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

CRYPTO FREEDOM ALLIANCE OF TEXAS and BLOCKCHAIN ASSOCIATION,

Plaintiffs,

v.

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

Defendants.

Case No. 4:24-cv-00361-O

**PLAINTIFFS' BRIEF IN SUPPORT OF
THEIR MOTION FOR SUMMARY JUDGMENT**

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PRELIMINARY STATEMENT

This case involves another attempt by the Securities and Exchange Commission to expand its regulatory ambit through unexplained and irrational rulemaking. Nearly a century ago in the Securities Exchange Act, Congress empowered the Commission to regulate securities "dealers"—market intermediaries who make their living from buying securities their customers want to sell and selling securities their customers want to buy, often along with related services such as providing investment advice and clearing and safekeeping customer assets. These intermediary services are critically important in traditional financial markets. But due to the information asymmetries and risks inherent in the dealer-customer relationship, Congress recognized the potential for misconduct by dealers and deputized the Commission to guard against it.

The digital asset industry, however, has developed a novel trading model that allows peer-to-peer trading and direct access to market liquidity, without relying on dealer intermediaries. This new model of decentralized finance (or "DeFi") relies on distributed ledgers—decentralized networks such as blockchains that record and publish the history and details of digital asset transactions. Transactions are facilitated through protocols and "smart contracts" built with open-source software that participants can freely inspect, allowing a trader to know in advance exactly how and when a transaction will be executed and at what cost. And to ensure liquidity, the industry has developed "liquidity pools" that crowdsource digital assets, so that any user can trade a digital asset he or she holds for another asset available in the pool. These pools also operate using open-source software that automatically adjusts prices as the makeup of assets in the pools shifts. Digital asset traders accordingly no longer need to rely on dealers to quote prices, advise on trades, settle

transactions, or take custody of assets; pricing is determined by open-source software protocols, settlement takes place on a peer-to-peer basis, and traders custody their own assets. Although the software substitutes for a dealer in performing these functions, it is merely transparent, open-source, automated code, not a dealer itself.

Together, these innovations in DeFi have substantially eliminated the "human risk" posed by dealers. Anyone acting as a "dealer" or market maker in digital assets would participate on these protocols on the same terms as any other trader, without any special role or informational advantage over anyone else.

All of that is why it is so puzzling that plaintiffs have been forced to bring this litigation. Earlier this year, the Commission adopted a rule that drastically expands the statutory definition of "dealer" under the Securities Exchange Act. App. 54 ("Dealer Rule"). That new interpretation is so broad that it could sweep in traders and other participants in DeFi protocols, despite the fact that these markets innovated to operate without the need for dealer intermediation. Yet in insisting that the new rule will apply to digital assets despite numerous objecting comments from the digital asset industry, the Commission refused to even address that paradoxical result, much less justify it.

In particular, contrary to the text and longstanding interpretation of the Exchange Act—which looked to whether an individual offered traditional dealer services to customers as part of a "regular business"—the Commission's new rule would treat any person whose trading activity regularly has *the effect of providing liquidity* as a "dealer." That reinterpretation is unlawful not only because it conflicts with the statutory definition, but also due to the Commission's unexplained refusal to sufficiently address or explain its

application to the digital asset industry. As Commissioner Peirce pointed out in her dissenting statement, the Dealer Rule "reflects little thought regarding its practical application in the crypto markets." App. 205. Whether through willful blindness or as part of a broader campaign of strategic ambiguity, the Commission ignored critical questions raised by industry participants and failed to grapple with how the Dealer Rule would (or even could) apply in digital asset markets. That is quintessential arbitrary and capricious rulemaking, and this Court should set the rule aside.

At the outset, the Commission's new interpretation of what it means to be a "dealer" is invalid because it is contrary to the definition in the Exchange Act. As has been understood since the Act's passage, Congress defined dealers to mean those engaged in "the regular business" of buying and selling securities as a service to customers, and specifically exempted traders who buy and sell securities for their own purposes rather than as part of a dealer business. The Rule unlawfully attempts to jettison that distinction by redefining the "regular business" of being a dealer as conduct that has the *post hoc* effect of providing market liquidity.

But beyond that statutory problem, the Dealer Rule represents a total failure to meet the Administrative Procedure Act's standards for reasoned decisionmaking due to the manner in which the Commission addressed the digital asset industry. First, the Commission made no meaningful effort to respond to the numerous comments and questions raised by the industry about why or how the Dealer Rule would apply to digital asset market participants. Commenters pointed out that the Commission still had not clarified which digital asset transactions qualify as securities transactions, which is a

threshold requirement for determining whether the Rule applies at all. On top of that, commenters raised numerous questions about how a regulatory framework designed for dealers acting as intermediaries in traditional financial markets would or could apply to trading activity in decentralized digital asset markets that employ software to *eliminate* the need for a dealer intermediary between traders. Substantively addressing these comments and questions is one of the Commission's most fundamental APA duties. Yet the Commission ignored them.

Second, the Commission never explained why its new rule was warranted in the context of digital asset markets. The Commission focused entirely on a perceived need to address risks in *traditional* financial markets, particularly the role of proprietary trading firms operating in the Treasuries market. The Commission never identified any comparable concerns with digital asset markets, or otherwise explained why applying the new rule to digital asset markets was justified. The APA requires agencies to rationally explain their decisionmaking, and promulgating a rule to expand regulatory reach does not satisfy that requirement.

Third, the Commission failed to analyze the economic effects of the rulemaking on efficiency, competition, and capital formation in the digital asset industry, as required by the APA and the Exchange Act. The Commission hardly even gestured at this obligation. It instead threw up its hands and claimed that it was too difficult to even estimate the number of digital asset market participants that would be affected by the Rule. But that excuse does not hold up. The Commission could have availed itself of the publicly available transaction data that is a defining feature of decentralized finance, or it could have solicited

data from the digital asset industry. Its failure to even try to estimate the costs that the Rule would impose on an industry before subjecting it to amorphous new regulatory obligations falls far short of the Commission's duties under the Exchange Act and the APA.

Finally, the Commission's application of the Dealer Rule to the digital asset industry fails basic notice requirements under the APA. The Proposed Rule mentioned potential application to digital assets in a lone footnote and did not contain a single request for comment about the new rule's potential application to those markets. Although industry participants nonetheless submitted comments raising substantial questions and concerns, the public cannot meaningfully comment on a proposed rule when the Commission never even hints at how the rule might apply to them. The Commission's apparent view that a single, vague footnote in a proposed rule provides sufficient notice under the APA would effectively eliminate the APA's notice requirement altogether.

For each of these independent reasons, the Dealer Rule violates the APA and should be set aside.

BACKGROUND

A. The Regulation Of "Dealers" Under The Exchange Act

The Exchange Act provides the statutory authority for federal regulation of the secondary securities markets. The different requirements of the Act depend on the nature of the securities transaction in question and a party's role in the transaction.

The Act focuses much of its regulatory application on intermediaries involved in securities transactions. For example, the Act provides for regulation of "brokers," i.e., "any person engaged in the business of effecting transactions in securities for the account of others." 15 U.S.C. § 78c(a)(4)(A). In other words, a broker acts as an agent, navigating the

markets and buying and selling securities on behalf of clients. The Act also provides for regulation of "dealers," i.e., a "person engaged in the business of buying and selling securities . . . for such person's *own account*." 15 U.S.C. § 78c(a)(5)(A) (emphasis added); *see also id.* § 78c(a)(44) (similarly defining "government securities dealer"). Dealers, like brokers, provide an important service to their customers, but they do so as a counterparty rather than an agent. Using their own inventories, dealers fulfill traders' demands to buy and sell securities at prices set by the dealer based on his or her assessment of the market.

The Act recognizes a core distinction between dealers and traders. The definition of "dealer" specifically excludes persons buying or selling securities for their own accounts, "but not as a part of a regular business." *Id.* § 78c(a)(5)(B). Commonly referred to as the "trader exception," this carve-out for individuals who buy and sell securities for their own investment purposes, rather than as part of a "regular business" of buying and selling securities as a service to customers, has been a part of Congress's statutory scheme since the passage of the Exchange Act. The Exchange Act's definition of "dealer" thus turns on whether a party affirmatively holds itself out to the market as being in the business of buying and selling securities, in order to profit from fees and the price spreads the dealer sets for those transactions. *See* Compl. ¶¶ 46-52.

