UNITED STATES DISTRICT COURT
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*.	No. 4:24-cv-00361-O

DEFENDANTS' REPLY IN SUPPORT OF CROSS-MOTION FOR SUMMARY JUDGMENT

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INTRODUCTION

The Commission adopted the rule under review to address recent advancements in electronic trading that had resulted in a gap in the regulation of those engaged in traditional dealer activity. Entities engaging in automated, algorithmic high-frequency-trading strategies have been performing the same *de facto* market-making function as traditional dealers, but some of those entities have done so without registering with the Commission and being subject to the dealer regulatory framework. As the Commission explained in adopting the rule, market participants that buy and sell securities for their own account and engage in at least one of two specific trading patterns that have the effect of providing significant liquidity—(1) regularly expressing trading interest at or near the best available prices on both sides of the market for the same security, or (2) earning revenue primarily from capturing bid-ask spreads or trading incentives—are engaged in the regular business of buying and selling securities and thus are dealers under the Exchange Act.

Plaintiffs' challenge to the Commission's authority fails because the rule's further definition of the term "as a part of a regular business" in the dealer and government securities dealer definitions is within the definitional authority expressly delegated to the Commission in the Exchange Act and is consistent with the statutory text and longstanding judicial and agency interpretations. Plaintiffs contend that a dealer must offer certain services to investors, such as handling clients' money and rendering investment advice, but they cannot identify anything in the Exchange Act or precedent interpreting it that would support grafting such a requirement onto the statutory text. Plaintiffs' flawed argument that dealers must have customers similarly has "no grounding in the statutory text," the "Exchange Act's structure," or the relevant "legal backdrop," as numerous courts have held in rejecting similar claims. *SEC v. Keener*, 102 F.4th 1328, 1334 (11th Cir. 2024); *accord SEC v. Almagarby*, 92 F.4th 1306, 1318 (11th Cir. 2024);

SEC v. Auctus Fund Mgmt., No. 23-cv-11233, 2024 WL 3498593, at *3-4 (D. Mass. July 22, 2024); *SEC v. Long*, No. 23-cv-14260, 2024 WL 3161669, at *1-3 (N.D. Ill. June 25, 2024).

Nor can plaintiffs meet their burden to prove that the Commission failed to engage in reasoned decisionmaking. Their claims rest on an erroneous characterization of the so-called "decentralized finance" or "DeFi" model, pursuant to which some (but not all) crypto asset securities are transacted. In plaintiffs' telling, so-called DeFi systems are "decentralized" and do not rely on dealer intermediaries, rendering dealer regulation unnecessary. As the Commission explained, however, that assertion has no basis in fact or law. So-called DeFi systems involve intermediaries whose failure, like that of significant liquidity providers, can harm securities markets. And the federal securities laws—including the Exchange Act's dealer definition—regulate the securities markets, not the technology that any particular platform or industry uses to transact in securities. Thus, consistent with both the Exchange Act and the Administrative Procedure Act, the Commission reasonably declined to give so-called DeFi crypto asset securities special treatment by carving them out of the rule's application based solely on the technology used in securities transactions. Plaintiffs disagree with the Commission's policy choices and weighing of costs and benefits, but under settled case law, such disagreements provide no basis to set aside the Commission's reasonable exercise of its congressionally granted authority.

ARGUMENT

I. Plaintiffs have not shown that the Commission lacks statutory authority to adopt the rule.

Congress authorized the Commission to "define technical, trade, … and other terms used" in the Exchange Act. 15 U.S.C. § 78c(b). The "best reading" of the statute is that Congress "'expressly delegate[d]' to [the] agency the authority to give meaning to a particular

statutory term" (*Loper Bright Enters. v. Raimondo*, 144 S. Ct. 2244, 2263 (2024)), and the rule is a proper exercise of that authority. Consistent with the text of the Exchange Act's definitions of "dealer" and "government securities dealer" and judicial and agency interpretations of those definitions, the rule further defines what it means to be engaged in the business of buying and selling securities "as a part of a regular business." P.App.55; *see* 15 U.S.C. § 78c(a)(5), (44).[1]

The "historical" understanding is that "a dealer provided market liquidity." *Almagarby*, 92 F.4th at 1315. Thus, as the Commission has long recognized, a market participant "acting as a *de facto* market maker whereby market professionals or the public look to the firm for liquidity" is engaged in a regular business of buying and selling securities. *Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934*, 67 Fed. Reg. 67,496, 67,499 (Nov. 5, 2002) (2002 Release). The rule builds on that understanding by identifying two trading patterns tailored to how a market participant provides liquidity by acting as a *de facto* market maker in today's securities markets: (1) regularly communicating trading interest on both sides of the market for the same security, or (2) earning revenue primarily from capturing bid-ask spreads or trading incentives. P.App.125.

