFT token may be on-chain and might include metadata such as a link or URL address that refers to a reference asset, a record maintained by a smart contract. The record may just point to an asset or represent some incorporeal asset so the token may not purchase any legal rights or direct ownership over the asset. Consumers and investors of tokens and crypto-coins may be exposed to risks, such as false introduction about token assets and their ownership status and the potential bankruptcy of cryptocurrency exchange platforms. Tokens that are out of the definition of a security may not benefit from the protections guaranteed by the *Securities Act of 1933* and the *Securities Exchange Act of 1934.* [89]

[88]Ibid.

[89]Ibid.

IV. KEY CONCEPTS

1. Security

a) Definition

A security is a financial instrument, typically any financial asset that can be traded. [90] The term *"security"* is defined broadly to include a wide array of investments, such as stocks, bonds, notes, debentures, limited partnership interests, oil and gas interests, and investment contracts. Generally, if an investment of money is made in a business with the expectation of a profit to come through the efforts of someone other than the investor, it is considered a security. The Securities Act of 1933 is the first federal legislation to regulate the U.S. stock market, an authority that was previously regulated at the state level. In the United States, the U.S. Securities and Exchange Commission (SEC) regulates the public offer and sale of securities.

b) Characteristics of Securities

Financial instruments can be distinguished on the basis of negotiability. A financial instrument is negotiable if legal ownership of the instrument can be easily transferred from one institutional unit to another by means of delivery or endorsement. The criteria for a financial instrument to be considered negotiable are: (1) the ability to be transferred to another person's legal ownership (or offset in the case of financial derivatives); (2) standardization and an eligible International Securities Identification Number (ISIN) and (3) no right of recourse against previous holders of the relevant asset.

Currency and deposits, loans, money market fund (MMF) shares or units, open-ended investment fund shares or units, other equity, and other accounts receivable or payable are not typically negotiable neither are insurance, pension, or standardized guarantee schemes. Securities, financial derivatives, monetary gold, and special drawing rights (SDR) are all negotiable financial instruments. Securities include debt securities, equity securities and, to some extent, investment fund shares or units.[91]

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[90] Security, Corporate Finance Institute , accessed November 24, 2024.

[91] Main Features of Securities, IMF e-library, accessed November 24, 2024.

i. Debt Securities

Debt securities should display all, or most, of the following quantitative characteristics: (1) an issue date; (2) an issue price; (3) a redemption price (or face value); (4) a maturity (or redemption date); (5) the coupon rate that the issuer pays to the holders; (6) the coupon dates; and (7) the currency of denomination and settlement. Characteristics: (1)The issue date is the point in time at which the debt security is issued. (2) The issue price is the price at which investors buy the debt securities when first issued. (3) The redemption price, or face value, is the amount to be paid by the issuer to the holder at maturity. (4) The redemption (or maturity) date is the point in time at which the final contractually scheduled repayment of the principal is due. (5) Debt securities can be issued with a short- or long-term maturity. A debt security with a short-term maturity is defined as one that is payable on demand or in one year or less. A debt security with a long-term maturity is defined as one that is payable in more than one year or that has no stated maturity. (6) Original maturity is the period from the issue date until the final contractually scheduled payment. Remaining (or residual) maturity of a debt security is the period from the reference date until the final contractually scheduled payment.(7) Debt securities generate property income in the form of interest receivable. Owners of debt securities are entitled to interest receivable as a result of having placed funds at the disposal of the issuers.

Qualitative features of debt securities include the documents specifying the rights of debt securities issuers, in the form of indentures or covenants. The contract terms may be changed only with great difficulty, with amendments generally requiring approval by a majority vote of the debt securities' holders. The default risk attached to debt securities, which is the creditworthiness of individual debt securities issues assessed by credit rating agencies.[92]

ii. Equity Securities

The main features of equity securities are: They are claims by shareholders on the net worth of the issuing Corporation. They are either listed on a stock exchange or unlisted. They are issued on a specific issue date with a specific issue price. They do not usually have a stated maturity. They are usually issued in the domestic currency. They generate income in the form of dividends.[93]

[92] Main Features of Securities, IMF e-library, accessed November 24, 2024.

[93]Ibid.

2. SWIFT

SWIFT is a vast and secure messaging system that allows banks and other financial institutions from all around the world to send and receive encrypted information, namely cross-border money transfer instructions. Based in Brussels, Belgium, the Society for Worldwide Interbank Financial Telecommunications, or SWIFT for short, was founded in 1973 by 239 banks from 15 countries as a cooperative in order to create a secure financial messaging system. Today, SWIFT covers 11,000 banks and financial institutions in over 200 countries and territories, with almost 38 million encrypted transactions passing through the system daily.[94]

The SWIFT messaging system is called "SWIFTNet," and members can access SWIFTNet via permanent leased lines, over the internet, or via the Cloud. To begin with, each member on the SWIFT network is assigned a unique code that is either 8 or 11 alphanumeric characters long. This code is formally known as the Business Identifier Code (BIC) but colloquially referred to as the SWIFT code or SWIFT ID. The first four characters represent the name of the financial institution, the next two characters represent the country code, and the last two characters, the business party suffix. The way that the secured message is sent and received is over SWIFTNet's FIN encrypted secure messaging system. Messages are in a specific format in order to increase efficiency and avoid mistakes.

If things go according to plan, a SWIFT transfer takes about 24-48 hours to reach its destination but can take as long as five days, especially if the transfer is cross-border and may require a payment chain that spans three to four banks. There are obviously costs when making a SWIFT transfer. The bank or financial institution must pay an annual fee to SWIFT in order to access SWIFTNet, but there is also a small fixed nominal fee for each FIN message sent. the system has evolved from 239 banks in 1973 to over 11,000 members now.[95]

3. U.S. Securities and Exchange Commission

The U.S. Securities and Exchange Commission is an independent federal government regulatory agency. SEC oversees securities exchanges, securities brokers and dealers,

[94] SWIFT, Corporate Finance Institute, accessed November 25, 2024.

[95] Ibid.

investment advisors, and mutual funds in an effort to promote fair dealing, the disclosure of important market information, and to prevent fraud.[96]

The SEC is headed by five commissioners appointed by the president, one of whom is the chair. The commissioners have a five-year term, but may serve an additional 18 months until a replacement is found. Present SEC chair Gary Gensler took office in April 2021. The law requires that no more than three of the five commissioners come from the same political party to promote nonpartisanship.[97] The SEC consists of five divisions and 23 offices. Their goals are to interpret and enforce securities laws, issue new rules, oversee securities institutions, and coordinate regulations among different parts of the government.[98]

Since the 1930s, the SEC has enforced securities laws and regulations through two primary mechanisms, often in conjunction with criminal cases brought by Department of Justice (DOJ) and other prosecutorial authorities:

1.Civil action in federal court: The SEC initiates lawsuits in the U.S. District Court, seeking remedies like court orders to halt illegal activities, monetary fines, and the return of illicit profits. Federal judges preside over these cases, giving the defendant the right to a jury trial.

2.Administrative proceedings: These are internal hearings conducted by administrative law judges within the SEC. Administrative actions can lead to injunctions against the activity about which the SEC has concerns, bans on working in the securities industry, financial penalties, and the repayment of profits from an unlawful enterprise.[99]

4.EDGAR

EDGAR, the Electronic Data Gathering, Analysis, and Retrieval system, is the primary system for companies and others submitting documents under the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939 and the Investment Company Act of

[96]Securities and Exchange Commission (SEC), United States Government, https://www.usa.gov/agencies/securities-and-exchange-commission ,accessed November 25, 2024.

[97] Securities and Exchange Commission (SEC) Defined, How It Works, Investopedia, accessed November 25, 2024.

[98]U.S. Securities and Exchange Commission, Mission, https://www.sec.gov/about/mission , accessed November 27, 2024.

[99]U.S. Securities and Exchange Commission, How Investigations Work, https://www.sec.gov/about/divisions-offices/division-enforcement/how-investigations-work ,accessed November 27, 2024.

1940. Containing millions of company and individual filings, EDGAR benefits investors, corporations, and the U.S. economy overall by increasing the efficiency, transparency, and fairness of the securities markets. The system processes about 3,000 filings per day, serves up 3,000 terabytes of data to the public annually, and accommodates 40,000 new filers per year on average.[100]

Access to EDGAR's public database is free, allowing you to research, for example a public company's financial information and operations by reviewing the filings the company makes with the SEC. One can also research information provided by mutual funds (including money market funds), exchange-traded funds (ETFs), variable annuities, and individuals. EDGAR provides a wealth of resources to help filers, including: (1)How to apply for EDGAR access; (2) Website support for EDGAR filers; and (3)Telephone support for EDGAR filers.

5.Howey Test

The *"Howey Test"* is the framework set by the U.S. Supreme Court to determine whether a transaction qualifies as an investment contract and therefore be considered a security. The 1946 U.S. Supreme Court case SEC vs. Howey Co. debated whether a leaseback agreement between Howey Co. and landowners was an investment contract. Howey Co. leased and tended to citrus groves and agreed to share resulting revenue with landowners.