Given the importance of dealer services and potential for abuse due to their information disparity and pricing power, Congress subjected securities dealers to a comprehensive regulatory framework to protect investors. *See* App. 212 (The Twentieth Century Fund, *The Security Markets: Findings and Recommendations of a Special Staff of the Twentieth Century Fund* (1935) at 267) ("It is easy to see that there is considerable

opportunity for exorbitant charges [by dealers] . . . [and] no good check on the prices reported to customers."). Dealers must register with the Commission and comply with extensive regulations. They must abide by recordkeeping requirements, 17 C.F.R. § 240.17a-4, stay above net capital thresholds, *id.* § 240.15c3-1, and comply with various disclosure obligations, including providing mandated notices to customers, *id.* §§ 240.10b-10(a)(2), 240.15l-1(a)(2)(i)(A)(2). The Commission also requires dealers to become members of the Financial Industry Regulatory Authority (FINRA) and join and contribute to the Securities Investor Protection Corporation (SIPC). The compliance costs associated with these requirements run well into the hundreds of thousands of dollars per year (or more).

B. The Digital Asset Industry's Facilitation Of Trading Without The Need For Dealers Or Other Market Intermediaries

While intermediaries such as dealers are necessary to the successful functioning of traditional financial markets, the digital asset industry has developed a new model of direct peer-to-peer trading that is expressly designed to avoid the need to rely on intermediaries. Digital assets are "digital representations of value." App. 215 (Eva Su, *Digital Assets and SEC Regulation*, CONG. RESEARCH SERV., at I (June 23, 2021)). Evolving from a mere concept in a 2008 whitepaper, digital assets are today an ordinary facet of modern life and an institutionally supported asset class. *See* App. 238-40 (Kathleen Breitman, *Why Satoshi Nakamoto is smiling at BlackRock's embrace of Bitcoin*, FORTUNE CRYPTO (Jan. 20, 2024)). In addition to cryptocurrencies like Bitcoin, digital assets can fulfill any purpose for which software can be tailored—such as representing ownership of networks enabling digital products and services, operating as a digital store of value, or representing art, to name a few examples.

Today, digital assets are not merely the realm of the niche trader. Participants in digital asset markets now include institutional investors, retail customers, and everyone in between, and digital assets have become an important and increasing contributor to global economic growth. Indeed, a February 2023 survey found that 20% of adult Americans owned digital assets. App. 242 (*New survey of 2,000+ American adults suggests 20% own crypto*, COINBASE (Feb. 27, 2023)). Many "[h]ousehold" companies "now accept payment in one or more digital currencies." App. 129 (Consensys Comment Letter (May 26, 2022) at 3). And many financial advisors recommend "long-term investment[s]" in digital assets as part of Americans' investment portfolios, given their overall status as an important new asset class. App. 249-50 (Carmen Reinicke, *You should have cryptocurrency in your portfolio, no matter your age, advisors say*, CNBC (Dec. 9, 2021)). As of March 2024, digital assets represented a $2.7 trillion market. *See* App. 251 (*Digital Assets Dashboard*, FINANCIAL TIMES).

Digital asset transactions take advantage of a number of core technological innovations that increase transparency, eliminate middlemen, and lower costs. In doing so, these decentralized digital asset platforms facilitate peer-to-peer transactions without the need to rely on centralized, traditional financial intermediaries (such as banks, clearinghouses, brokers, and dealers).

Blockchains/Smart Contracts. Digital assets typically are "issued and transferred using distributed ledger or blockchain technology." App. 217 (Su, *Digital Assets and SEC Regulation* at 1). In its simplest sense, a distributed ledger (such as blockchain) is a database of transactions that is coordinated across a broad and diverse group of computer

"nodes" that form a network in which no third-party intermediary is required to maintain transaction data or broadcast a new transaction in the network. *See* App. 256-59 (*Blockchain basics: Introduction to distributed ledgers*, IBM (June 1, 2019)). Software programs built onto these networks, known as smart contracts, can facilitate any number of activities involving digital assets, from simple trading of digital assets to more complex activities like blockchain-based social media and video games. *See* App. 184 (DeFi Education Fund (DEF) Comment Letter (May 27, 2022) at 4). These programs are based on open-source code, which is not controlled by a single person or entity, and enable anyone with an internet connection to buy or sell digital assets at any time of day. *Id.* There is no need for a bank, clearinghouse, broker, or dealer in order to trade; a person wishing to transact on a distributed ledger utilizes the smart-contract software, which automatically executes the transaction without any need to identify a specific counterparty or involve a third-party intermediary. *Id.*

Liquidity Pools and AMMs. As with any nascent market, ensuring sufficient liquidity is particularly important. Early digital asset markets "had fewer buyers and sellers" than traditional markets and by design lacked third-party intermediaries to match buyers and sellers as counterparties to transactions. App. 186 (DEF Comment at 6). But the industry has developed creative ways to enhance liquidity in digital assets without the need for an intermediary. In particular, the DeFi ecosystem invented the concept of a liquidity pool, an "innovation" that has "no immediate equivalent in traditional finance." App. 266 (Ekin Genç, *What Are Liquidity Pools? The Funds That Keep DeFi Running*, DECRYPT, at 1 (Mar. 2, 2023)). A typical liquidity pool is an autonomous software program

operated on a blockchain that enables users to crowdsource relevant digital assets from a distributed ledger's users. Smart contract software then makes those assets available for trading based on the rules of the smart contract, which are public, transparent, and accessible by anyone who wishes to understand how the program functions. *See* App. 186 (DEF Comment at 6). With a liquidity pool, traders looking to buy or sell digital assets do not need to seek out counterparties willing to engage in the proposed transaction. They can simply access the liquidity pool's assets for the transaction. *Id.*

Unlike in traditional financial markets where market makers set prices on both sides of the market based on their assessment of supply and demand, prices in a liquidity pool are adjusted automatically. Using a formula built into the pool's smart contract—known as automated market maker (AMM) software—the prices of the remaining assets in the pool increase or decrease after each transaction according to supply and demand. App. 267 (Genç, *What Are Liquidity Pools? The Funds That Keep DeFi Running*, at 2). For example, if a user holding Digital Asset A wants to buy Digital Asset B, the user contributes Digital Asset A to the pool and receives Digital Asset B from the pool. *Id.* The AMM software then automatically adjusts the prices of the two digital assets accordingly, decreasing the price to transact in the more-plentiful Digital Asset A and increasing the price to transact in the less-plentiful Digital Asset B going forward. *Id.* Thus, "by leaving their assets in the pool," users "expos[e] those assets to sale at the pool's prevailing exchange rate," which changes on a transaction-by-transaction basis as dictated by the AMM software. App. 188 (DEF Comment at 8).

Users who contribute their assets to the pool receive liquidity provider tokens. App. 187 (DEF Comment at 7). These tokens provide users with the right to later reclaim their assets and the fees they have earned. *Id.* But unlike dealers, those users play no role in setting prices, which are determined entirely by automated AMM software.

C. The Commission's Expansive New Definition Of "Dealer"

In February 2024, a sharply divided 3-2 majority of the Commission adopted an expansive new interpretation of the Exchange Act's definition of "dealer." The Commission stated that the rule may capture digital asset market participants, but provided no clarity as to why or how it would do so.

i. The Commission's new *post hoc* interpretation

On April 18, 2022, the Commission issued its proposed rule to expand the meaning of the statutory term "dealer" under the Exchange Act. *See* App. 1 ("Proposed Rule"). Under the Proposed Rule, a market participant would be required to register as a "dealer" if it "[e]ngage[d] in a routine pattern of buying and selling" securities or government securities "that ha[d] the effect of providing liquidity to other market participants." App. 9.

The Proposed Rule was focused on certain participants in traditional financial markets. But it contained one isolated reference to digital assets in a footnote. That footnote stated that the proposed new tests would apply to "any digital asset that is a security or a government security within the meaning of the Exchange Act." App. 4. The Proposed Rule contained no discussion of which digital asset transactions constitute securities transactions, how or why the Proposed Rule would apply to trading in digital assets, or who would be required to register as a securities dealer based on their activities in those markets. Nor did it contain any economic analysis of the Proposed Rule's costs or

benefits for the digital asset industry. And although the Commission sought comment on a number of specific issues, none of those questions concerned the Proposed Rule's application to the digital asset industry.

ii. The digital asset industry raises concerns

For this proposed reinterpretation of what the Commission described as "one of the Exchange Act's most important definitions," App. 4, the Commission provided only 39 days for comment. Despite that rushed comment period, numerous commenters raised significant concerns. Particularly relevant here, in response to the single, vague reference to digital assets, the digital asset industry submitted numerous comments raising serious questions and objections to the Proposed Rule's application to that industry.