Plaintiffs do not seriously dispute that the Commission has statutory authority to further define "as a part of a regular business." Instead, they repeat their flawed arguments (Reply 2,

[1] "P.App." refers to plaintiffs' appendix in support of their summary judgment motion (Dkt. 30). "D.App." refers to defendants' appendix in support of their opposition and cross-motion for summary judgment (Dkt. 40). "P.Reply.App." refers to plaintiffs' appendix in support of their combined reply and opposition (Dkt. 45). "Mot." refers to plaintiffs' brief in support of their summary judgment motion (Dkt. 29). "Opp." refers to defendants' brief in opposition to plaintiffs' motion and in support of defendants' cross-motion for summary judgment (Dkt. 39). "Reply" refers to plaintiffs' reply in support of their motion and opposition to the defendants' (Dkt. 44).

16) that a dealer must offer certain services to investors; that a dealer must have customers; and that the rule is a "drastic reinterpretation" of the dealer definition. Those arguments lack merit.

A. Plaintiffs fail to demonstrate that the dealer definition is limited to those who offer particular services to investors.

Plaintiffs are incorrect in contending (Reply 19, 22) that the rule improperly defines a dealer "based solely on the effect of [one's] trading activities" rather than "the kinds of services a person chooses to offer to investors." As an initial matter, plaintiffs misconstrue the rule, which sets out two specific trading patterns that indicate a person is engaged in a regular business of buying and selling securities for its own account: regularly expressing trading interest on both sides of the market for the same security, and earning revenue primarily from capturing bid-ask spreads or trading incentives. P.App.125. By their terms, those standards focus on a person's conduct, not whether that conduct "ha[s] the effect of liquidity provision" (Reply 6). The rule thus properly determines dealer status based on a person's "specific conduct," *Almagarby*, 92 F.4th at 1306—that is, their "function," *Keener*, 102 F.4th at 1334.

Regardless, plaintiffs' claim (Reply 2, 6) that dealers must "affirmative[ly] offer … various services to investors," such as "soliciting clients" and "rendering investment advice," has no basis in the statutory text or precedent. The Exchange Act's dealer definition makes no mention of offering any particular services to investors. Instead, the statute defines a dealer as "any person engaged in the business of buying and selling securities … for such person's own account" as "a part of a regular business." 15 U.S.C. § 78c(a)(5)(A)-(B). And as the Eleventh Circuit has explained, being "*in the business* of buying and selling securities" means that a person "profits from executing trades" rather than "the 'appreciation in the value' of his investment portfolio." *Almagarby*, 92 F.4th at 1315; *see id.* at 1316 (citing 1933 Black's Law Dictionary definition of "dealer" as "one who buys to sell—not one who buys to keep, or makes

to sell"). That is in keeping with the "historical" understanding that "a dealer provided market liquidity." *Id.* at 1315. Thus, a person can qualify as a dealer under the Exchange Act based on the "nature, volume, regularity, and frequency" of the person's "transactions." *Keener*, 102 F.4th at 1334. There is no further requirement of soliciting clients, offering investment advice, or offering any other specific services to investors.

Court decisions applying the dealer definition confirm this understanding. In *Eastside Church of Christ v. Nat'l Plan, Inc.*, 391 F.2d 357 (5th Cir. 1968), the Fifth Circuit held that an entity was a "dealer within the meaning of the [Exchange] Act" because it "purchased many church bonds … for its own account as a part of its regular business and sold some of them"—without analyzing whether the entity provided any particular services to investors. *Id.* at 361-62. Similarly, the Eleventh Circuit in *Almagarby* relied on the "volume and regularity" of the defendant's "transactions" in concluding that he "was 'in the business' of buying and selling securities," explaining that the defendant profited from "acquir[ing]" shares "at a discount" and "immediately res[elling]" them. 92 F.4th at 1316-17. The court did not inquire whether the defendant handled clients' money, rendered investment advice, or performed similar services. Contrary to plaintiffs' suggestion (Reply 6), "underwriting" activities such as those at issue in *Almagarby* are not a "service[] to investors"; underwriting refers to "acquiring new shares from an issuer 'for the purpose of reselling them'" (*Almagarby*, 92 F.4th at 1316) and is an intermediary service. Regardless, the Eleventh Circuit made clear that the defendant's underwriting activities were "not the only factor" supporting the court's determination. *Id.* at 1318.