Howey Co. failed to register these transactions with the SEC, leading to their meeting in court. The Supreme Court's final ruling decided the leaseback agreements did qualify as investment contracts and must comply with SEC law. The SEC relies heavily on the Howey Test to determine whether a crypto company or product is subject to SEC law.[101]

How are we applying the Howey Test to Digital Assets:

i. ***The Investment of Money***

The investment of money requirement is typically fulfilled in the context of digital assets, as they are commonly acquired through various forms of consideration, such as real currency,

[100] About EDGAR, U.S. Securities and Exchange Commission, accessed December 1, 2024.

[101] The Howey Test: Is Your Crypto Token a Security? , Gordon Law, accessed December 1, 2024.

other digital assets, or alternative means of value exchange. This broad interpretation ensures that the investment of money element encompasses the diverse nature of transactions involving digital assets.

ii. Common Enterprise

While the Howey test does not explicitly require the presence of a “common enterprise,” courts have consistently recognized it as a distinct element of an investment contract. The SEC’s framework acknowledges that a common enterprise often exists in the context of digital assets, lending support to the potential classification of certain digital assets as securities.

iii. Reasonable Expectation of Profits Derived from Efforts of Others

The determination of whether purchasers have a reasonable expectation of profits derived from the efforts of others is a pivotal factor in applying the Howey test to digital assets. To facilitate this assessment, the SEC provides a range of technical information and considerations.

1. Reliance on the Efforts of Others

Evaluating whether purchasers reasonably rely on the efforts of an active participant (AP) involves analyzing the significance of the AP’s managerial efforts in the development, operation, or promotion of the network associated with the digital asset. The SEC highlights indicators of reliance on the efforts of others, including the AP’s performance of essential tasks, their role in decision-making impacting the network’s success, and the degree of control exerted by the AP.

2. Reasonable Expectation of Profits

In determining the reasonable expectation of profits, the SEC’s framework considers various characteristics of the digital asset. These characteristics include the association of the digital asset with the income or profits of the enterprise, the potential for appreciation resulting from network development or positive developments, and the existence of secondary markets or platforms for trading the digital asset.[102]

V. CASE BEFORE THE COURT: SEC v. RIPPLE

1. Overview

a) Ripple

In 2011, three engineers -David Schwartz, Jed McCaleb, and Arthur Britto- began developing the XRP Ledger (XRPL). Fascinated by Bitcoin, they set out to create a better version that improved upon its limitations with the goal of creating a digital asset that was more sustainable and built specifically for payments. The XRP Ledger launched in June 2012.

The cryptocurrency XRP is controlled by a company called Ripple. It's a payment settlement system and currency exchange network that can process transactions globally. Ripple positions itself as an updated version of the Society for Worldwide Interbank Financial Telecommunication (SWIFT) system and is already being used by banks and other financial institutions.

From 2013 to the end of 2020, Ripple sold and distributed XRP through various methods to counterparties such as institutional buyers and hedge funds. These sales were done through wholly owned subsidiaries and according to written contracts. Ripple also traded XRP "programmatically" on digital asset exchanges, which occurred blindly through trading algorithms. In this regard, Ripple was unaware of the purchaser's identity and the purchasers did not know the seller's identity. Lastly, Ripple distributed XRP to employees and third parties as payment for services.

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[102] Legal Analysis: The SEC's Howey Test and the Future of Digital Assets, Quijano & Associates - Attorneys at Law, accessed December 1, 2024.

b)XRP

XRP is a cryptocurrency and native token of the open-source XRP Ledger founded in 2012 by David Schwartz, Jed McCaleb and Arthur Britto. Due to its reported fast, efficient, reliable, carbon-neutral delivery, XRP is the technology that Ripple uses in its solutions.

The initial idea behind XRP was straightforward: it was described as a peer-to-peer trust network. XRPL and Ripple cite XRP as a faster, cheaper, and more energy-efficient digital asset that can process transactions within seconds and consume less energy than some counterpart cryptocurrencies.

The mechanism behind XRP transactions doesn't require a transaction fee, which is a standard feature for most cryptocurrencies. Instead, it requires the sender to burn a tiny portion of the XRP, which positions XRP as deflationary.

2. Facts of the Case

1. Ripple positions itself as an updated version of the Society for Worldwide Interbank Financial Telecommunication (SWIFT) system and is already being used by banks and other financial institutions. XRP is different from other cryptocurrencies in that it is owned by a single company and not run by a decentralised Community.[103]
2. From 2013 to the end of 2020, Ripple sold and distributed XRP through various methods to counterparties such as institutional buyers and hedge funds. These sales were done through wholly owned subsidiaries and according to written contracts. Ripple also traded XRP "programmatically" on digital asset exchanges, which occurred blindly through trading algorithms. In this regard, Ripple was unaware of the purchaser's identity and the purchasers did not know the seller's identity. Lastly, Ripple distributed XRP to employees and third parties as payment for services. Defendants Larsen and Garlinghouse also engaged in the sale and distribution of XRP in their individual capacities.[104]
3. Larsen stepped down as Chief Executive Officer (CEO) in December 2016 and became the Executive Chairman of Ripple's Board of Directors. Garlinghouse became the Chief Operating Officer (COO) of Ripple in April 2015 and became the CEO on January 1, 2017, after Larsen stepped down.

[103] What is Ripple (XRP) ?' https://www.bitpanda.com/academy/en/lessons/what-is-ripple-xrp/ accessed December 17, 2024.

[104] Ellie Kauffman, 'SEC v. Ripple Laps, Inc.' (2024) 25 Transactions: Tenn J Bus L 577.

4. RippleNet, Ripple's payment network, became the backbone of this strategy, helping financial institutions settle payments in real-time across borders. XRP played a key role, acting as a bridge currency to make those transactions faster and cheaper. By 2017, XRP's value had exploded, briefly making it the second-largest cryptocurrency by market capitalization at over $120 billion.
5. Ripple wasn't just building relationships with banks; it was eyeing the global remittance market, too. In 2019, Ripple teamed up with MoneyGram, a major player in the remittance industry, and invested $50 million into the company. MoneyGram started using XRP for cross-border payments, showing the real-world impact Ripple was striving for. By 2020, Ripple had partnered with over 300 financial institutions in more than 40 countries and processed billions of dollars in payments.
6. On December 22, 2020, The Security and Exchange Commission (SEC), sued Ripple, Chris Larsen and Bradley Garlinghouse. The SEC claimed that Ripple and its two executives violated Sections 5(a) and 5(c) of the Securities Act of 1933 in offering and selling XRP without registering these offers and sales with the SEC. Larsen and Garlinghouse additionally aided and abetted Ripple in violating these provisions, according to the SEC while Ripple argues that XRP is a digital currency, not a security. According to the SEC, Ripple's sales of XRP were essentially an investment contract, meaning buyers were expecting to profit from Ripple's efforts- making XRP a security under US law.

3. Claims of the Parties

a) Claims of the U.S. Securities and Exchange Commission

1. According to the Securities Act of 1933, xrp is a security. Ripple and its two executives had breached Sections 5(a) and 5(c) of the Securities Act of 1933 in offering and selling XRP without registering these offers and sales with the SEC.[105]
2. Ripple; Christian Larsen, the company's co-founder, executive chairman of its board, and former CEO; and Bradley Garlinghouse, the company's current CEO, raised capital to finance the company's business. Ripple raised funds, beginning in 2013, through the sale

[105] SEC v Ripple (2023) USDC 20 Civ, 10832 (AT).

of digital assets known as XRP in an unregistered securities offering to investors in the U.S. and worldwide.[106]

3. Ripple also allegedly distributed billions of XRP in exchange for non-cash consideration, such as labor and market-making services. In addition to structuring and promoting the XRP sales used to finance the company's business, Larsen and Garlinghouse also effected personal unregistered sales of XRP totaling approximately $600 million. The defendants failed to register their offers and sales of XRP or satisfy any exemption from registration, in violation of the registration provisions of the federal securities laws.
4. Ripple never filed a registration document, which is a requirement for companies when they are seeking to raise capital from the public. Ripple had "created an information vacuum" and only shared information that it felt necessary.

b) Claims of the Ripple

1. XRP is neither a security nor an investment contract. Xrp is a *currency*. Therefore, Ripple had never needed to register XRP, and the SEC did not have a claim. XRP was *"primarily used as a means of exchange,"* and thus characterized as an "exchange token" by security regulators in the UK, Japan, and Singapore.[107]
2. The SEC did not provide fair notice of any conduct that was in violation of any law. The SEC only selectively prosecuted "virtual currency […] losers" since other cryptocurrencies such as Bitcoin and Ethereum were not prosecuted.[108]

4. Established Agenda of the Court

1. Given the factual and legal circumstances of the proceedings, is there a violation of Sections 5(a) and 5(c) of the Securities Act of 1933 ?
2. According to the facts of the case , is XRP a security or a digital currency?
3. Considering the effect of the howey test in other cases, is it sufficient and valid for cryptocurrencies?