At the outset, industry members objected that the single mention of digital assets in a footnote provided insufficient notice of how, why, and to what extent the Commission intended to apply the rule to the digital asset markets. *See, e.g.*, App. 191-92 (DEF Comment at 11); App. 199-201 (Chamber of Digital Commerce Comment at 4-6) ("[I]t is completely unclear whether the Commission proposes that the term 'dealer' now include digital asset or cryptocurrency market participants since there is no reference to digital asset market intermediaries anywhere in almost 200 pages of regulatory discussion and not one request for comment relates to the impact of the Proposal[] on the digital asset industry."). The ambiguity of the footnote was particularly acute in light of the Commission's longstanding refusal to clarify which transactions in which digital assets constitute securities transactions. *See, e.g.*, Compl. ¶¶ 35, 52; App. 174 (Andreesen Horowitz (a16z) Comment Letter (May 27, 2022) at 10) ("[T]he Commission should not

compound the costs of uncertainty over the status of digital assets through a single sentence in a footnote of the Proposal.").

As for the substance of the proposal, like many other commenters, the digital asset industry explained that the Commission had exceeded its statutory authority by "effectively eliminat[ing] the statutory 'trader' exclusion to the 'dealer' definition." *See, e.g.*, App. 156 (Blockchain Association (BA) Comment Letter (May 27, 2022) at 1); App. 189-91 (DEF Comment at 9-11); App. 134-40 (Consensys Comment at 8-14). But the industry also raised significant and unique concerns about *how* the Proposed Rule would apply to the industry. Commenters raised concerns that the Proposed Rule's "breadth and ambiguity . . . raise many questions about the [registration] status" of market participants in light of the unique features of DeFi, such as AMM software, that are designed to facilitate liquidity in digital asset markets without need for intermediaries. App. 187 (DEF Comment at 7); *see also* App. 159 (BA Comment at 4) ("Even if certain digital assets are to be deemed securities, the SEC has provided no type of definitive guidance about how this dynamic, innovative, and fast-growing sector can comply with the various requirements of the securities laws, which were designed for the traditional securities markets."). For example, one commenter asked whether "[a]ll participants in a liquidity pool are, by leaving their assets in the pool [and] exposing those assets to sale at the pool's prevailing exchange rate," operating as dealers. App. 188 (DEF Comment at 8). That commenter also asked whether participants in a liquidity pool, because they "receive [liquidity provider tokens] for their participation," would now be considered to be in the "regular business" of dealing. *Id.* Another commenter asked who would be required to register when automated software (the AMM protocol)

facilitates trades, but obviously could not itself be a "dealer." App. 133 (Consensys Comment at 7).

Given these concerns, digital asset industry commenters warned that the Proposed Rule's "implications—mandating that an entire burgeoning industry be subject to onerous registration requirements . . . —are massive." App. 192 (DEF Comment at 12). Specifically, the Dealer Rule "may well drive firms to cease providing the very liquidity the safeguarding of which is the proposal's asserted core purpose." App. 143-44 (Consensys Comment at 17-18). "[I]f market participants cannot easily evaluate their obligations under the Exchange Act and Commission rules," commenters explained, "many will pare back their liquidity-providing activities or leave [decentralized exchanges] altogether." App. 174 (a16z Comment at 10). And reduced liquidity in the digital asset markets would have substantial downstream consequences for all digital asset markets participants, including driving users back to traditional, dealer-centric platforms and stifling innovation. *See* Compl. ¶¶ 70-71. The Commission's cost-benefit analysis in the Proposed Rule addressed only the proposal's impact on traditional securities markets, while "disregard[ing] economic effects on the digital assets markets." App. 162 (BA Comment at 7); *see* Compl. ¶¶ 72-73.

In light of these pervasive issues and unanswered questions, commenters urged the Commission, if it decided to finalize the rule in some form, "to exempt from [the Proposed Rule's] requirements activities implicating digital assets, as there is no support for this rulemaking to apply to them." App. 194 (DEF Comment at 14).

iii. The Commission's failure to address industry comments

On February 29, 2024, after another 3-2 vote, the Commission issued its final rule, reinterpreting the meaning of "dealer" to include any person whose trading activity

"regular[ly]" has the "effect of providing liquidity" to the market. App. 59. The Rule adopted two tests for provision of liquidity that would trigger dealer registration, both of which are based on the *post hoc* effect of a market participant's trading activities. Specifically, the Dealer Rule establishes that any person that engages in the following activities as part of a regular business would be a "dealer": (i) "Regularly expressing trading interest that is at or near the best available prices on both sides of the market for the same security and that is communicated and represented in a way that makes it accessible to other market participants"; or (ii) "Earning revenue primarily from capturing bid-ask spreads, by buying at the bid and selling at the offer, or from capturing any incentives offered by trading venues to liquidity-supplying trading interest." App. 60. The Rule then adds, however, that "no presumption shall arise that a person is not a dealer" even if the person does not satisfy either of the two new tests. App. 62.

Market participants whose trading activity is captured by either of these two new tests are required to "register as dealers with the Commission," "become members of [FINRA]," and "adhere to a comprehensive regulatory regime," including operational integrity rules, net capital requirements, books and records requirements, reporting and disclosure requirements, and antifraud and anti-manipulation provisions. App. 82. Notably, the Commission did not address how a participant in digital asset markets would go about registering, given that there is no clear framework for registering as a traditional or special purpose broker-dealer in digital assets. App. 149-50 (Global Digital Asset & Cryptocurrency Association (GDACA) Comment Letter (May 27, 2022) at 2-3).

The Commission declined to substantively engage with the extensive concerns raised by the digital asset industry. It simply asserted that "[t]he final rule[] appl[ies] to the buying and selling of all securities, including crypto assets that are securities or government securities within the meaning of the Exchange Act," and that "[t]he dealer framework is a functional analysis based on the securities trading activities undertaken by a person, not the type of security being traded." App. 76. In response to comments explaining the unique features of DeFi and raising questions about how the rule would apply to participants using DeFi trading protocols, the Commission simply stated that "[t]here is nothing about the technology used, including distributed ledger technology-based protocols using smart contracts, that would preclude crypto asset securities activities from falling within the scope of dealer activity." *Id.* And the Commission again focused its cost-benefit analysis almost exclusively on the U.S. Treasury market, proprietary trading firms (PTFs), and hedge funds. As a purported explanation for ignoring the costs to the digital asset industry, the Commission stated that it was "unable to estimate the number of crypto asset market participants who would be affected by the rule[]." App. 90.

The Dealer Rule took effect on April 29, 2024, with a compliance date one year after the effective date. App. 54, 80.[1]

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[1] Plaintiffs undoubtedly have standing to challenge the Dealer Rule. "Associations may assert the standing of their own members." *Tex. Ass'n of Mfrs.* v. *U.S. Consumer Prod. Safety Comm'n*, 989 F.3d 368, 377 (5th Cir. 2021). Members of both Plaintiff CFAT and Plaintiff BA will suffer substantial economic harms if they are required to register with the Commission under the Dealer Rule. *See* Compl. ¶¶ 16, 43; App. 359-64 (Declaration of B. Quintenz (CFAT Decl.)); App. 353-58 (Declaration of M. Coppel (BA Decl.)). Liquidity pools also depend on broad participation by asset holders, many of whom will likely abandon these protocols altogether due to the risks of being labeled a dealer under the Rule,

LEGAL STANDARD

"In the context of a challenge to an agency action under the APA, '[s]ummary judgment is the proper mechanism for deciding, as a matter of law, whether an agency action is supported by the administrative record and consistent with the APA standard of review.'" *Texas* v. *U.S. Dep't of Transp.*, 2024 WL 1337375, *6 (N.D. Tex. Mar. 27, 2024) (citation omitted).

The APA requires that a court "hold unlawful and set aside agency action, findings, and conclusions found to be," among other things, "in excess of statutory jurisdiction, authority, or limitations." 5 U.S.C. § 706(2)(C). The "core inquiry" in such a challenge is "whether the proposed agency rule is a lawful extension of the statute under which the agency purports to act." *VanDerStok* v. *Garland*, 86 F.4th 179, 188 (5th Cir. 2023). The APA further directs that agency rulemakings be set aside if they are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). A court's review is "searching and careful," and requires that an agency "examine the relevant data and articulate a satisfactory explanation for its action." *Univ. of Tex. M.D. Anderson Cancer Ctr.* v. *U.S. Dep't of Health & Human Servs.*, 985 F.3d 472, 475 (5th Cir. 2021) (citation omitted).