Treatises dating back to the Exchange Act's enactment also undermine plaintiffs' argument. A treatise published in 1934 explained that the "ultimate test" of "whether a person is

or is not a 'dealer' within the meaning of the [Exchange] Act" is "whether his operations are *sufficiently extensive* to be considered 'part of a regular business.'" Charles H. Meyer, The Securities Exchange Act of 1934 Analyzed and Explained 34 (1934) (D.App.40) (emphasis added). Notwithstanding Meyer's "caution" (Reply 9) that the treatise offered only "the author's interpretation of the law" (P.Reply.App.374), courts have frequently looked to Meyer's 1934 treatise in interpreting the Exchange Act's dealer definition. *Keener*, 102 F.4th at 1335; *SEC v. Auctus Fund Mgmt., LLC*, No. 23-cv-11233, 2024 WL 3498593, at *5 (D. Mass. July 22, 2024). Another leading securities-law treatise explained that the statutory phrase "engaged in the business" "connotes a certain regularity of participation in purchasing and selling activities rather than a few isolated transactions." Louis Loss, Securities Regulation 720 (1st ed. 1951) (D.App.2). Loss further described "furnish[ing] the services which are usually provided by dealers," such as "quoting the market" and "rendering incidental advice," as merely a "characteristic[]" of dealers, while emphasizing that "a person does not have to exhibit all or any given number of these dealer characteristics in order to be considered a dealer." *Id.* at 722 (D.App.4). Plaintiffs criticize Loss's 1951 treatise as published "two decades after the Exchange Act" (Reply 8), but courts routinely rely on similarly "contemporaneous[]" views of "respected commentators" in interpreting statutory text. *Loper Bright*, 144 S. Ct. at 2247 (citing commentary from 1947, 1950, and 1965 in interpreting the APA, adopted in 1946).

Further, plaintiffs' argument cannot be squared with Commission precedent. More than three decades ago, the Commission explained that "[c]ase law has established that the primary indicia in determining that a person has 'engaged in the business' within the meaning of the term 'dealer' is that the level of participation in purchasing and selling securities involves more than a few isolated transactions." *Gordon Sodorff, Jr.*, 1992 WL 224082, at *4 (SEC Sept. 2, 1992).

The Commission did not state that one must offer some specific services to investors to be "engaged in the business" of buying and selling securities for one's own account. Nor are the Commission releases that plaintiffs invoke (Reply 21-23) to the contrary. For instance, while the Commission has described "carrying a dealer inventory in municipal securities" and "advertising or listing as a dealer in professional publications" as examples of activities that may qualify a bank as a municipal securities dealer (*Adoption of Rule 15Ba2-1*, 1975 WL 163406, at *3 (Oct. 15, 1975)), it did not suggest that any particular activities or services are *necessary* to meet the dealer definition. Similarly, the Commission has listed "buying and selling directly to securities customers together with conducting any of an assortment of professional market activities such as providing investment advice" as conduct that "may satisfy the definition" of a dealer. 2002 Release, 67 Fed. Reg. at 67,499. But it also identified "acting as a *de facto* market maker whereby market professionals or the public look to the firm for liquidity" as an example of dealing activity, and it stressed that "the analysis of whether a person meets the definition of a dealer depends upon all of the relevant facts and circumstances." *Id.* There is thus a dearth of support for plaintiffs' claim that the Commission disregarded supposed "reliance interests of market participants" or "unquestionably changed its position" in adopting the rule under review. Reply 23-24; *cf. Keener*, 102 F.4th at 1335 (Commission did not deprive defendant of "fair notice" because agency "has never issued guidance condoning" specific conduct at issue).