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[106] U.S. Securities and Exchange Commission, SEC Charges Ripple and Two Executives with Conducting $1.3 Billion Unregistered Securities Offering, https://www.sec.gov/newsroom/press-releases/2020-338 , accessed December 27, 2024.

[107] Franziska M. Renz, Julian U. N. Vogel, 'Ripple Makes Waves' (2022) Journal of Case Research and Inquiry.

[108] Ibid.

4. Should XRP fall under the Commodity Exchange Act of 1936 as a "commodity" instead of being governed by the Securities Act of 1933?
5. Do secondary market transactions of XRP, where Ripple is not directly involved, still constitute the sale of an investment contract?
6. Would classifying XRP as a security hinder innovation in blockchain technology and conflict with the public interest?
7. How does the interpretation of "investment contract" in *SEC v. W.J. Howey Co. (1946)* apply to XRP, given its use as both a payment method and an investment vehicle?
8. Considering the emphasis on investor protection in *SEC v. Cavanagh*, should the court factor in potential harm to XRP holders when determining the appropriateness of penalties or equitable remedies?
9. How should the court apply the principles from *SEC v. Cavanagh* regarding equitable remedies to Ripple's alleged violations, particularly in terms of disgorgement and asset freezes?

V. APPLICABLE LAW

1. THE SECURITIES ACT OF 1933

A. SECTION 5: 15 U.S. Code § 77e - Prohibitions relating to interstate commerce and the mails

(a)Sale or delivery after sale of unregistered securities

Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1)to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2)to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

(b)Necessity of prospectus meeting requirements of section 77j of this title

It shall be unlawful for any person, directly or indirectly—

(1)to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this subchapter, unless such prospectus meets the requirements of section 77j of this title; or

(2)to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 77j of this title.

(c)Necessity of filing registration statement

It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 77h of this title.

(d)Limitation

Notwithstanding any other provision of this section, an emerging growth company or any person authorized to act on behalf of an emerging growth company may engage in oral or written communications with potential investors that are qualified institutional buyers or institutions that are accredited investors, as such terms are respectively defined in section 230.144A and section 230.501(a) of title 17, Code of Federal Regulations, or any successor thereto, to determine whether such investors might have an interest in a contemplated securities offering, either prior to or following the date of filing of a registration statement with respect to such securities with the Commission, subject to the requirement of subsection (b)(2).

(e)Security-based swaps

Notwithstanding the provisions of section 77c or 77d of this title, unless a registration statement meeting the requirements of section 77j(a) of this title is in effect as to a security-

based swap, it shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell, offer to buy or purchase or sell a security-based swap to any person who is not an eligible contract participant as defined in section 1a(18) of title 7.

B. SECTION 2. 15 U.S. Code § 77b - Definitions; promotion of efficiency, competition, and capital formation

(a)Definitions

When used in this subchapter, unless the context otherwise requires—

(1)The term "security" means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

C. SECTION 4. 11 U.S. Code § 1145 - Exemption from securities laws

(a)Except with respect to an entity that is an underwriter as defined in subsection (b) of this section, section 5 of the Securities Act of 1933 and any State or local law requiring registration for offer or sale of a security or registration or licensing of an issuer of, underwriter of, or broker or dealer in, a security do not apply to—

(1)the offer or sale under a plan of a security of the debtor, of an affiliate participating in a joint plan with the debtor, or of a successor to the debtor under the plan—

(A)in exchange for a claim against, an interest in, or a claim for an administrative expense in the case concerning, the debtor or such affiliate; or

(B)principally in such exchange and partly for cash or property;

(2)the offer of a security through any warrant, option, right to subscribe, or conversion privilege that was sold in the manner specified in paragraph (1) of this subsection, or the sale of a security upon the exercise of such a warrant, option, right, or privilege;

(3)the offer or sale, other than under a plan, of a security of an issuer other than the debtor or an affiliate, if—

(A)such security was owned by the debtor on the date of the filing of the petition;

(B)the issuer of such security is—

(i)required to file reports under section 13 or 15(d) of the Securities Exchange Act of 1934; and

(ii)in compliance with the disclosure and reporting provision of such applicable section; and

(C)such offer or sale is of securities that do not exceed—

(i)during the two-year period immediately following the date of the filing of the petition, four percent of the securities of such class outstanding on such date; and

(ii)during any 180-day period following such two-year period, one percent of the securities outstanding at the beginning of such 180-day period; or

(4)a transaction by a stockbroker in a security that is executed after a transaction of a kind specified in paragraph (1) or (2) of this subsection in such security and before the expiration of 40 days after the first date on which such security was bona fide offered to the public by the issuer or by or through an underwriter, if such stockbroker provides, at the time of or before such transaction by such stockbroker, a disclosure statement approved under section 1125 of this title, and, if the court orders, information supplementing such disclosure statement.

(b) (1)Except as provided in paragraph (2) of this subsection and except with respect to ordinary trading transactions of an entity that is not an issuer, an entity is an underwriter under section 2(a)(11) of the Securities Act of 1933, if such entity—

(A)purchases a claim against, interest in, or claim for an administrative expense in the case concerning, the debtor, if such purchase is with a view to distribution of any security received or to be received in exchange for such a claim or interest;

(B)offers to sell securities offered or sold under the plan for the holders of such securities;

(C)offers to buy securities offered or sold under the plan from the holders of such securities, if such offer to buy is—

(i)with a view to distribution of such securities; and

(ii)under an agreement made in connection with the plan, with the consummation of the plan, or with the offer or sale of securities under the plan; or

(D)is an issuer, as used in such section 2(a)(11), with respect to such securities.

(2)An entity is not an underwriter under section 2(a)(11) of the Securities Act of 1933 or under paragraph (1) of this subsection with respect to an agreement that provides only for—

(A)

(i)the matching or combining of fractional interests in securities offered or sold under the plan into whole interests; or

(ii)the purchase or sale of such fractional interests from or to entities receiving such fractional interests under the plan; or

(B)the purchase or sale for such entities of such fractional or whole interests as are necessary to adjust for any remaining fractional interests after such matching.

(3)An entity other than an entity of the kind specified in paragraph (1) of this subsection is not an underwriter under section 2(a)(11) of the Securities Act of 1933 with respect to

any securities offered or sold to such entity in the manner specified in subsection (a)(1) of this section.

2. SECURITIES EXCHANGE ACT OF 1934

A. SECTION 10(b): 15 U.S. Code § 78j - Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(a)

(1)To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security other than a government security, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(2)Paragraph (1) of this subsection shall not apply to security futures products.

(b)To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement [1] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(c) (1)To effect, accept, or facilitate a transaction involving the loan or borrowing of securities in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(2)Nothing in paragraph (1) may be construed to limit the authority of the appropriate Federal banking agency (as defined in section 1813(q) of title 12), the National Credit

Union Administration, or any other Federal department or agency having a responsibility under Federal law to prescribe rules or regulations restricting transactions involving the loan or borrowing of securities in order to protect the safety and soundness of a financial institution or to protect the financial system from systemic risk.

B. SECTION 12(g): 17 CFR § 240.12g-1 - Registration of securities; exemption from section 12(g).

An issuer is not required to register a class of equity securities pursuant to section 12(g)(1) of the Act (15 U.S.C. 78l(g)(1)) if on the last day of its most recent fiscal year:

(a) The issuer had total assets not exceeding $10 million; or

(b) (1) The class of equity securities was held of record by fewer than 2,000 persons and fewer than 500 of those persons were not accredited investors (as such term is defined in § 230.501(a) of this chapter, determined as of such day rather than at the time of the sale of the securities); or

(2) The class of equity securities was held of record by fewer than 2,000 persons in the case of a bank; a savings and loan holding company, as such term is defined in section 10 of the Home Owners' Loan Act (12 U.S.C. 1461); or a bank holding company, as such term is defined in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

3. INVESTMENT COMPANY ACT OF 1940

a. SECTION 3(a)(1): 15 U.S. Code § 80a–3 - Definition of investment company

When used in this subchapter, “investment company” means any issuer which—

(A) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities;

(B) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or

(C) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer’s total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

b. SECTION 8: 15 U.S. Code § 80a–8 - Registration of investment companies

(a)Notification of registration; effective date of registration

Any investment company organized or otherwise created under the laws of the United States or of a State may register for the purposes of this subchapter by filing with the Commission a notification of registration, in such form as the Commission shall by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors. An investment company shall be deemed to be registered upon receipt by the Commission of such notification of registration.