The Exchange Act imposes on the Commission the specific obligation to consider if a new rule "will promote efficiency, competition, and capital formation." 15 U.S.C. § 78c(f);

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inflicting harms on the members that operate these platforms and develop software for participants to trade on them. Compl. ¶ 115; App. 362-63 (CFAT Decl. ¶¶ 8, 10); App. 356-57 (BA Decl. ¶¶ 8, 10). Each of these harms will be redressed by an order setting aside the Dealer Rule.

see also id. § 78w(a)(2). The Commission therefore has a statutory duty "to determine as best it can the economic implications of the rule." *Bus. Roundtable* v. *SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (citation omitted).

ARGUMENT

The Dealer Rule constitutes unlawful agency rulemaking for several independent reasons. At a foundational level, the Dealer Rule exceeds the statutory authority Congress gave the Commission to regulate securities dealers, because the Rule impermissibly expands the meaning of "dealer" beyond what the statutory text, structure, and context will bear. On top of that, the Commission's determination that the Rule applies to the digital assets markets violated virtually every requirement imposed by the APA as a condition of reasoned decisionmaking. The Court should thus apply the "default rule" under the APA and vacate the Rule. *Chamber of Com. of U.S.* v. *SEC*, 88 F.4th 1115, 1118 (5th Cir. 2023) (citation omitted).

I. THE COMMISSION'S DEPARTURE FROM THE WELL-SETTLED MEANING OF "DEALER" EXCEEDS ITS STATUTORY AUTHORITY (COUNTS I, IV).

Congress defined who is a "dealer" under the Exchange Act. The Act provides the Commission the authority to regulate persons who meet that definition, not to redefine that term to expand its regulatory reach. But the Commission has done just that. The Commission's expansive reinterpretation of the definition of "dealer," which contradicts the text of the statute, years of consistent judicial interpretation, and the Commission's own decades-long prior practice without explanation, exceeds its statutory authority and violates the APA.

A. The Exchange Act's Definition Of "Dealer" Turns On *Ex Ante* Consideration Of The Services Offered To Customers, Not The *Post Hoc* Effect Of Trading Activity.

Congress defined "dealer" as "any person engaged in the business of buying and selling securities" for his or her "own account," but specifically excluded from the definition anyone whose buying and selling of securities is "not as part of a regular business." 15 U.S.C. § 78c(a)(5). That definition, as the text and historical context make clear, distinguishes between traders and dealers by looking at the services that an individual offers as part of a regular business. A trader that "does not provide advice or services to other investors, but is instead acting in its own best interests," is not engaging in the "regular business" of dealing and thus does not constitute a dealer under the Act. *Chapel Invs., Inc.* v. *Cherubim Ints., Inc.*, 177 F. Supp. 3d 981, 991 (N.D. Tex. 2016). By seeking to now sweep in traders based on a *post hoc* assessment of the effect of their trading activities, the Commission's definition unlawfully "obliterates" that statutory distinction. App. 203 (Peirce, *Dissenting Statement*).

1. The statutory question here involves the correct interpretation of "a regular business" under § 78c(a)(5)(B). Where Congress imports into a statute language that has developed "accumulated settled meaning," courts will generally infer that Congress incorporated that meaning unless the statute dictates otherwise. *Field* v. *Mans*, 516 U.S. 59, 69 (1995) (citation omitted); *see La. Public Serv. Comm'n* v. *FCC*, 476 U.S. 355, 372 (1986) ("[T]echnical terms of art should be interpreted by reference to the trade or industry to which they apply."). In passing the Exchange Act, Congress was not legislating in a

vacuum; it acknowledged that it was stepping into an existing industry with developed "practices" within a "national market system." 15 U.S.C. § 78b.

As contemporaneous sources around the time of the Act's passage make clear, the industry at that time understood the "regular business" of dealing to refer to a market intermediary offering to buy and sell securities to customers as a regular service. As one prominent treatise explained, a dealer is "in the business of buying and selling securities for his own account," and "sells to his customers . . . securities which he has purchased for his own account elsewhere, or buys from his customers securities for his own account with a view of disposing of them elsewhere at a profit." App. 271-72 (Charles H. Meyer, *The Law of Stockbrokers and Stock Exchanges*, 32-33 (1933)); *see Johnson* v. *Winslow*, 279 N.Y.S. 147, 156-57 (Sup. Ct., N.Y. Cnty. 1935) (relying on Meyer in defining dealer).

In other words, a dealer "buys a given security from one customer and sells it to another," attempting to "profit from the difference between his buying and selling prices." App. 210, 212 (The Twentieth Century Fund, *The Securities Markets*, 263, 266); *see also Schafer* v. *Helvering*, 299 U.S. 171, 173 (1936) (defining dealer as "one who, as a merchant, buys and sells securities to customers for the profit thereon"). That was the "business" of dealing then, just as it is now. Notably, because dealing refers to services offered to the public, dealers necessarily *choose* whether to provide these kinds of services and engage in that business model. Congress imported that "accumulated settled meaning" into the statute when it made the definition turn on the "regular business" of dealing.

2. It is therefore unsurprising that courts, including this one, have looked to the services that a person offers to the market to distinguish dealers from traders—meaning

that individuals and firms necessarily know in advance whether they are engaged in the business of dealing. As this Court explained, "[t]o be considered a dealer, a person must be engaged in the securities *business*," a business that entails "soliciting investor clients, handling investor clients' money and securities, rendering investment advice to investors, and sending investors subscription agreements for their review and execution." *Chapel Invs.*, 177 F. Supp. 3d at 990 (emphasis added). "These factors," the Court recognized, "'distinguish the activities of a dealer from those of a private investor or trader.'" *Id.* at 990-991 (citation omitted); *see XY Plan. Network, LLC* v. *SEC*, 963 F.3d 244, 248 (2d Cir. 2020) ("Broker-dealers effect securities transactions for *customers*, for which they typically charge a commission or other transaction-based fee. In connection with their services, broker-dealers often provide advice and make recommendations about securities transactions and investment strategies.") (emphasis added).

Other courts have followed suit, likewise distinguishing between the kinds of services that dealers choose to provide and the investing activities and strategies of traders. *See, e.g.*, *Discover Growth Fund, LLC* v. *Camber Energy, Inc.*, 602 F. Supp. 3d 982, 989 (S.D. Tex. 2022) ("Whereas an investor or trader may buy securities from issuers at substantial discounts and resell them into the public market for a potentially significant profit, a dealer buys and sells securities from its customer and to its customer for a relatively small markup or fixed commission."); *In re Immune Pharms. Inc.*, 635 B.R. 118, 124 (Bankr. D.N.J. 2021) ("[A] dealer buys and sells securities from its customer and to its customer."); *see also Discover Growth Fund, LLC* v. *Beyond Commerce, Inc.*, 561 F. Supp. 3d 1035, 1040 (D. Nev. 2021) (same). Indeed, for the carve-out for ordinary traders "to be

a meaningful exception, only an entity that is 'engaged in the securities business,' i.e., 'engaged in the business of dealing' or 'providing dealer services to others' such as clients, can be considered a dealer." *Radzinskaia* v. *NH Mountain, LP*, 2023 WL 6376457, at *4 (S.D. Fla. Sept. 2023) (citation omitted). As a result, "[t]he statute does not make 'every securities trader who makes money through buying and selling of securities' a dealer." *Camber Energy*, 602 F. Supp. 3d at 988 (citation omitted). Engaging in the "business" of trading is categorically distinct from the "business" of dealing.

3. Abandoning the statute's focus on the services that a person offers to customers in determining who must register as a dealer, the Dealer Rule instead "categorically" states for the first time "that liquidity provision alone by a person trading for its own account constitutes dealing activity." App. 203 (Peirce, *Dissenting Statement*). The Rule sets forth two new qualitative tests for assessing whether a trader's liquidity provision turns them into a securities dealer. Under the first new test, a person now qualifies as a dealer simply by "[r]egularly expressing trading interest" at or near the best available sale and purchase price for the same security—conduct that traders regularly engage in as part of their own investment strategies. App. 60. Under the second, a person now qualifies as a dealer if they earn revenue primarily from capturing bid-ask spreads, buying at the bid and selling at the offer, or by capturing other types of incentives for providing liquidity—again, all conduct engaged in by numerous market participants who do nothing resembling traditional dealing. *Id.* Neither of those tests comports with the settled meaning of the "business" of securities dealing. Instead, the Dealer Rule impermissibly sweeps in anyone whose trading activity provides more than "incidental"

liquidity. App. 61. Because that interpretation is contrary to the long-settled meaning of the statute, the Rule exceeds the Commission's authority and must be set aside.

B. The Commission's Reinterpretation Of "Dealer" Is Impermissibly Broad And Inconsistent With The Existing Regulatory Framework.