Nor do the court decisions plaintiffs cite (Reply 5-6) support the proposition that dealers *must* provide certain services to investors. In *Chapel Investments, Inc. v. Cherubim Interests, Inc.*, 177 F. Supp. 3d 981 (N.D. Tex. 2016), this Court observed that a dealer "must be engaged in the securities business, *such as* soliciting investor clients, handling investor clients' money and securities, rendering investment advice to investors, and sending investors subscription

agreements for their review and execution." *Id.* at 990 (emphasis added). The Court did not address—and had no occasion to address—whether a market participant that "profit[s] from trade execution," such as by "capturing bid-ask spreads," may also be engaged in the securities business, as the Eleventh Circuit has correctly concluded. *Almagarby*, 92 F.4th at 1315. Nor did *Discover Growth Fund, LLC v. Camber Energy, Inc.*, 602 F. Supp. 3d 982 (S.D. Tex. 2022), address market participants that profit from trade execution: that decision concluded that certain entities were "not dealers because their only activity is *investing* their own money in securities." *Id.* at 989 (emphasis added).

To be sure, the *Camber Energy* court also suggested that "an entity whose only activities are buying and selling securities for its own account" cannot be a dealer because the Exchange Act defines a dealer as one who buys and sells securities for its own account "as a *part* of a regular business" rather than "all" of a regular business. *Id.* (emphasis added). But both the dealer definition and neighboring Exchange Act definitions are most naturally read as using "as part of" to mean "in the course of," not "as a subset of." *See, e.g.*, 15 U.S.C. § 78c(a)(4)(B)(v) (exception from broker definition where "bank effects transactions as part of a program for the investment or reinvestment of deposit funds"). After all, the "normal rule of statutory construction" is that "identical words used in different parts of the same act are intended to have the same meaning." *Sullivan v. Stroop*, 496 U.S. 478, 484 (1990). And in any event, the Eleventh Circuit has rejected such a counterintuitive statutory interpretation, holding that "[w]hile evidence of merely some profits from buying and selling securities may alone be inconclusive proof," the defendants were dealers because their "entire business model was predicated on the purchase and sale of securities." *SEC v. Big Apple Consulting USA, Inc.*, 783

F.3d 786, 809 (11th Cir. 2015) (emphases omitted); *see Almagarby*, 92 F.4th at 1317 (defendant's "*entire* business model relied on buying and selling securities").

B. Plaintiffs are wrong that the dealer definition is limited to only those market participants who are in the regular business of buying and selling securities for their own account in service of effectuating customer orders.

While plaintiffs now seek to distance themselves from the argument that dealers must have customers—describing it as "an argument set forth in a different brief filed by private-fund advisers in a different case"—they nonetheless insist that the rule's alleged "departure from that core component of dealer conduct is fatal." Reply 13. Plaintiffs' apparent retreat from this oft-defeated argument is understandable. As the Commission's motion explained (Opp. 17-22), and as the Eleventh Circuit has squarely held, a customer-facing requirement has "no grounding in the statutory text," "structure," or "legal backdrop." *Keener*, 102 F.4th at 1334; *see Almagarby*, 92 F.4th at 1318. "[T]he Exchange Act makes no mention of a customer-facing role in its statutory definition" of a dealer; instead, "the Act defines dealers by their function, as being '*in the business of* buying and selling securities.'" *Keener*, 102 F.4th at 1334 (quoting 15 U.S.C. § 78c(a)(5)(A)); *Almagarby*, 92 F.4th at 1318 (same). Two other courts recently reached the same conclusion, rejecting the customer requirement that plaintiffs advance here. *Long*, 2024 WL 3161669, at *1-3 (Exchange Act's dealer definition "does not require the buying and selling of securities be pursuant to a customer request because the focus is on the regularity of the conduct and the goal of securing a profit"); *Auctus*, 2024 WL 3498593, at *3-7 (rejecting argument that dealers must "effectuate customer orders" and explaining that dealer definition turns on "a business-based analysis").

Plaintiffs cannot sidestep *Almagarby* and *Keener* (Reply 10-12). The Eleventh Circuit's rejection of a customer requirement was not "expressly limited" to the "specific facts of those cases" involving "toxic lending" and "underwriting" (Reply 10-11). While the court's

conclusions that the defendants qualified as dealers turned on their "specific conduct" (*Almagarby*, 92 F.4th at 1318) or "activit[ies]" (*Keener*, 102 F.4th at 1334), its analysis of the Exchange Act's text, structure, and history in rejecting a customer-facing requirement is not limited to any particular set of facts. And *Almagarby*'s recognition that "not … *every* professional investor who buys and sell[s] securities in high volumes is a 'dealer'" (92 F.4th at 1318) is entirely consistent with the rule here. As the Commission explained, the "historical[]" understanding of "dealer activity" is "trading in a manner designed to profit from bid-ask spreads or liquidity incentives rather than with a view toward appreciation in value." P.App.68. The rule's standards reflect that historical understanding: they do not turn on the total volume of one's securities transactions, but instead are designed to distinguish between the "[t]ypical" dealer activity of "profit[ing] from trade execution" itself, on one hand, and profiting from "appreciation in the value" of securities, on the other. *Almagarby*, 92 F.4th at 1315; *see* P.App.69-70.