(b)Registration statement; contents

Every registered investment company shall file with the Commission, within such reasonable time after registration as the Commission shall fix by rules and regulations, an original and such copies of a registration statement, in such form and containing such of *the following information and documents as the Commission shall by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors:*

(1) a recital of the policy of the registrant in respect of each of the following types of activities, such recital consisting in each case of a statement whether the registrant reserves freedom of action to engage in activities of such type, and if such freedom of action is reserved, a statement briefly indicating, insofar as is practicable, the extent to which the registrant intends to engage therein: (A) the classification and subclassifications, as defined in sections 80a–4 and 80a–5 of this title, within which the registrant proposes to operate; (B) borrowing money; (C) the issuance of senior securities; (D) engaging in the business of underwriting securities issued by other persons; (E) concentrating investments in a particular industry or group of industries; (F) the purchase and sale of real estate and commodities, or either of them; (G) making loans to other persons; and (H) portfolio turn-over (including a statement showing the aggregate dollar amount of purchases and sales of portfolio securities, other than Government securities, in each of the last three full fiscal years preceding the filing of such registration statement);

(2) a recital of all investment policies of the registrant, not enumerated in paragraph (1), which are changeable only if authorized by shareholder vote;

(3) a recital of all policies of the registrant, not enumerated in paragraphs (1) and (2), in respect of matters which the registrant deems matters of fundamental policy;

(4) the name and address of each affiliated person of the registrant; the name and principal address of every company, other than the registrant, of which each such person is an officer, director, or partner; a brief statement of the business experience for the preceding five years of each officer and director of the registrant; and

(5) the information and documents which would be required to be filed in order to register under the Securities Act of 1933 [15 U.S.C. 77a et seq.] and the Securities Exchange Act of 1934 [15 U.S.C. 78a et seq.], all securities (other than short-term paper) which the registrant has outstanding or proposes to issue.

(c)Alternative information

The Commission shall make provision, by permissive rules and regulations or order, for the filing of the following, or so much of the following as the Commission may designate, in lieu of the information and documents required pursuant to subsection (b):

(1) copies of the most recent registration statement filed by the registrant under the Securities Act of 1933 [15 U.S.C. 77a et seq.] and currently effective under such Act, or if the registrant has not filed such a statement, copies of a registration statement filed by the registrant under the Securities Exchange Act of 1934 [15 U.S.C. 78a et seq.] and currently effective under such Act;

(2) copies of any reports filed by the registrant pursuant to section 78m or 78o(d) of this title; and

(3) a report containing reasonably current information regarding the matters included in copies filed pursuant to paragraphs (1) and (2) of this subsection, and such further information regarding matters not included in such copies as the Commission is authorized to require under subsection (b).

(d)Registration of unit investment trusts

If the registrant is a unit investment trust substantially all of the assets of which are securities issued by another registered investment company, the Commission is authorized to prescribe for the registrant, by rules and regulations or order, a registration statement which eliminates inappropriate duplication of information contained in the registration statement filed under this section by such other investment company.

(e)Failure to file registration statement or omissions of material fact

If it appears to the Commission that a registered investment company has failed to file the registration statement required by this section or a report required pursuant to section 80a–29 (a) or (b) of this title, or has filed such a registration statement or report but omitted therefrom material facts required to be stated therein, or has filed such a registration statement or report in violation of section 80a–33(b) of this title, the Commission shall notify such company by registered mail or by certified mail of the failure to file such registration statement or report, or of the respects in which such registration statement or report appears to be materially incomplete or misleading, as the case may be, and shall fix a date (in no event earlier than thirty days after the mailing of such notice) prior to which such company may file such registration statement or report or correct the same. If such registration statement or report is not filed or corrected within the time so fixed by the Commission or any extension thereof, the Commission, after appropriate notice and opportunity for hearing, and upon such conditions and with such exemptions as it deems appropriate for the protection of investors, may by order suspend the registration of such company until such statement or report is filed or corrected, or may by order revoke such registration, if the evidence establishes—

(1) that such company has failed to file a registration statement required by this section or a report required pursuant to section 80a–29(a) or (b) of this title, or has filed such a registration statement or report but omitted therefrom material facts required to be stated therein, or has filed such a registration statement or report in violation of section 80a–33(b) of this title; and

(2) that such suspension or revocation is in the public interest.

4. DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT OF 2010

A. SECTION 913: Study And Rulemaking Regarding Obligations Of Brokers, Dealers, And Investment Advisers.

(b) The Commission shall conduct a study to evaluate--

(1) the effectiveness of existing legal or regulatory standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice and recommendations about securities to retail customers imposed by the Commission and a national securities association, and other Federal and State legal or regulatory standards; and

(2) whether there are legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers that should be addressed by rule or statute.

5. **COMMODITY EXCHANGE ACT 1936**

A. 7 U.S. Code § 1a - Definitions

(1) Alternative Trading System

The term "alternative trading system" means an organization, association, or group of persons that—

(A) is registered as a broker or dealer pursuant to section 15(b) of the Securities Exchange Act of 1934 [15 U.S.C. 78o(b)] (except paragraph (11) thereof);

(B) performs the functions commonly performed by an exchange (as defined in section 3(a)(1) of the Securities Exchange Act of 1934 [15 U.S.C. 78c(a)(1)]);

(C) does not—

(i) set rules governing the conduct of subscribers other than the conduct of such subscribers' trading on the alternative trading system; or

(ii)discipline subscribers other than by exclusion from trading; and

(D) is exempt from the definition of the term "exchange" under such section 3(a)(1) [15 U.S.C. 78c(a)(1)] by rule or regulation of the Securities and Exchange Commission on terms that require compliance with regulations of its trading functions.

(9)Commodity

The term "commodity" means wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions (as provided by section 13–1 of this title) and motion picture box office receipts (or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in.

(10)Commodity pool

The term "commodity pool" means any investment trust, syndicate, or similar form of enterprise operated for the purpose of trading in commodity interests, including any—

(i)commodity for future delivery, security futures product, or swap;

(ii)agreement, contract, or transaction described in section 2(c)(2)(C)(i) of this title or section 2(c)(2)(D)(i) of this title;

(iii)commodity option authorized under section 6c of this title; or

(iv)leverage transaction authorized under section 23 of this title.

B. 7 U.S. Code § 6c - Prohibited transactions

(a)In general

(1)Prohibition

It shall be unlawful for any person to offer to enter into, enter into, or confirm the execution of a transaction described in paragraph (2) involving the purchase or sale of any commodity for future delivery (or any option on such a transaction or option on a commodity) or swap if the transaction is used or may be used to—

(A) hedge any transaction in interstate commerce in the commodity or the product or byproduct of the commodity;

(B) determine the price basis of any such transaction in interstate commerce in the commodity; or

(C) deliver any such commodity sold, shipped, or received in interstate commerce for the execution of the transaction.

(3)Contract of sale

It shall be unlawful for any employee or agent of any department or agency of the Federal Government or any Member of Congress or employee of Congress (as such terms are defined under section 2 of the STOCK Act) or any judicial officer or judicial employee (as such terms are defined, respectively, under section 2 of the STOCK Act) who, by virtue of the employment or position of the Member, officer, employee or agent, acquires information that may affect or tend to affect the price of any commodity in interstate commerce, or for future delivery, or any swap, and which information has not been disseminated by the department or agency of the Federal Government holding or creating the information or by Congress or by the judiciary in a manner which makes it generally available to the trading public, or disclosed in a criminal, civil, or administrative hearing, or in a congressional, administrative, or Government Accountability Office report, hearing, audit, or investigation, to use the information in his personal capacity and for personal gain to enter into, or offer to enter into—

(A) a contract of sale of a commodity for future delivery (or option on such a contract);

(B) an option (other than an option executed or traded on a national securities exchange registered pursuant to section 78f(a) of title 15); or

(C) a swap.

(b)Regulated option trading

No person shall offer to enter into, enter into or confirm the execution of, any transaction involving any commodity regulated under this chapter which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty", contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission shall prescribe. Any such order, rule, or regulation may be made only after notice and opportunity for hearing, and the Commission may set different terms and conditions for different markets.

C. 7 U.S. Code § 9 - Prohibition regarding manipulation and false information

(1)Prohibition against manipulation

It shall be unlawful for any person, directly or indirectly, to use or employ, or attempt to use or employ, in connection with any swap, or a contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the Commission shall promulgate by not later than 1 year after July 21, 2010, provided no rule or regulation promulgated by the Commission shall require any person to disclose to another person nonpublic information that may be material to the market price, rate, or level of the commodity transaction, except as necessary to make any statement made to the other person in or in connection with the transaction not misleading in any material respect.

(A)Special provision for manipulation by false reporting

Unlawful manipulation for purposes of this paragraph shall include, but not be limited to, delivering, or causing to be delivered for transmission through the mails or interstate commerce, by any means of communication whatsoever, a false or misleading or inaccurate report concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce, knowing, or acting in reckless disregard of the fact that such report is false, misleading or inaccurate.

(B)Effect on other law

Nothing in this paragraph shall affect, or be construed to affect, the applicability of section 13(a)(2) of this title.

(C)Good faith mistakes

Mistakenly transmitting, in good faith, false or misleading or inaccurate information to a price reporting service would not be sufficient to violate paragraph (1)(A).