The Commission's new interpretation of "dealer" is an impermissible attempt to expand its regulatory authority beyond what the statute allows. "[T]he words of the statute should be read in context, the statute's place in the overall statutory scheme should be considered, and the problem Congress sought to solve should be taken into account to determine whether Congress has foreclosed the agency's interpretation." *Goldstein* v. *SEC*, 451 F.3d 873, 878 (D.C. Cir. 2006) (internal quotation marks omitted). Because the Commission's expansive new interpretation cannot be reconciled with the statutory scheme, it "is utterly unreasonable and thus impermissible." *Id.* at 881.

1. The Dealer Rule attempts to substantially expand the Commission's regulatory reach. Under its new qualitative tests, a "dealer" includes any person "engage[d] in a 'regular' pattern of buying and selling securities that has the effect of providing liquidity to other market participants." App. 60. As Commissioner Peirce pointed out, that standard is "so broad" that it subsumes the existing dealer-trader distinction. App. 204. Making matters worse, the Commission adds that "[n]o presumption shall arise that a person is not a dealer within the meaning of the [Act] solely because that person does not satisfy the" two new qualitative standards set out in the Dealer Rule. App. 125. Combining that vague residual clause with the overbroad new rule makes the definition of dealer "practically limitless." App. 274 (Uyeda, *Dissenting Statement*).

Vividly confirming the overbreadth of the new definition, the Commission "determined that it needed to expressly exclude" a number of actors who would fall within the reach of the Dealer Rule, but clearly are not dealers. App. 204 (Peirce, *Dissenting Statement*). The Commission acknowledged, for example, that registered investment companies—which are already subject to a "comprehensive regulatory framework"—fall within the new tests and thus required an exemption. App. 72. The Commission also had to exempt central banks and other sovereign entities, like the Federal Reserve Bank of New York, which regularly engages in "open market transactions" that would meet the Commission's new tests. App. 75. The fact "[t]hat a cure was needed" for the Commission's "overbroad interpretation" "should have alerted [the Commission] that it had taken a wrong interpretive turn." *Chamber of Commerce* v. *U.S. Dep't of Labor*, 885 F.3d 360, 383 (5th Cir. 2018) (citation omitted).

The Commission attempts to justify its expansion of the statutory definition on the basis that it needs to extend its "regulatory oversight of significant liquidity providers" so that the Commission can better "investigate, understand, and address significant market events." App. 56. That is a startling admission that the Commission's goal is to use the dealer definition to extend its regulatory reach beyond the jurisdiction provided by Congress in the statute.

The D.C. Circuit previously rejected a similar attempt by the Commission to expand its statutory jurisdiction by manipulating statutory text. In *Goldstein*, the Commission had claimed that hedge funds and other private funds had grown in their market share and become "national in scope," which led the Commission to look for ways to sweep them into

its regulatory reach. 451 F.3d at 882-83. The Commission attempted to redefine "client" in the Investment Advisers Act to force the managers of private funds to register as advisers on the basis that each of the investors in a fund should be counted as "clients" of the fund manager. *See id.* The D.C. Circuit rejected that maneuver, explaining that the Commission could not "accomplish its objective" of "more comprehensive regulation" of private funds "by a manipulation of [the] meaning" of the statute's definition of client. *Id.* at 882. The same result should follow here.

The Commission also claims that its Rule is not recasting the meaning of "dealer," but is instead an exercise of the Commission's authority to "define terms used *in* the statutory definition[] of 'dealer'"—specifically, what "as part of a regular business" means. App. 55 (emphasis added) (citing 15 U.S.C. § 78c(b)). That argument does nothing to fix the problem. The point is that Congress likewise intended "regular business" to refer to securities dealing, which is why it referred to "*the* business of buying and selling securities," 15 U.S.C. § 78c(a)(5). The Commission "cannot use [its] definitional authority [under § 78c(b)] to expand" a settled meaning that Congress adopted in the Exchange Act. *Am. Bankers Ass'n* v. *SEC*, 804 F.2d 739, 755 (D.C. Cir. 1986). The Court should reject the Commission's attempt to "redraft the statutory boundaries set by Congress." *Loan Syndications & Trading Ass'n* v. *SEC*, 882 F.3d 220, 229 (D.C. Cir. 2018).

2. The Commission's attempted expansion of "dealer" regulations is also inconsistent with the very purpose of that regulatory regime. In traditional markets, dealers provide critical services to their customers, including advising them, clearing and safekeeping their assets, and setting prices by providing quotes that clients can execute

against. Those services often entail significant information disparities and potential conflicts of interest between a dealer and its customers. To protect investors from those risks, the Act's registration requirement is designed to ensure that "some discipline may be exercised over those who may engage in the securities business." *Eastside Church of Christ* v. *Nat'l Plan, Inc.*, 391 F.2d 357, 362 (5th Cir. 1968). Persons qualifying as dealers must comply with detailed disclosure requirements, contribute to insurance funds designed to protect customers in the event of insolvency, and comply with minimum standards of care governing their interactions with clients. App. 83.

But those requirements make little sense for the trader the Rule purports to now sweep into the dealer framework. That trader, though he provides liquidity, does not directly serve clients, solicit customers, or hold himself out as providing market-making services. The trader thus presents none of the risks associated with dealer services that dealer regulations are designed to protect against.

And the requirements make even less sense for digital asset markets, because the DeFi ecosystem innovated to enable individual traders to transact without the need for intermediaries and to provide liquidity without taking on traditional dealer responsibilities. Traders can contribute their digital assets to liquidity pools, but those contributions are passive and do not require the trader to interact directly with other participants in the pool. Nor does the trader dictate the prices at which trades will be executed. Instead, any trading in the assets that the trader contributes is facilitated and priced by automated software based on transparent, pre-established rules. The Commission's new tests could nonetheless sweep these traders into an expensive, burdensome, and ill-fitting regulatory regime.

C. The Commission's Reinterpretation Of "Dealer" Unreasonably Departs From Its Own Prior Interpretation Of That Term.

The Rule also represents a sharp break from the Commission's own longstanding approach to determining who qualifies as a dealer under the Act—yet the Commission failed to even acknowledge that change. "[T]he requirement that an agency provide reasoned explanation for its action would ordinarily demand that it display awareness that it *is* changing position." *FCC* v. *Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009). And an agency must remain "cognizant that longstanding policies may have 'engendered serious reliance interests that must be taken into account.'" *Dep't of Homeland Sec.* v. *Regents of the Univ. of California*, 140 S. Ct. 1891, 1913 (2020) (quoting *Encino Motorcars, LLC* v. *Navarro,* 579 U.S. 211, 212 (2016)).

Under the Rule's new definition, "persons are now subject to Commission enforcement, even though they have been operating under the same business model for a long time with the understanding that they were not dealers." App. 276 (Uyeda, *Dissenting Statement*). Again, this concern is particularly acute for participants in the digital asset markets, who have utilized or developed the innovative features unique to DeFi without having any reason to believe that their activities would paradoxically require them to register as dealers under the Exchange Act.

Remarkably, the Commission claims that the Dealer Rule "do[es] not modify existing . . . Commission interpretations" of the term "dealer." App. 80. That is plainly wrong. The Commission's new definition defies its own guidance and staff no-action letters issued over the past 50 years, which have consistently looked to the services a person chooses to offer to customers in determining if that person is engaged in the regular

business of dealing. *See, e.g.*, SEC Release No. 34-11742, 1975 WL 163406, at *3 (Oct. 15, 1975) (explaining that activities such as "underwriting," "carrying a dealer inventory," "advertising or listing as a dealer," or "otherwise holding [one]self out to other dealers or investors as a dealer" all indicate that a person is acting as a dealer); Continental Grain Co., SEC Staff No-Action Letter, 1987 WL 108902, at *10 (Oct. 28, 1987) ("As a general matter, a trader does not handle other people's money or securities; he does not hold himself out as being willing to buy and sell securities for his own account on a continuous basis; and he does not furnish the services which are usually provided by such dealers, such as quoting the market in one or more securities, rendering incidental investment advice, or extending or arranging for the extension of credit in connection with securities activities."); *see also* Compl. ¶¶ 46-51.

The Commission thus failed its obligation to even "display awareness" of its change of interpretation, much less provide any "detailed justification" for that new interpretation. *Wages & White Lion Invs., L.L.C.* v. *Food & Drug Admin.*, 90 F.4th 357, 381 (5th Cir. 2024) (quoting *Fox Television*, 556 U.S. at 515). That failure is another reason to vacate the Rule, and the Commission cannot "escape" that result by "shift[ing] its understanding of the law" or "deny[ing] or downplay[ing] the shift." *Id.*

II. THE COMMISSION'S ARBITRARY AND CAPRICIOUS ADOPTION OF THE DEALER RULE VIOLATED THE APA (COUNTS II, III, V, VI).

Regardless of whether the Commission's reinterpretation of the meaning of "dealer" exceeds its statutory authority under the Exchange Act, the Commission plainly violated the APA's requirements in adopting the Dealer Rule due to its failure to adequately address

the Rule's application to the digital asset markets. The Commission violated the APA in at least four independent ways, and the Rule should be set aside.