Plaintiffs fail to identify any precedent holding, contrary to *Almagarby*, *Keener*, *Long*, and *Auctus*, that Exchange Act "dealers" must effectuate customer orders. Reply 13-16. Plaintiffs rely on *Schafer v. Helvering*, 299 U.S. 171 (1936), which interpreted a Treasury regulation that defined a dealer "[f]or the purpose of this rule" as one "regularly engaged in the purchase of securities and their resale *to customers*." 299 U.S. at 173 n.1 (emphasis added). The absence of similar language in the Exchange Act's dealer definition renders this decision inapposite; in fact, it underscores the soundness of *Almagarby* and its progeny. And as explained above (*supra* pp. 7-8), *Chapel Investments* and *Camber Energy* did not address whether a market participant who profits from trade execution—but does not effectuate customer orders—can

qualify as a dealer. *Contra* Reply 15 n.4. It is no wonder that plaintiffs only half-heartedly advance this argument.

C. The rule's exemptions and qualifications do not support plaintiffs' claims that the rule exceeds the Commission's statutory authority.

Contrary to plaintiffs' argument (Reply 16-18), the rule's exclusions for certain entities, including registered investment companies and central banks, do not show that the rule's definition of "as a part of a regular business" is overbroad. It is Congress that broadly defined "dealer" as "any person"—including a "company" or "instrumentality of a government"—"engaged in the business of buying and selling securities ... for such person's own account" as "a part of a regular business." 15 U.S.C. § 78c(a)(5)(A)-(B), (9). The rule is limited to refining a portion of that broad definition to clarify its application to significant liquidity provision. Nothing in the Exchange Act precludes investment companies or central banks that engage in the rule's specified trading patterns from meeting the statutory dealer definition. The Commission nonetheless reasonably excluded registered investment companies and central banks from the rule's scope because existing oversight of these entities accomplishes similar purposes as would dealer regulation. Opp. 26-27. Plaintiffs identify no support for their assertion (Reply 17) that registered investment companies and central banks would be "captured by the [rule's] definition because of their extensive trading activities." And the Exchange Act's express exclusion from the dealer definition for banks to the extent they are engaged in specified banking activities (*see* 15 U.S.C. § 78c(a)(5)(C)) does not suggest that "Congress did not understand the trading activities" of registered investment companies or central banks "to constitute the 'business' of dealing" (Reply 18). To the contrary, it underscores what the statutory text makes clear: unless Congress has expressly provided otherwise, the dealer definition encompasses "any person" that

buys and sells securities for their own account as a part of a regular business. 15 U.S.C. § 78c(a)(5)(A)-(B).

Nor do the rule and its no-presumption provision leave market participants "to feel their way on a case-by-case basis." Reply 19 (quoting *Sackett v. EPA*, 598 U.S. 651, 681 (2023)). The Commission reasonably explained how each of the rule's two qualitative standards would operate in practice, responding to commenters' concerns and modifying the proposal in response. *See* P.App.62-70. Applying the rule's qualitative standards involves consideration of a market participant's "facts and circumstances." P.App.88. That is nothing new: the "analysis of whether a person meets the [statutory] definition of a dealer" has always "depend[ed] upon all of the relevant facts and circumstances" (2002 Release, 67 Fed. Reg. at 67,499). *See also, e.g.*, Loss, *supra*, at 722 (D.App.4) ("when … a person's trading activities make him a 'dealer'" involves "no ready distinction"). And although the Commission explained that market participants engaging in other dealing activities, such as underwriting, "will still be a dealer even though those activities are not addressed by the [rule's] two qualitative factors" (P.App.61; *see* P.App.125), the agency made clear that "otherwise applicable interpretations and precedent" will continue to govern assessments of those other activities (P.App.61).