(2)Prohibition regarding false information

It shall be unlawful for any person to make any false or misleading statement of a material fact to the Commission, including in any registration application or any report filed with the Commission under this chapter, or any other information relating to a swap, or a contract of sale of a commodity, in interstate commerce, or for future delivery on or subject to the rules of any registered entity, or to omit to state in any such statement any material fact t hat is necessary to make any statement of a material fact made not misleading in any material respect, if the person knew, or reasonably should have known, the statement to be false or misleading.

(3)Other manipulation

In addition to the prohibition in paragraph (1), it shall be unlawful for any person, directly or indirectly, to manipulate or attempt to manipulate the price of any swap, or of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity.

VII. CASE LAW

1. SEC v. Cavanagh[109]

WTS Transnational, Inc. had an idea and needed cash in order to rent space in which it could produce what it called a "pre-production unit" that could be shown to potential customers. Maier Lehman ("Lehman") introduced Cavanagh to WTS representatives at a meeting in New York City on July 15, 1997, that was attended by Lehman and two other persons involved in the search for financing for WTS, Michelle Weiss ("Weiss") and Ari Friedman ("Friedman"). After the merger, Cavanagh gave Lehman, Weiss, and Friedman unlegended Curbstone stock as a "finder's fee" to compensate them for their roles in introducing Milestone to WTS. Milestone agreed to act as investment banker for WTS. By November 5, 1997, WTS's Weaver was complaining to Milestone about the status of negotiations with Levy. Specifically, the private placement memorandum that Levy had developed for WTS reflected WTS giving up 40% of its stock for a $1 million investment. Levy was pushing for a merger with a shell to coincide with the $1 million investment, although WTS's Weaver didn't understand that those events had to coincide.

In a memorandum labelled "status of letter of intent," which responded to a proposed letter of intent sent by Levy to WTS on November 7, WTS complained vociferously to Milestone about Levy's proposal. It contemplated that WTS would give up 40% of its equity in return for an investment of $4 million dollars, $3 million of which would be invested four to six months after the initial investment. WTS planned to use the first $1 million invested in the company to produce "preproduction units that demonstrate performance and actual production costs." With the "hardware" that would result from such work, WTS expected that Milestone would be able to find an investor to place the next $3 million into the company.

In contrast, Levy's proposal treated the investors, whom WTS considered a "key" ingredient to its success as a business, "almost [as] an after thought [sic]." Levy wanted WTS to exchange 40% of its equity for $1 million and to give Milestone thereafter the right to raise an additional $3 million for an additional 600,000 shares, which Levy suggested should be priced at $5 per share. Under Levy's plan, 10% of WTS's equity would be used as a finder's fee for Milestone and the investment of $3 million would result in a market capitalization of $53 million. The author pointed out that a finder's fee of 10% was customary and that a market capitalization

[109] US District Court for the Southern District of New York - 1 F. Supp. 2d 337 (S.D.N.Y. 1998) April 20, 1998.

of $53 million was "astronomical at this stage." WTS predicted that the next investor would "rachet" down the $5 per share price. In contrast, WTS estimated that the appropriate market capitalization at the point at which $1 million was invested was approximately $3.4 million, and after an investment of all $4 million, approximately $10 million.

In December 1997, and contemporaneous with the acquisition described below, Milestone oversaw a $1 million offering of EOSC shares. Specifically, the Optimum Fund bridge loan was converted into 1,054,241 EOSC shares at a price of $.47 per share, and Agira Trading, of the British Virgin Islands, also invested $500,000 for an identical number of shares at the same price per share. There is no evidence that these Regulation S shares have been sold since they were issued. Milestone was paid $100,000 by EOSC and $30,000 by the investors for these Regulation S offerings.

In November 1997, Levy selected Curbstone as the WTS merger partner. The Curbstone Management, that is its four principal shareholders, had agreed to pursue the transaction. Levy negotiated the terms of the transaction with Chachas, who kept the other three principal shareholders advised of the progress of the talks.

Chachas prepared a draft exchange agreement by marking up the agreement that Levy had used in the prior transaction in which Levy and Chachas had both been involved. This would allow WTS management to control the company, and give the Curbstone shareholders an investment opportunity in a company with an operating business. It was also agreed that the officers and directors of Curbstone would all resign and be replaced by WTS personnel. A November 25 draft Acquisition Agreement reflects these terms. This structure resembles the understanding between Weaver and Milestone reflected in the November 13 Letter of Intent, that is, that WTS would give up no more that 5% of its stock for a merger into a shell.

By December 1, Chachas was requesting $125,000 in cash at the closing and $2,352 million within six weeks thereafter in return for the sale by the Curbstone Management of a majority of their shares in the new company. Under both proposals there would be no change in the Curbstone transfer agent until March 15, 1998, or until all the 542,000 shares had been acquired, whichever occurred first.

Chachas, Cavanagh, and Levy decided that the vast majority of the Curbstone Management Shares would not be cancelled. Instead, they arranged a sale for $100,000 of 2,563,000 of the shares that had been slated for cancellation. Although Chachas at first understood that the shares were to be transferred to Milestone, he was later informed that the certificates for the shares were to be issued in the names of three Spanish clients of Milestone ("the Spanish Shares"). Although Chachas presents this arrangement simply as a means by which Curbstone Management could get $100,000 for shares that otherwise would have been cancelled, this critical decision substantially changed the entire transaction, and was essential to the fraud. It afforded Milestone, and those associated with it, the means to profit enormously from the fraud while giving absolutely nothing of value to WTS. Indeed, the arrangement radically transformed the terms of the merger, in that it would no longer be true that all but 5% of the shares of the new entity would be traded for WTS stock. As a result of the decision not to cancel over 2.5 million of the Management Shares, not 5%, but approximately 16% of the EOSC stock was held by Curbstone shareholders or those to whom they sold. In any event, both Milestone and Curbstone Management now had a strong motive to create a market price for the new entity that would allow them to sell the shares covered by the call option agreement and the Spanish Shares for a significant profit. As Brooksbank frankly recognized at the hearing with respect to the option agreements, "if we were going to make any money [out of the merger] this was where it was going to happen."

The Exchange Agreement, which bears the date December 5 on its cover, but was executed by Chachas and Brooksbank on December 8. The Closing was to be held on or prior to January 16, 1998.

Cavanagh contends that the 2,563,000 Curbstone Management Shares purchased for $100,000 were sold to three clients of Vicente Tur Ortola, an attorney whom Cavanagh had met in Spain in June 1996. According to Cavanagh. While Cavanagh contends that he told Levy in late November that some Milestone clients wanted to purchase Curbstone stock, both Levy and Cavanagh deny negotiating the terms of the transaction between Chachas and Tur Ortola. On the other hand, it is undisputed that Chachas never spoke to Tur Ortola and dealt for all practical purposes solely with Levy. In any event, I find that Cavanagh, through Levy, negotiated these sales with Chachas.

Chachas structured the sale of the Spanish Shares so that it appeared to occur on December 18, immediately after the closing of the acquisition. He fully recognized that, if sold before the *closing, these shares were indisputably "control shares." Relying on the fact that the shares had been registered initially in 1996 under an S-8, the Purchase Agreements for the sale of the Spanish Shares drafted by Chachas (there were three identical agreements except for the name of the purchaser) represented that the shares "have been registered securities and will be free of restrictive legend upon delivery." The Agreements further provided that Chachas would hold the shares until "all conditions for the Closing of the Agreement for Exchange of Stock between Curbstone and WTS ... have been satisfied ...." The Purchase Agreements also included a provision that the Curbstone Management Shareholders had the right to repurchase the shares at the same price for which they had sold them, in the event that the Closing of the acquisition of WTS by Curbstone was completed on or before January 16, 1998. The Purchase Agreements also contained "representation and warranties" by the purchasers, discussed at greater length below, which provided that the purchasers were accredited investors and had no present agreements to resell the shares.*

Chachas provided the Purchase Agreement to Levy with blanks for the number of shares and total purchase price, the name of the purchaser and the date of purchase. It appears that Levy faxed the Purchase Agreements to Milestone on December 5; that Milestone's Nicolois faxed the Agreements to "Vincent Tur" on December 10; and that three such agreements were executed on December 11 on behalf of purchasers, and returned. Chachas contends that he signed the Agreements on December 19.

Although there are three separate agreements, each for the purchase of one-third of the Spanish Shares, it is apparent that the purchase of the entire block was controlled by a single entity.Moreover, as is evident from the date on the account opening statement at Donald & Co., Cavanagh laid the groundwork for reselling these shares into the American securities market on December 11, that is, even before the shares had been paid for. On December 12, Milestone sent the cash $100,000 for purchasing the 2.563 million Spanish Shares to Chachas' escrow account from its escrow account at Levy's law firm. Thus, the Spanish Shares were purchased at a price of less than four cents per share, specifically, $.39.