A. The Commission Failed To Respond To Industry Comments And Therefore Did Not Engage In Reasoned Decisionmaking (Count II).

The Commission first failed one of the most fundamental requirements of the APA: its obligation to meaningfully respond to public comments to demonstrate that it engaged in reasoned decisionmaking. Federal agencies must "articulate a satisfactory explanation for [their] action[s]" and establish "a rational connection between the facts found and the choice made." *Motor Vehicle Mfrs. Ass'n of U.S.* v. *State Farm Mut. Auto. Ins.*, 463 U.S. 29, 43 (1983) (citation omitted). "That requires the agency to consider all relevant factors raised by the public comments and provide a response to significant points within." *Chamber of Com. of U.S.* v. *SEC*, 85 F.4th 760, 774 (5th Cir. 2023). A rulemaking is arbitrary and capricious if an agency "ducks the hard questions" raised by the public or "bur[ies] its head in the sand." *Mexican Gulf Fishing Co.* v. *U.S. Dep't of Com.*, 60 F.4th 956, 973 (5th Cir. 2023). An agency cannot say "[b]asically nothing" and rest on "bare acknowledgement[s]" of comments to satisfy the APA's requirements. *Louisiana* v. *U.S. Dep't of Energy*, 90 F.4th 461, 473 (5th Cir. 2024).

The Commission badly flunked these obligations in the Dealer Rule. The digital asset industry flooded the Commission with urgent and thoughtful comments about the effects that the rule would have on the industry and digital asset markets. Yet the Commission barely acknowledged those comments, much less substantively engage with them. That is not reasoned decisionmaking under the APA.

1. From the outset, digital asset markets participants raised significant concerns about the "ambiguity concerning the parties actually affected by" the Rule. App. 192 (DEF Comment at 12). That ambiguity emanated from two issues with the Rule. First, the Commission did not provide clarity as to which digital asset transactions constitute securities transactions and thus fall under the Dealer Rule's reach. Second, the Commission refused to engage with the innovative features of DeFi and answer commenters' questions about how the Dealer Rule might implicate those features, the traders using them, and the developers behind them.

a. As the first source of critical ambiguity surrounding the Rule's application to the digital asset industry, commenters pointed to the Commission's general "failure to provide adequate guidance regarding the classification of digital assets as securities." App. 156 (BA Comment at 1). Because the Commission only has authority to regulate dealers of *securities*, the threshold inquiry governing which digital asset market participants might be required to register under the Dealer Rule is whether transactions in particular digital assets are securities transactions. That determination requires an intensive, fact-based assessment of the nature of the asset and the particular transaction—an assessment that is even more difficult for participants in digital asset markets given the novelty of those assets and the dearth of applicable precedent. *See* App. 166-67 (a16z Comment at 2-3).

Despite calls for clarity from digital asset market participants, the Commission took a "wait-and-see" approach to questions about the reach of the Dealer Rule, leaving participants in an untenable position. Indeed, the Commission's only response to these

comments was to acknowledge commenters' questions and offer the generalized statement that the Rule "appl[ies] to the buying and selling of all securities, including crypto assets that are securities or government securities within the meaning of the Exchange Act. App. 76; *see also* App. 66 ("The application of the [Dealer Rule] turns on whether a particular crypto asset is a security, as defined under the U.S. Federal securities laws."). If that is not "duck[ing] the hard questions" about the real-world application of the Dealer Rule, it is hard to imagine what would be. *Mexican Gulf Fishing Co.*, 60 F.4th at 973.

b. Commenters also raised numerous concerns and questions about how the new qualitative tests for determining who is a dealer would be (or even could be) applied to unique aspects of DeFi. *See supra* pp. 13-14. Again, the Commission refused to substantively respond to these comments, instead dismissing them in conclusory fashion: "While some commenters stated that the proposed rule[] should not apply to so called DeFi, whether there is a dealer involved in any particular transaction or structure (whether or not referred to as so-called DeFi) is a facts and circumstances analysis. There is nothing about the technology used, including distributed ledger technology-based protocols using smart contracts, that would preclude crypto asset securities activities from falling within the scope of dealer activity." App. 76. That conclusory response explained nothing and was contrary to evidence before the Commission pointing out the important differences between traditional markets and DeFi. Such an oversimplified, "bare acknowledgement" of serious concerns raised by commenters does not satisfy the Commission's burden to reasonably engage with and respond to public comments. *Louisiana*, 90 F.4th at 473.

Commissioner Peirce highlighted the Commission's refusal to address the Dealer Rule's application to DeFi innovations. As one example, she posited: "AMM is a software protocol, who will have to register?" App. 206. And she criticized the majority for its failure to "engage seriously with these questions" based on its "hint[]" that some persons engaged in trading digital assets might be considered dealers already. *Id.*

Ultimately, the Commission's refusal to respond to comments about the reach and practical implications of the Dealer Rule has left an entire industry in the lurch. Participants in the digital asset markets now face intolerable uncertainty and the risk of the Commission deciding that (a) their transactions in given digital assets are securities transactions and (b) the innovations they use trigger the Dealer Rule's new qualitative tests, despite avoiding the risks that Congress intended to address through the dealer regulations. This unresolved—and seemingly intentional—ambiguity on the part of the Commission toward the digital asset industry will leave individual "market participants exposed to *post hoc* second-guessing and 'gotcha' enforcement actions," with serious financial and compliance ramifications if they do not spend the resources on registering as dealers from the outset. App. 163 (BA Comment at 8). In fact, this is exactly what is already happening. *See, e.g.*, App. 286 (Mem. in Supp. of Mot. to Cert. Interloc. App. 1, *SEC* v. *Coinbase*, No. 23 CIV. 4738 (KPF) (S.D.N.Y. 2024)) (describing the Commission's "blitz of recent enforcement actions against the digital asset industry" advancing a new "theory" regarding what qualifies as an investment contract); App. 340 (Compl., *Consensys Software Inc.* v. *Gensler*, No. 4:24-cv-00369-Y (N.D. Tex. 2024)) (seeking to enjoin Commission from pursuing enforcement actions based on a company's software). Leaving affected parties in

a state of such fundamental uncertainty about whether and how rules even apply to them does not comport with the APA's requirements for reasoned decisionmaking.

2. In addition to concerns about the vagueness and uncertainty of the Dealer Rule's application to digital asset market participants, numerous commenters raised concerns about the effects that the Rule would have across the industry and DeFi. Again, the Commission failed to substantively respond to these comments.

a. Many commenters raised significant concerns about the negative impact that the threat of regulation as securities dealers would have on liquidity and price efficiency in digital asset markets. Commenters explained that the Dealer Rule "may well drive firms to cease providing the very liquidity the safeguarding of which is the proposal's asserted core purpose." App. 143-44 (Consensys Comment at 17-18); *see also supra* at p. 14. In particular, commenters explained that ambiguity and uncertainty about whether particular innovations—such as liquidity pools or AMM software—could require users of those innovations to register as a dealer under the Rule will lead rational traders to look for alternatives that avoid those potential costs and regulatory restrictions.

The Commission again all but ignored these concerns. Although the Commission did not dispute commenters' statements that the Rule "would harm liquidity in markets for crypto assets," App. 112, it did not address any of the ramifications of reduced liquidity in these markets, such as increased volatility and systemic risk, as well as decreased price discovery. Instead, the Commission merely stated that "trading volumes in crypto asset markets could fall, harming the liquidity and efficiency of these markets," if "PTFs curtail their crypto asset trading activities." *Id.* The Commission's brief acknowledgement of one

of the significant harms that will result to the digital asset markets if one class of participant (PTFs) alters its trading activities does not sufficiently address the issue. The Commission never even attempted to justify this harm, much less address or even acknowledge the adverse impacts of the new dealer definition on "individual [decentralized-exchange] participants." App. 178 (a16z Comment at 14) (The Commission "homes in on PTFs, omitting any reference to the individual [decentralized-exchange] participants even while acknowledging that the Proposal 'could potentially capture a wide array of persons.'").

b. Commenters also raised significant concerns about the adverse effects that the Rule would have on U.S. participants in digital asset markets. They warned that participants could be driven out of digital asset markets entirely because of the "substantial costs" associated with dealer registration, which would result "in concentrated and centralized control over [decentralized exchanges] in the hands of fewer market participants." App. 177 (a16z Comment at 13). This, in turn, would "tilt[] the competitive playing field towards incumbents" who could absorb the dealer registration and compliance costs (or non-U.S. participants who are not subject to registration). App. 183 (DEF Comment at 3); *see also* App. 133 (Consensys Comment at 7). And U.S. digital asset markets would suffer, because "foreign jurisdictions where market participants may have greater clarity as to the obligations accompanying digital asset transactions" would have a competitive advantage. App. 174 (a16z Comment at 10).