Plaintiffs' reliance (Reply 16) on *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006), is also misplaced. *Goldstein* involved a provision of the Investment Advisers Act of 1940 that exempted investment advisers with "fewer than fifteen clients" from that Act's registration requirement. 451 F.3d at 874. The Commission had adopted a rule that defined a hedge fund adviser's "clients" to include the fund's investors. *Id.* at 877. The D.C. Circuit rejected the rule's interpretation of "client" at step two of the then-applicable *Chevron* framework, concluding that treating a hedge fund's investors as clients was inconsistent with the Advisers

Act's text, history, and background legal principles, and that the Commission had "not adequately explained" its contrary conclusion. *Id.* at 878-84. *Goldstein* did not hold that the Commission lacks authority to further interpret "definitional terms" used in statutes that Congress charged the Commission with administering, as plaintiffs suggest (Reply 16). And "both the statutory fit and the [Commission's] detailed explanation for its decision readily distinguish this case from *Goldstein*." *Nat'l Ass'n for Fixed Annuities v. Perez*, 217 F. Supp. 3d 1, 29 (D.D.C. 2016).

II. Plaintiffs have not demonstrated that the Commission failed to engage in reasoned decisionmaking.

Under the APA's arbitrary-and-capricious standard, "there is a presumption that the agency's decision is valid" (*Tex. Clinical Labs, Inc. v. Sebelius*, 612 F.3d 771, 775 (5th Cir. 2010)), and plaintiffs "ha[ve] the burden of proving that the agency's determination was arbitrary and capricious" (*Medina Cnty. Env't Action Ass'n v. Surface Transp. Bd.*, 602 F.3d 687, 699 (5th Cir. 2010)). Plaintiffs' reply confirms that they have not met their burden. Plaintiffs repeat their claims that the Commission failed to respond to certain comment letters, but the Commission recognized each of the concerns raised in those comments and nonetheless concluded that, on balance, the rule would promote the stability of liquidity provision and protect investors. Plaintiffs thus fail to show that the Commission contravened the APA's "minimal standards of rationality." *Clean Water Action v. EPA*, 936 F.3d 308, 312 (5th Cir. 2019).

A. Plaintiffs fail to show that the Commission inadequately substantiated the problems that the rule is designed to address.

The Commission explained that, due to advancements in electronic trading, certain market participants—particularly proprietary trading firms in the government securities markets—have a "significant share of market volume" and "perform[] critical market functions, in particular liquidity provision, that historically have been performed by dealers." P.App.54-56.

But some of those entities that perform traditional dealer functions "are not registered as dealers" or government securities dealers. P.App.56. The Commission detailed the "negative externalities" created by this lack of dealer registration. P.App.82. For instance, the absence of leverage constraints on these entities' trading activities increases the risk that these significant liquidity providers could "fail financially," which would "not only harm their counterparties but also cause wider harm throughout securities markets." P.App.91-92. The "limited regulatory oversight" of these entities also "increases the difficulty and complexity for regulators to investigate, understand, and address significant market events." P.App.56. And the "unevenness of regulation potentially gives less-regulated entities an unfair advantage over registered dealers that engage in similar activities." P.App.82.

Plaintiffs dispute the need for the rule with respect to crypto asset securities markets (Reply 34-38), but they disregard the Commission's explanation. The adopting release explained in detail how significant liquidity providers can harm other market participants and markets if they fail (P.App.91-92) and how significant liquidity providers being unregistered undermines the Commission's ability to oversee securities markets and investigate any market disruptions that occur (P.App.56-57). The Commission emphasized that these principles apply equally to crypto asset securities markets: crypto asset "intermediaries perform a wide range of functions, many of which may already qualify them as dealers under the Exchange Act." P.App.76 n.284. "[D]igital asset … intermediaries whose activities may increase risks to financial stability," the Commission explained, should be subject to the same "regulatory and supervisory standards that govern traditional market infrastructures and financial firms." P.App.76 n.284 (citation omitted). The Commission thus concluded that the rule should apply to market participants "engaging in *de facto* market making … regardless of which … technology is used." P.App.66. As support

for that conclusion, the Commission cited a report (P.App.66 n.135) that observed that "the way [DeFi protocols] operate does not materially differ from that of traditional financial markets" (Board of International Organizations of Securities Commissions, Final Report with Policy Recommendations for Decentralized Finance (DeFi), at 9 (Dec. 2023) (IOSCO Report)).[2]