In a twice-underlined instruction to Day on December 17, Chachas ordered Day to issue 2,353,217 shares to the three Spanish entities "without legend." On December 18, 1997, the stock certificates were issued and sent to Levy. Chachas understood that it was important to both Levy and Cavanagh that any shares sent to Milestone or its clients be unlegended shares.

Chachas was acutely aware that there were severe restrictions on the sale of Curbstone Management Shares if sold by affiliates or persons in control of Curbstone. According to Chachas, so long as the Curbstone Management Shares were sold after the acquisition, and thus after the four Curbstone Management Shareholders were no longer affiliates or in control of the corporation's operations, the stock could be sold without any restrictions on its being traded in United States securities markets. Among the steps Chachas took to make it appear that the sale of Spanish Shares did occur after the acquisition, were (1) inserting language in the Purchase Agreement making the delivery of the shares contingent on the acquisition; (2) holding the $100,000 paid for the shares in an escrow account until after the acquisition; (3) executing virtually all of the documents associated with the acquisition prior to sending instructions to Day to transfer the Spanish Shares; and (4) issuing instructions to Day directing him to issue the unregistered Curbstone shares to WTS (which were exchanged for the WTS shares and thus effected the merger) prior to transferring the 2,353,217 Curbstone Management Shares to the three Spanish entities.

Levy was fully familiar with Chachas' rationalization that taking the above-described steps would justify the sale of the Curbstone Management Shares without any legend restricting their resale. He testified at the hearing that he conveyed to Cavanagh Chachas' own legal conclusion that the Spanish Shares were "free trading" shares, as well as his concurrence in that judgment. Cavanagh in turn contends that he was entitled to and did rely upon Levy's legal opinion that the Spanish Shares were free trading shares. In any event, all three men knew that the purchase of unlegended Spanish Shares was an essential part of the acquisition of WTS by Curbstone, and that at the time those shares were committed to be sold, and were paid for, they were owned by men who controlled the decision as to whether Curbstone would acquire WTS.

Between December 24 and 26, the Spanish Shares as well as other EOSC shares were deposited into trading accounts at Donald & Co. The 2,713,000 shares so deposited constituted at least 77% of the "market float," that is, 77% of the 3,521,876 shares that were available for trading in the public market. Beginning in late December 1997, Tacopino began systematically liquidating these shares. When these shares are combined with the remaining 392,000 shares tied up by the Option Agreement and the 200,000 shares held by Curbstone Management under a lock-up agreement, Cavanagh controlled approximately 95% of the market float prior to liquidation.

On December 16, 1997, Milestone signed the agreement dated November 20, 1997, that Weiss and Friedman who had introduced Milestone to WTS had sent to Milestone on November 21, 1997. Pursuant to this document, Milestone agreed to convey 150,000 shares of EOSC to the two individuals as full payment for their consulting services.

During this period of time, Chachas obtained a CUSIP number for the new company and was notified that the company would bear the OTC trading symbol of EOSC On December 17, 1997, Chachas sent by overnight mail instructions to Day to issue new stock and to cancel and transfer existing stock. On December 18, Chachas and Brooksbank, acting as the "entire Board of Directors," executed a corporate resolution appointing four WTS employees as directors, accepting their own resignations as officers, and appointing in their stead five WTS employees as officers. On that same day, Day acted on the instructions that Chachas had sent him, completing both the acquisition and the sale of the Spanish Shares.

On December 19, at about 10:22 a.m., before there had been any public announcement of the acquisition, Cavanagh called Proudian, a trader at Alexander, Wescott & Co., and told him to buy 500 shares of EOSC at $7 per share for his client, Optimum Fund. Proudian called Donald & Co, placed the order, and made the trade. A trade at $7 per share reflected a market capitalization for EOSC of $140,000,000. As recently as November, the President of WTS labelled a market capitalization of $53 million after the investment of $4 million (which WTS had yet to receive) "astronomical."

The last trade before this $7 purchase of stock had, of course, occurred before the acquisition that had fundamentally changed the nature of the company. It occurred on November 12, 1997, when the stock had traded around 20 cents per share. Prior to Cavanagh's purchase, the December 19 market maker quotes for the stock were $.50 bid for 5,000 shares and no offer, that is, the market maker would pay $.50 for the stock and was not quoting a price at which it would sell the stock. After Cavanagh's purchase, Donald & Co. immediately changed its market maker quotes to $5 bid for 500 shares and $7 ask. Within minutes a second market maker followed suit.

The second trade in EOSC occurred at 10:53 a.m., when 3,000 shares were purchased at $5.50 per share through a Canadian broker-dealer for the account of Banca del Gottard, Zurich, Switzerland. Jean-Pierre Neuhaus, a Milestone client, who has signatory power over the *account that placed the order, soon received 50,000 EOSC shares from Cavanagh out of the Customer Safety account.*

Cavanagh orchestrated another purchase of EOSC stock on behalf of Optimum Fund at 11:13 a.m. This time Cavanagh placed a market order for 2,500 shares, which was filled at $5,375. Cavanagh contends that Stieghorst of Optimum Fund was enthusiastic about the stock and wished to own some.

Chachas then placed the fourth and final retail trade of the day: a market order for 100 EOSC shares at 2:10 p.m. The order was filled at $5 7/8 .

The effect of Cavanagh's first trade was to shift the market maker quotes for the EOSC stock. The cumulative effect of these four trades was to set a price for EOSC stock at over $5 per share prior to the public announcement of the acquisition, which occurred at 6:17 p.m. that day. Cavanagh and Chachas each had a substantial motive to move the price of the EOSC stock as high as possible in order to maximize their profits from the sales of Management Shares that they would be making in succeeding weeks.

At the request of Levy, Chachas prepared the Curbstone Form 8-K, filed on December 23, 1997. According to Chachas, he prepared the 8-K as an accommodation to EOSC, because he knew how to do electronic filing with the SEC (through the Edgar system), and, since the Christmas holidays were approaching, it would have been difficult for the company to find someone else to prepare the filing on short notice.

The 8-K provided the public with its most extensive information to date about WTS and the terms of the Curbstone/WTS merger. It included a copy of the Exchange Agreement, but did not disclose the sale of the Spanish Shares, the option agreement, the transfer of restricted stock to Milestone,[35] or the transfer of restricted stock to Levy. The 8-K indicated, as discussed above, that WTS had received a bridge loan in the amount of $500,000 that was to be converted into equity, and that an additional $500,000 was to be invested in Curbstone immediately after the closing. It did not disclose, however, that Regulation S stock had already been issued in connection with this $1 million investment.

The 8-K indicated that a total of 19,009,996 shares of Curbstone/EOSC stock would be outstanding after the closing. That figure includes the 3,521,876 shares that were represented as issued and outstanding prior to the closing, and the 15,488,120 shares that were represented *as being newly issued to WTS. It did not indicate what the architects of the transaction already knew namely, that the total number of outstanding shares was actually closer to 21 million shares. The additional 2.1 million shares had been issued to Agira and Optimum under Regulation S concurrently with the closing.*

The 8-K was amended by a filing that EOSC made on February 18, 1998. This filing disclosed the Regulation S sales to Agira and Optimum. It also indicated that the total number of shares outstanding was 21,084,818. The amended 8-K did not, however, cure all of the deficiencies in the December 23 filing. Because the amended 8-K was not the focus of the preliminary injunction hearing, the Court will note only a few brief observations about its failings.

Most importantly, it continued to portray the WTS-Curbstone merger as a stock-for-stock transaction, without disclosing the considerable additional terms of the deal that have been set forth in this Opinion. It also continued to represent, as had the December 23 8-K, that the 15,488,120 shares of Curbstone stock that were issued at the time of the acquisition went directly to WTS shareholders. Although it may have been true that EOSC management did not know about the side agreements arranged by Cavanagh, Levy, and Chachas, these agreements certainly did exist and EOSC's attorney, Levy, was their primary architect.

On January 12, 1998, an internet publication called The Future Superstock released to its subscribers its choice as the "Stock Pick of the Year for 1998" EOSC. It observed, after a lengthy discussion of the company's product plans, that The Future Superstock had set "a price target" of \$15 to \$18 per share for the EOSC stock over the next three months to a year. Among the data the publication relied upon in making its assessment of the company was its trading history, which was described as having begun on December 19, 1997, and having included a high of \$7 per share and a low of \$5 per share. On January 24, 1998, this article was publicly released. During the mid-January period, Cavanagh stepped up the pace of his liquidation of EOSC shares and the volume of trading in EOSC stock soared. Lehman, the man responsible for introducing Cavanagh to WTS, was responsible for introducing Bruss, Future Superstock's owner, to EOSC. Bruss, who testified at the hearing, explained that his investigation of EOSC included studying the EOSC trading history, interviewing its management, and looking at its business plan.