Again, the Commission's response to these concerns showed little regard for the effects that the Dealer Rule will have on digital asset markets. The Commission summarily claimed that the Dealer Rule's "effect on competition in crypto asset markets would be

similar to the effects on competition already discussed for other markets," ignoring all of the unique features and innovations of digital asset markets and failing to even attempt to justify the negative ramifications on this nascent industry's ability to compete. App. 112. Indeed, in declining to exempt the digital asset industry from the Dealer Rule, the Commission made the puzzling and unsupported claim that exempting "market participants that deal in crypto asset securities" from dealer registration would lead to "negative competitive effects" across *all* markets because "market participants that deal in other types of securities would not enjoy such an exemption." App. 116.

The Commission's cursory remarks about digital asset markets make little sense and are not responsive to commenters' concerns. As explained, decentralized digital asset markets function in unique ways as compared to traditional markets, particularly with respect to innovations that eliminate the need for intermediaries to facilitate trading. The two types of markets simply cannot be lumped together. And contrary to its stated concerns about unfairly exempting the digital asset industry, the Commission never addressed that, for many digital asset market participants, the costs of registration as a dealer would be prohibitive or provide competitive *advantages* to traditional markets and foreign markets. *See infra* Section II.C.

c. Finally, multiple commenters also raised concerns about the ramifications that the Rule would have on innovation in DeFi and even other related technologies, which would hurt everyday Americans. Specifically, market participants will avoid DeFi protocols altogether to avoid newfound regulatory risk, limiting their value and stifling further investment and development of these platforms. As one commenter warned, such

avoidance of DeFi protocols would also "hinder[] the United States' goal of becoming a leader in" next-generation internet, in the form of web3, given that DeFi protocols "serve as an infrastructure layer for all web3 applications, products, and services." App. 174 (a16z Comment at 10). Again, the Commission offered no substantive response. It merely acknowledged the concern that adopting the Dealer Rule could "hinder innovation," and left it at that. App. 116. Such rote acknowledgement of a concern does not satisfy the requirements of the APA. *See State* v. *Biden*, 10 F.4th 538, 554 n.4 (5th Cir. 2021) ("[T]he opportunity to comment is meaningless unless the agency responds to significant points raised by the public.") (quoting *Sherley* v. *Sebelius*, 689 F.3d 776, 784 (D.C. Cir. 2012)).

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At best, the Commission merely acknowledged and punted on numerous substantial comments and questions from the digital asset industry about the Rule. That does not come close to meeting the APA's requirements for meaningfully addressing "significant" points raised by commenters. *Mexican Gulf Fishing Co.*, 60 F.4th at 973. This fundamental APA violation requires that the Dealer Rule be vacated.

B. The Commission Failed To Provide Any Reason For Applying The Dealer Rule To The Unique Digital Asset Markets (Count III).

The Commission also violated the APA by failing to give a reasoned explanation for attempting to apply the Rule's new tests to decentralized digital asset markets. "[A]gency action" must "be reasonable and reasonably explained." *FCC* v. *Prometheus Radio Project*, 592 U.S. 414, 423 (2021). The Commission's justification for the expanded interpretation of "dealer"—namely, increased regulatory oversight of PTFs operating in the Treasuries market—provides no basis for applying that Rule to the entirely different digital asset

markets, and the Commission failed to grapple with the substantial uncertainties of applying that Rule to those markets.

In adopting the Dealer Rule, the Commission's stated goal was "to ensure that market participants that take on significant liquidity-providing roles are appropriately registered and regulated as dealers." App. 55. But in explaining that goal, the Rule repeatedly refers to the Commission's concern over PTFs operating "in the U.S. Treasury market," which "account for about half of the daily volume in the interdealer market." App. 56. With regard to this purported "regulatory gap," the Commission explained that "limited regulatory oversight of significant liquidity providers increases the difficulty and complexity for regulators to investigate, understand, and address significant market events." *Id.*

In particular, the Commission relied on "[t]wo examples" as illustrating its concern that "[m]arket participants engaged in dealing activities but without being registered create the potential for serious externalities." App. 92. It first pointed to a market event in 1982 when Drysdale Government Securities "was actively dealing in the U.S. Treasury market for its own account," without being "registered as a dealer." *Id.* According to the Commission, when Drysdale collapsed, its "failure harmed market functioning for several days." *Id.* In the second example, the Commission explained that, in March 2020, "PTFs' market withdrawal . . . contribute[d] to stress in the overall U.S. Treasury market." *Id.*

In light of these purported issues, the Commission explained that the costs of the Dealer Rule were outweighed by its benefits—again solely referencing PTFs operating in the U.S. Treasury market. The Commission stated that "PTFs and hedge funds would be

the primary affected parties, and registering PTFs that are dealing would provide the largest benefits." App. 93-94. And it believed that the costs associated with the Rule were justified by bringing PTFs into the regulatory fold. App. 110 (noting that, "[b]ecause some PTFs have become especially prominent intermediaries in the market for U.S. Government securities, any harm to market liquidity may be more pronounced in that market," but concluding that the Rule "will reduce the risk that a significant liquidity provider fails").[2]

Notably absent from this discussion is any analysis of digital asset markets. The Commission never acknowledged that digital asset markets have innovated and evolved in such a way that does not require dealers to function as intermediaries. The Commission never identified any purported "regulatory gap" that needed to be addressed in the digital asset markets, or any negative market event in digital asset markets. And while the Commission acknowledged that "trading volume in crypto asset markets could fall" if "PTFs curtail their crypto asset trading activities," App. 112, the Commission ignored a wide range of other costs to the digital asset markets, and failed in any event to offer any justification of those costs.

All told, the application of the Dealer Rule to the digital asset industry amounts to a solution in search of a problem (which itself spawns more problems). The Commission's decision to sweep an entire industry into the Rule's ambit without so much as an explanation of why it was doing so does not meet the APA's requirements. *Mexican Gulf Fishing Co.*,

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[2] Notably, the Commission could have attempted to address this concern about the Treasury market in a much more targeted fashion by limiting its rulemaking to the definition of "government securities dealer," which is separate from the Act's definition of "dealer." *Compare* 15 U.S.C. § 78c(a)(44) *with id.* § 78c(a)(5)(A) (defining "dealer").

60 F.4th at 973; *see also Nat'l Fuel Gas Supply Corp.* v. *FERC*, 468 F.3d 831, 843 (D.C. Cir. 2006) ("Professing that an order ameliorates a real industry problem but then citing no evidence demonstrating that there is in fact an industry problem is not reasoned decisionmaking.").

C. The Commission Failed To Conduct Its Statutorily Required Economic Analysis By Ignoring The Costs To Digital Asset Markets (Count V).

The Commission also failed to satisfy its statutory obligation to conduct a thorough economic analysis of the effects of its rulemaking. Section 13(f) of the Exchange Act requires the Commission to consider whether a rule "will promote efficiency, competition, and capital formation." 15 U.S.C. § 78c(f). Likewise, Section 23(a)(2) of the Act requires the Commission to consider the "impact any such rule . . . would have on competition." *Id.* § 78w(a)(2). Courts have routinely set aside rules when the Commission failed to meet its "unique obligation" to "adequately assess the economic effects of a new rule." *Bus. Roundtable*, 647 F.3d at 1148-49; *Am. Equity Inv. Life Ins. Co.* v. *SEC*, 613 F.3d 166, 177 (D.C. Cir. 2010) ("hold[ing] that the Commission's consideration of the effect of [the rule] on efficiency, competition, and capital formation was arbitrary and capricious" under analogous provision in the Securities Act of 1933); *Chamber of Com.*, 85 F.4th at 776.

Importantly, "uncertainty" as to the effects of a rule "may limit what the Commission can do, but it does not excuse the Commission from its statutory obligation to do what it can to apprise itself." *Chamber of Com. of U.S.* v. *SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005). Here, the Commission failed to fulfill these statutory obligations with respect to the Dealer Rule's costs and effects on efficiency, competition, and capital formation in the digital asset markets.