Unable to simply rely on their assertion that so-called DeFi protocols result in an intermediary-free marketplace, plaintiffs resort to characterizing the Commission's motion as relying on no more than "post hoc rationalizations" (Reply 35). The Commission's response to plaintiffs' arguments about the need for the rule (Opp. 28-33) is entirely consistent with the reasoning in the adopting release. Plaintiffs' assertion that the release did not "cite the IOSCO report for the proposition that digital asset markets and their underlying technologies are analogous to traditional markets" (Reply 38) ignores the context in which the Commission relied on that report (P.App.66 & n.135). In any event, the principle that "'[t]he grounds upon which an administrative order must be judged are those upon which the record discloses that its action was based' … does not bar an agency's counsel from merely elaborating on the consistent stance the agency articulated below." *Chiquita Brands Int'l Inc. v. SEC*, 805 F.3d 289, 299 (D.C. Cir. 2015) (quoting *SEC v. Chenery Corp.*, 318 U.S. 80, 87 (1943)); *see* Reply 35 (citing cases applying *Chenery* principle). And while plaintiffs object to the IOSCO Report's reference to FTX's insolvency (Opp. 32-33) on the ground that "FTX was a cryptocurrency exchange, not a trader" (Reply 37-38), that example nonetheless shows that even so-called DeFi systems present risks with respect to failure of market intermediaries.

Nor does *National Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831 (D.C. Cir. 2006) support plaintiffs' argument (Reply 36-37) that the Commission failed to "substantiate[] the

[2] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD754.pdf.

'threat' in the digital asset markets" of significant liquidity providers acting as dealers without registering with the Commission. The D.C. Circuit there explained that, for the agency at issue to "rely solely on a theoretical threat" of anticompetitive conduct to support rules restricting sharing of information, the agency "would need to explain" why existing reporting mechanisms "do not suffice" and "explain how" market developments "pose[] a threat of actual abuse," among other possible justifications. 468 F.3d at 844-45. That is what the Commission has done here: it explained how market participants that provide significant liquidity without registering as dealers create an actual threat of imposing negative externalities on other market participants and the Commission's market oversight. *See* P.App.56-57, 91-92. And the Commission explained why existing regulations were inadequate to address this problem. For instance, proprietary trading firms that engage in dealing activities without registering as dealers are not subject to leverage constraints that "reduce the risk that a significant liquidity provider fails and harms its counterparties and the broader functioning of the markets" (P.App.94), nor are they subject to other dealer regulations that "provide fundamental protections that contribute to fair and orderly markets" (P.App.57; *see* P.App.93-97). *National Fuel* does not disturb the settled principle that agencies can "adopt prophylactic rules to prevent potential problems before they arise." *Nasdaq Stock Mkt. LLC v. SEC*, 38 F.4th 1126, 1143 (D.C. Cir. 2022).

B. Plaintiffs cannot establish that the Commission acted unreasonably in explaining the rule's applicability to crypto asset markets.

Plaintiffs do not meet their burden to prove that the Commission "failed to adequately address" comments about the rule's "potential application" to crypto asset securities markets (Reply 25-26).

1. The Commission explained "[w]hich digital asset transactions constitute securities transactions" and thus fall within the rule (Reply 26-28). The Exchange Act defines a "security"

to include an "investment contract." P.App.66 n.134; *see* 15 U.S.C. § 78c(a)(10). And the Commission explained that "whether a particular crypto asset is an investment contract that is a security" under the Exchange Act is "governed by the test first articulated by the Supreme Court in *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946)." P.App.66 n.134; *see* Opp. 34 (describing *Howey* test).

Plaintiffs' assertion (Reply 26-27) that the *Howey* test creates "substantial uncertainty" as applied to "digital asset securities" does not withstand scrutiny. The adopting release (P.App.66 n.134) and the Commission's motion (Opp. 34-35 & n.5) cited numerous cases in which courts have applied Congress's definitions and Supreme Court precedents including *Howey* to the particular facts and circumstances of crypto asset securities offers, sales, and transactions. Plaintiffs' cited cases holding that certain sales of particular crypto assets were not investment contracts under *Howey* (Reply 26-27 (citing *SEC v. Binance Holdings Ltd.*, No. 23-cv-1599, 2024 WL 3225974, at *17-22 (D.D.C. June 28, 2024); *SEC v. Ripple Labs, Inc.*, 682 F. Supp. 3d 308, 328-31 (S.D.N.Y. 2023)) do not show that the *Howey* test is uncertain or unworkable. Those decisions applied *Howey* to the facts and circumstances of the offerings at issue and concluded that the offerings did not meet the statutory definition of a security.