By January 30, however, EOSC abandoned any reticence it had about issuing press releases. It issued a release conveying that EOSC was already selling its new product to a company *called ADL Data Systems, Inc. ("ADL"). The release of this statement to the press was orchestrated by Levy and Friedman, one of those responsible for introducing WTS to Cavanagh in the summer of 1997. In late January 1998, Friedman, who also was a client of ADL, suggested to ADL's President David Pollack that Pollack might want to look at, and get distribution rights to, EOSC's fingerprint identification unit. Pollack contacted Weaver and began discussions about the fingerprint technology. Shortly thereafter, on January 30, Levy sent a draft letter to Pollack describing an agreement between the two companies. Pollack revised the draft letter to EOSC and sent it to Weaver. Pollack specifically told Levy that the letter was not a purchase order, and that he couldn't purchase what he hadn't evaluated.*

During the April hearing, the EOSC fingerprint identification technology was demonstrated in court using a computer "mouse" and computer terminal. The devices on which the process was demonstrated to the Court were not those intended for ADL. EOSC was creating a miniaturized version of the technology for ADL, among other potential customers, and had hoped to have a prototype manufactured by June or July 1998 to hand to prospective customers so that orders could be solicited. The point at which that prototype could be handed to customers would mark the end of the development stage for the product. As of January 30, ADL did not even have mechanical drawings for the prototype. If EOSC had successfully created a prototype to give to ADL and prospective customers by June or July, and had the customers wanted to order the product, EOSC could have been manufacturing it in significant quantities by the end of 1998. While EOSC may yet create a viable product, it has not yet done so and its development of the product was nowhere near the level of completion that was represented in the January 30 press release.

The SEC seeks various forms of preliminary relief predicated on an extension of the individual measures embodied in the March 13 Order, namely: (1) a preliminary injunction enjoining the defendants from future violations of the securities laws; (2) an asset freeze; (3) an accounting of the defendants' assets; (4) the repatriation of all monies associated with trades by the defendants in EOSC stock; and (5) a freeze on any further trading by the defendants and relief defendants in EOSC stock. An injunction against future securities violations is among the sanctions noted by the Second Circuit in Unifund SAL as having "grave consequences."

The SEC claims that Chachas and the Curbstone Management Shareholders were "issuers" under the foregoing definition, or affiliates, when they sold the Spanish shares in that they were under direct or indirect common control with the issuer, Curbstone. The SEC bases this *argument on the facts that two of the Management Shareholders, Chachas and Brooksbank, were officers and directors of Curbstone, and that the group collectively controlled 97% of its stock prior to the merger with WTS. Because the SEC maintains that the sale of the Spanish shares occurred prior to the completion of the merger with WTS on December 18, it argues that, at the time of the sale, the Management Shareholders were still in control of Curbstone. In the alternative, the SEC argues that, should the Court find that the actual sale occurred after the merger, the Management Shareholders acting through Chachas offered to sell their shares prior to the merger, and that such an offer alone constitutes a violation of Section 5.*

The question of whether a person is in a position of "control" is a question of fact and depends on the totality of the circumstances, including an appraisal of the influence the individual has on the management and policies of a company. See United States v. Corr, 543 F.2d 1042, 1050 (2d Cir. 1976). A person can be in a position of control over a corporation even without owning a majority of the voting stock. Id. Here, the Court finds that the SEC has amply met its burden of establishing that, for purposes of determining whether a Section 5 violation occurred, the Management Shareholders, acting through Chachas, were in a position of control over the company at the time that their shares were sold to the Spanish entities, even if the certificates comprising the majority ownership of the merged entity were transferred simultaneously or a few moments before the certificates effecting the sale of Spanish Shares were transferred. Throughout the days at issue here, the Management Shareholders controlled the decision of whether to acquire WTS and whether to file a registration statement to cover their sale of the Management Shares. They chose to proceed with the former and to omit the latter. Accordingly, the Court finds that the sale of the Spanish Shares was not exempt from registration under Section 4(1), because, for all practical purposes, it was a sale by affiliates.

The Court turns next to the SEC's alternative argument that an offer to sell unregistered securities constitutes a violation of Section 5. The pertinent section provides:

it shall be unlawful for any person, directly or indirectly ... to offer to sell or offer to buy ... any security, unless a registration statement has been filed as to such security ....

15 U.S.C. § 77e(c) (emphasis added). The SEC contends that, at a minimum, Chachas offered to sell the Management Shares to the Spanish entities in the two weeks prior to the completion of the merger, while he and the Management Shareholders unequivocally were still affiliates.

Chachas claims that, even if the Court should find that he made an offer of securities or sold securities while he was an affiliate, an injunction would not be warranted since he did not act *with scienter. According to Chachas, he was entitled to and did rely on an exemption known as 4(1) ½, which is not contained in the Securities Act but nevertheless has been recognized implicitly by the SEC and explicitly by commentators.*

The 4(1) ½ exemption, which allows affiliates to sell substantial amounts of their shares to private investors, has been so named because it falls between the cracks of the 4(1) and 4(2) exemptions, which allow, respectively, for private sales among persons who are not issuers, underwriters, or dealers, and for private sales by an issuer. As is the case for an issuer claiming an exemption for a private sale under 4(2), an affiliate claiming a 4(1) ½ exemption has the burden of establishing that such sales do not constitute a disguised public distribution.

In sum, the Court finds that the evidence concerning the 4(1) ½ exemption does not indicate that Chachas acted in good faith, even when viewed in the light most favorable to him. There simply is no evidence to support a finding that he either actually or reasonably believed that the Spanish Shares had been purchased with a view to long-term investment rather than with an intent to resell. Having rejected this argument as to why he should not be enjoined against future violations of Section 5, the Court concludes that the SEC has a strong likelihood of proving successfully at trial that Chachas, on behalf of the Management Shareholders, made an offer and a sale of affiliate shares in contravention of Section 5's requirements, and that he did so in knowing and intentional violation of the requirements of the law.

In light of the foregoing discussion, the analysis of the oral option agreement can be relatively brief. The terms of the agreement were effectively presented in writing by Chachas to Levy on December 3. The only material modification to those terms was the decision to advance the purchase of the first block of 150,000 shares covered by the options agreement to December 12, when Levy and Cavanagh sent Chachas $450,000. The record does not appear to reflect the date on which the certificates for those shares were transferred, but by later December the shares were apparently deposited in the Cambiarios account and were among the shares Cavanagh sold between late December and the end of January. Thus, Chachas, on behalf of the Management Shareholders, offered to sell and did sell Management Shares through an option agreement while an affiliate. These sales also violate Section 5, for all of the reasons set forth above with respect to the sale of the Spanish Shares.

The SEC alleges that the defendants violated two different statutory prohibitions against fraudulent activity. First, the SEC contends that the defendants violated Section 17(a) of the Securities Act, which is a general prohibition against fraud in the offer or sale of securities.

The three categories of activities prohibited by Section 17(a) do not have uniform culpability requirements. While scienter is a requirement to establish a violation of Section 17(a) (1), it is not a necessary element of the latter two categories. See Aaron v. SEC, 446 U.S. 680, 697, 100 S. Ct. 1945, 64 L. Ed. 2d 611 (1980); SEC v. First Jersey Secs., Inc., 101 F.3d 1450, 1467 (2d Cir.1996), cert. denied, U.S., 118 S. Ct. 57, 139 L. Ed. 2d 21 (1997).[65]

Second, the SEC alleges that the defendants violated Section 10(b) of the Exchange Act, which prohibits the use of manipulative or deceptive devices in connection with the purchase or sale of securities. Section 10(b) is enforced through SEC Rule 10b-5 ("Rule 10b-5"), which prohibits the use of any device, scheme, or artifice to defraud; any untrue statement or omission of material fact; and any acts, practice, or course of business that operates as a fraud or deceit upon any person, in connection with the purchase or sale of any security. 17 C.F.R. § 240.10b-5. Scienter is a necessary element of a Section 10(b) or Rule 10b-5 violation. Aaron v. SEC, 446 U.S. at 691.

For the reasons set forth above, the Court finds that the SEC has established a substantial likelihood of success in proving that the following defendants violated Section 5 of the Securities Act: Cavanagh, Milestone, Customer Safety, Cambiarios, Construcciones, Optimum, Agira, Levy, Chachas, Brooksbank and Hantges. Accordingly, the Court orders the assets frozen of these defendants to the extent of all proceeds received from sales of EOSC shares, except with respect to Cavanagh and Milestone. Because the Court has concluded that all of the Management Shares transferred to Customer Safety, Cambiarios, Construcciones, and Inversora were effectively under the control of Cavanagh and Milestone, the amount of the freeze order as it applies to Cavanagh and Milestone shall include the proceeds from the sales of any of those shares, including sales by those who received Customer Safety shares, unless those shares or proceeds have already effectively been frozen.

387 The Court enters a preliminary injunction against future violations of Section 5 as to the defendants Levy, Cavanagh, Milestone, Customer Safety, Cambiarios, Construcciones, and Chachas.