1. By its own admission, the Commission made no attempt to account for the costs of the Dealer Rule on participants in the digital asset markets. Instead, the Commission conclusorily claimed that it was "unable to estimate the number of crypto asset market participants who would be affected by the [Rule], because data do not allow us to match crypto asset security transactions to individual traders, especially across platforms." App. 90. That is an excuse, not a justification. The Commission has an "obligation to do what it can to apprise itself" of the costs of a rule, *Chamber of Com.*, 412 F.3d at 144, and here the Commission failed to do anything.

More fundamentally, that excuse falls flat because the Commission *did have* the ability to estimate the number of participants that would be impacted by the Rule. Transactions on distributed ledgers are public, transparent, and immutable. Anyone, including the Commission, can readily look up these transactions on a variety of free, open-source online databases. *See e.g.*, App. 342-44 (*WalletExplorer.com: smart Bitcoin block explorer*) (recording transactions attributed to users' digital-assets "wallets"). In fact, the U.S. government has routinely matched digital asset transactions to particular users in law enforcement actions. *See, e.g.*, App. 348 (Nicole Perlroth *et al.*, *Pipeline Investigation Upends Idea That Bitcoin Is Untraceable*, N.Y. TIMES (June 9, 2021)) (former Treasury Department official explaining that "[c]ryptocurrency allows us to use . . . tools to trace funds and financial flows along the blockchain"). The Commission did not even attempt to explain its failure to even examine public-source data that is "readily accessible" to the Commission. *Chamber of Com.*, 85 F.4th at 775.

In addition, the Commission could have simply asked digital asset market participants for whatever data the Commission believed it needed to conduct its statutorily required economic analysis. Agencies do this all the time. *See, e.g.*, *Chamber of Com.*, 85 F.4th at 776. The Commission could have done so in the first instance through a request for comments in the Proposed Rule. Or the Commission could have reopened the comment period and solicited data after the outpouring of concerns raised by the digital asset industry. But the Commission did neither. If the Commission truly believed that it required additional data to carry out its statutory obligation to evaluate the economic effects of its proposed rulemaking, then it should have asked for it.

To be sure, the Commission does not have to "undertake a quantitative analysis to determine a proposed rule's economic implications." *Chamber of Com.*, 85 F.4th at 773. And it "need not create data that doesn't already exist." *Id.* at 776. But the Commission is required to make *some* effort to assess the effects of a rule—qualitative or quantitative. Its failure to do so here, when its rulemaking would indisputably have substantial effects on an entire industry, renders its economic analysis entirely insufficient.

In short, the Commission's unjustified failure to conduct any analysis of the Dealer Rule's impact on digital asset markets participants does not pass muster under the Exchange Act.

2. The Commission also omitted any analysis of digital asset markets in its discussion of the effects of the Rule on efficiency, competition, and capital formation. Instead, the Commission again focused exclusively on the effects of the Rule on *traditional*

markets like the Treasuries market, despite digital asset industry commenters providing information to the Commission on each of these three statutory considerations.

a. As to efficiency, industry commenters explained that market participants would abandon using protocols that raise the prospect of dealer registration. In turn, the "[l]iquidity lost" from the departure of market participants would "caus[e] [decentralized exchange] trading to dry up," App. 178 (a16z Comment at 14), which would come with a litany of costs like increased "market concentration," "volatility," and "[s]ystemic [r]isk," App. 189 (DEF Comment at 9). They explained that, due to the threat of dealer regulation, participants would be "discourage[d]" from "trading strategies and market structures designed to promote liquidity," thereby "reducing innovation and market efficiency." App. 183 (DEF Comment at 3). The Rule would threaten the development of web3-based innovations that would enhance efficiency in the digital asset markets by reducing "downtime" and increasing "security" when transacting via DeFi protocols. App. 178 (a16z Comment at 14).

b. As to competition, commenters explained that the Rule's "approach of painting the digital assets market with the same brush used for the traditional securities market is flawed and will stifle . . . competition" for many of the same reasons that they explained it would harm liquidity provision. *See, e.g.*, App. 164 (BA Comment at 9). The burdens associated with dealer registration would reduce competition in the digital asset markets by favoring well-funded incumbents in these markets over smaller entities, competitively advantage traditional markets over digital asset markets, and benefit foreign digital asset markets over their American counterparts. *See supra* p. 34.

Despite these concerns, the Commission summarily asserted that the Dealer Rule would "level[] the competitive playing field between liquidity provision conducted by entities that are currently registered as dealers and government securities dealers and by entities that are not." App. 54. The Commission then made the conclusory statement that the "effect on competition in crypto asset markets would be similar to the effects on competition already discussed for other markets." *Id.* This assertion not only made little intuitive sense, but was directly contrary to the Commission's own acknowledgement elsewhere in the Rule that the net capital requirements for dealers would be disproportionately higher for participants in the digital asset markets. App. 104 & n.573. And the Commission failed to take account of the numerous other competition concerns that digital asset markets participants raised.

c. Finally, as to capital formation, commenters explained that the Rule would wreak havoc for the formation of capital across the digital asset markets. *See, e.g.*, App. 153 (GDACA Comment at 6). One commenter went so far as to say that, "[f]or DeFi market participants especially, the message from the Commission seems clear: they should not operate at all." App. 194 (DEF Comment at 14).

The Commission's response once more ignored the unique concerns raised in the context of digital asset markets: "We expect the final rule['s] effect on capital formation" across *all* markets "to be mixed." App. 113. Again, the Commission's insistence on lumping the digital asset industry together with traditional financial markets is irrational and unexplained, and does not fulfill the Commission's statutory obligation to analyze the impact of the Rule on capital formation.

D. The Commission Failed To Provide Adequate Notice Of The Rule's Application To The Digital Asset Industry (Count VI).

Finally, the Commission's decision to apply the Rule to the digital asset industry after including only a passing reference to digital assets in a single footnote of the 194-page Proposed Rule violated the APA's notice requirement. The APA demands that agencies advise the public of "the terms or substance of the proposed rule or a description of the subjects and issues involved." 5 U.S.C. § 553(b)(3). The "objective" of this requirement is "fair notice" to potentially affected parties. *Tex. Ass'n of Mfrs.*, 989 F.3d at 381.

Importantly, "notice must come from the [proposed rule]" itself. *Chesapeake Climate Action Network* v. *EPA*, 952 F.3d 310, 320 (D.C. Cir. 2020) (citation omitted). A "mere mention" buried in pages of a proposed rule does not meet the fair-notice requirement. *CSX Transp., Inc.* v. *Surface Transp. Bd.*, 584 F.3d 1076, 1082 (D.C. Cir. 2009). Commenters are not required to "be mind readers," *Chesapeake*, 952 F.3d at 322, but even if they manage "to 'divine' the [agency's] 'unspoken thoughts'" in their comments, those comments do not absolve the agency of its obligation to provide fair notice, *Mexican Gulf Fishing Co.*, 60 F.4th at 975 (quoting *CSX Transp.*, 584 F.3d at 1080).

Here, the only notice provided to an industry that has never before been subject to regulation as securities dealers was buried in a single footnote in a nearly 200-page Proposed Rule. All the Commission said was that the Proposed Rule would apply to "any digital asset that is a security or a government security within the meaning of the Exchange Act," App. 4—a statement that is itself entirely vague given the uncertainty as to which transactions constitute securities transactions. *See supra* pp. 12-13, 30-31. Without any discussion or analysis of the particular features of the digital asset industry in the Proposed

Rule, the Commission failed to "adequately frame the subjects for discussion." *Mexican Gulf Fishing Co.*, 60 F.4th at 975. The Proposed Rule instead required members of the digital asset industry to guess as to whether and how the rule might apply to them.

As discussed at length above, industry commenters realized the potential "implications" of "mandating that an entire burgeoning industry be subject to onerous registration requirements." App. 192 (DEF Comment at 12). Commenters immediately objected to the lack of notice provided by the single footnote and raised concerns that no final rule could be considered a logical outgrowth of a Proposed Rule that provided so little notice.

Notwithstanding these comments, the Commission declined to provide any additional notice or reopen the comment period. It instead proceeded to finalize the Rule, adding some passing references to digital assets but nonetheless failing to provide any clarification as to how or even why the Rule would be applied to participants in the digital assets markets. Compounding these problems is the "practically limitless" nature of the new Rule, which maintains that a person could still be classified as a dealer even if they do not satisfy the new tests. App. 274 (Uyeda, Dissenting Statement). The Commission's failure to provide sufficient notice of the Rule's application to members of the digital assets community provides yet another reason that the Rule violates the APA.

CONCLUSION

For all of these independent reasons, this Court should grant Plaintiffs' motion for summary judgment and set aside the Dealer Rule.

Dated: May 17, 2024

Respectfully submitted,

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