The Court finds that the SEC has established a substantial likelihood of success in proving that the following defendants violated Sections 17(a) and 10(b): Cavanagh, Milestone, Customer Safety, Cambiarios, Construcciones, and Chachas. Accordingly, the Court finds that an asset freeze, with the same terms as outlined above with respect to the Section 5 freeze, is warranted as to these defendants. The Court enters a preliminary injunction against future violations of

Sections 17(a) and 10(b) against Cavanagh, Milestone, Customer Safety, Cambiarios, and Construcciones.

2. SEC v. W.J. Howey Co[110]

The Securities and Exchange Commission instituted this action to restrain the respondents from using the mails and instrumentalities of interstate commerce in the offer and sale of unregistered and nonexempt securities in violation of § 5(a) of the Act[111]. The Howey Company owns large tracts of citrus acreage in Lake County, Florida. During the past several years, it has planted about 500 acres annually, keeping half of the groves itself and offering the other half to the public "to help us finance additional development." Each prospective customer is offered both a land sales contract and a service contract, after having been told that it is not feasible to invest in a grove unless service arrangements are made. While the purchaser is free to make arrangements with other service companies, the superiority of Howey-in-the-Hills Service, Inc., is stressed. Indeed, 85% of the acreage sold during the 3-year period ending May 31, 1943, was covered by service contracts with Howey-in-the-Hills Service, Inc.

The land sales contract with the Howey Company provides for a uniform purchase price per acre or fraction thereof, varying in amount only in accordance with the number of years the particular plot has been planted with citrus trees. Upon full payment of the purchase price, the land is conveyed to the purchaser by warranty deed. Purchases are usually made in narrow strips of land arranged so that an acre consists of a row of 48 trees. During the period between February 1, 1941, and May 31, 1943, 31 of the 42 persons making purchases bought less than 5 acres each. These tracts are not separately fenced, and the sole indication of several ownership is found in small land marks intelligible only through a plat book record.

The service contract, generally of a 10-year duration without option of cancellation, gives Howey-in-the-Hills Service, Inc., a leasehold interest and "full and complete" possession of the acreage. For a specified fee plus the cost of labor and materials, the company is given full discretion and authority over the cultivation of the groves and the harvest and marketing of the crops. The company is well established in the citrus business, and maintains a large force of

[110] SEC v. Howey Co., 328 U.S. 293 (1946).

[111] Securities Act of 1933.

skilled personnel and a great deal of equipment, including 75 tractors, sprayer wagons, fertilizer trucks, and the like. Without the consent of the company, the landowner or purchaser has no right of entry to market the crop; thus, there is ordinarily no right to specific fruit. The company is accountable only for an allocation of the net profits based upon a check made at the time of picking. All the produce is pooled by the respondent companies, which do business under their own names.

The purchasers, for the most part, are nonresidents of Florida. They are predominantly business and professional people who lack the knowledge, skill, and equipment necessary for the care and cultivation of citrus trees. They are attracted by the expectation of substantial profits. It was represented, for example, that profits during the 1943-1944 season amounted to 20%, and that even greater profits might be expected during the 1944-1945 season, although only a 10% annual return was to be expected over a 10-year period. Many of these purchasers are patrons of a resort hotel owned and operated by the Howey Company in a scenic section adjacent to the groves. The hotel's advertising mentions the fine groves in the vicinity, and the attention of the patrons is drawn to the groves as they are being escorted about the surrounding countryside.

They are told that the groves are for sale; if they indicate an interest in the matter, they are then given a sales talk. It is admitted that the mails and instrumentalities of interstate commerce are used in the sale of the land and service contracts, and that no registration statement or letter of notification has ever been filed with the Commission in accordance with the Securities Act of 1933 and the rules and regulations thereunder.

Section 2(1) of the Act defines the term "security" to include the commonly known documents traded for speculation or investment. This definition also includes "securities" of a more variable character, designated by such descriptive terms as "certificate of interest or participation in any profit-sharing agreement," "investment contract," and, "in general, any interest or instrument commonly known as a security.'" The legal issue in this case turns upon a determination of whether, under the circumstances, the land sales contract, the warranty deed and the service contract together constitute an "investment contract" within the meaning of § 2(1). An affirmative answer brings into operation the registration requirements of § 5(a), unless the security is granted an exemption under § 3(b). The lower courts, in reaching a negative answer to this problem, treated the contracts and deeds *as separate transactions involving no more than an ordinary real estate sale and an agreement by the seller to manage the property for the buyer.*

The term "investment contract" is undefined by the Securities Act or by relevant legislative reports. But the term was common in many state "blue sky" laws in existence prior to the adoption of the federal statute, and, although the term was also undefined by the state laws, it had been broadly construed by state courts so as to afford the investing public a full measure of protection. Form was disregarded for substance, and emphasis was placed upon economic reality. An investment contract thus came to mean a contract or scheme for "the placing of capital or laying out of money in a way intended to secure income or profit from its employment." State v. Gopher Tire & Rubber Co., 146 Minn. 52, 56, 177 N.W. 937, 938. This definition was uniformly applied by state courts to a variety of situations where individuals were led to invest money in a common enterprise with the expectation that they would earn a profit solely through the efforts of the promoter or of some one other than themselves. By including an investment contract within the scope of § 2(1) of the Securities Act, Congress was using a term the meaning of which had been crystalized by this prior judicial interpretation. It is therefore reasonable to attach that meaning to the term as used by Congress, especially since such a definition is consistent with the statutory aims. In other words, an investment contract, for purposes of the Securities Act, means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise. Such a definition necessarily underlies this Court's decision in SEC v. Joiner Corp., 320 U. S. 344, and has been enunciated and applied many times by lower federal courts. It permits the fulfillment of the statutory purpose of compelling full and fair disclosure relative to the issuance of "the many types of instruments that, in our commercial world, fall within the ordinary concept of a security." It embodies a flexible, rather than a static, principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.

The transactions in this case clearly involve investment contracts, as so defined. The respondent companies are offering something more than fee simple interests in land, something different from a farm or orchard coupled with management services. They are offering an *opportunity to contribute money and to share in the profits of a large citrus fruit enterprise managed and partly owned by respondents. They are offering this opportunity to persons who reside in distant localities and who lack the equipment and experience requisite to the cultivation, harvesting, and marketing of the citrus products. Such persons have no desire to occupy the land, or to develop it themselves; they are attracted solely by the prospects of a return on their investment. Indeed, individual development of the plots of land that are offered and sold would seldom be economically feasible, due to their small size. Such tracts gain utility as citrus groves only when cultivated and developed as component parts of a larger area. A common enterprise managed by respondents or third parties with adequate personnel and equipment is therefore essential if the investors are to achieve their paramount aim of a return on their investments. Their respective shares in this enterprise are evidenced by land sales contracts and warranty deeds, which serve as a convenient method of determining the investors' allocable shares of the profits. The resulting transfer of rights in land is purely incidental.*

Thus, all the elements of a profit-seeking business venture are present here. The investors provide the capital and share in the earnings and profits; the promoters manage, control, and operate the enterprise. It follows that the arrangements whereby the investors' interests are made manifest involve investment contracts, regardless of the legal terminology in which such contracts are clothed. The investment contracts in this instance take the form of land sales contracts, warranty deeds, and service contracts which respondents offer to prospective investors. And respondents' failure to abide by the statutory and administrative rules in making such offerings, even though the failure result from a bona fide mistake as to the law, cannot be sanctioned under the Act.

This conclusion is unaffected by the fact that some purchasers choose not to accept the full offer of an investment contract by declining to enter into a service contract with the respondents. The Securities Act prohibits the offer, as well as the sale, of unregistered, nonexempt securities. Hence, it is enough that the respondents merely offer the essential ingredients of an investment contract.

We reject the suggestion of the Circuit Court of Appeals, 151 F.2d at 717, that an investment contract is necessarily missing where the enterprise is not speculative or promotional in character and where the tangible interest which is sold has intrinsic value independent of the success of the enterprise as a whole. The test is whether the scheme involves an investment of *money in a common enterprise with profits to come solely from the efforts of others. If that test be satisfied, it is immaterial whether the enterprise is speculative or nonspeculative, or whether there is a sale of property with or without intrinsic value. See SEC v. Joiner Corp., supra, 320 U. S. 352. The statutory policy of affording broad protection to investors is not to be thwarted*[112] *by unrealistic and irrelevant formulae.*

[112]Prevent (someone) from accomplishing something.

VIII. CONCLUSION

The SEC v. Ripple case is crucial as is set to clarify how cryptocurrencies are classified under U.S. securities law, influencing the regulatory landscape. The case touches many complex issues such as definition of a security, regulatory clarity and precedent setting. This case has underscored the importance of legal debates over how crypto assets are classified and regulated in the United States.The case that will be heard by the court contains matters that make it fit to be considered a precedent for other industry players while demonstrating the need for collaboration between regulators and market participants to develop clearer and fairer regulations. Moving forward, this case shall serve as a blueprint for future disputes, encouraging collaboration and fostering a regulatory environment that protects investors without stifling technological advancement.

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