2. The Commission also adequately responded to comments about how the rule's "qualitative tests apply to digital asset markets" (Reply 28). Referencing comments about the supposedly unique features of "liquidity pool[s]" (P.App.65) and "automated market maker[s]" (P.App.69)—the very so-called DeFi arrangements plaintiffs claim the Commission ignored—the Commission explained 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," including the *de facto*

market making that the rule addresses. P.App.76. Thus, the Commission explained, "[w]hether a particular activity in the crypto asset securities market, including in the so-called DeFi market, gives rise to dealer activity requires an analysis of the totality of the particular circumstances against all elements of the expressing trading interest factor." P.App.66; *see* P.App.70 (similar for rule's "primary revenue" factor).

The Commission thus reasonably described the general, technology-neutral principles governing the application of the rule's standards to all securities, regardless of the technologies used or the trading platform's structure. Plaintiffs deem this approach "deficient" (Reply 29) but still cite no authority holding that the Commission was required to determine *ex ante* how the rule's standards would apply to particular crypto asset security market activities—much less how the Commission could do so in a prospective rulemaking, outside the context of a specific "liquidity pool," "automated market maker," or similar so-called DeFi system. After all, an agency "need not announce in advance how it might rule on … hypothetical scenarios." *U.S. Postal Serv. v. Postal Regul. Comm'n*, 963 F.3d 137, 143 (D.C. Cir. 2020). And as explained (*supra* pp. 14-15), the record before the Commission rebuts plaintiffs' assertion (Reply 29) that so-called "DeFi innovations render digital asset markets fundamentally different from traditional markets."

C. Plaintiffs do not show that the Commission inadequately considered the rule's potential effects on crypto asset markets.

Plaintiffs fail to carry their burden to prove that the Commission did not "substantively respond[]" to comments about the rule's potential costs, including its possible effects on markets for crypto asset securities. Reply 30. Contrary to plaintiffs' claims, "[c]onsistent with the comments received," the Commission considered the rule's potential effects on crypto asset securities markets, as well as "an alternative that would treat crypto asset securities differently

from other types of securities." P.App.116. The Commission declined to categorically exempt crypto asset securities from the rule's scope because "the application of the dealer regulatory regime" to market participants that engage in *de facto* market making "will be beneficial and critical to promot[ing] the Commission's mission"—"[r]egardless of the technology used." P.App.116. Conversely, "carv[ing] out or narrow[ing]" the rule's application to crypto asset securities would "reduce the benefits" of the rule, as doing so "would not apply the dealer regime to market participants that provide liquidity in crypto asset securities markets." P.App.116.

1. *Liquidity provision*. The Commission responded to comments stating that the rule "would harm liquidity in markets for crypto assets." P.App.112; see P.App.76 (similar). The Commission distinguished between liquidity volume and stability, acknowledging that "[i]f affected [proprietary trading firms]" in crypto asset markets "curtail their crypto asset trading activities, then trading volumes in crypto asset markets could fall, harming the liquidity and efficiency of these markets" (P.App.112), but concluding that the rule would promote the "stability and resiliency" of liquidity provision. P.App.54-55. Plaintiffs' claim (Reply 30) that the rule "seeks to protect" liquidity thus ignores the Commission's stated purpose of reducing liquidity *volatility* during market disruptions and facilitating the Commission's oversight of securities markets. Opp. 38-39; *see* P.App.54-55. The Commission's explanation belies plaintiffs' assertion (Reply 31) that the Commission did not take commenters' concerns about reduced liquidity "into consideration in fashioning the [r]ule." And the Commission's acknowledgement that affected crypto asset market participants could respond to the rule by curtailing their trading (P.App.112) is equally responsive to comments asserting that the rule will cause "liquidity providers" to "leave U.S. markets in favor of foreign markets due to the regulatory uncertainty resulting from" the rule (Reply 33). The Commission "made reasonable

trade-offs," and the APA does not "require[] anything more." *Covad Commc'ns Co. v. FCC*, 450 F.3d 528, 543 (D.C. Cir. 2006); *see also Huawei Techs. USA, Inc. v. FCC*, 2 F.4th 421, 450 (5th Cir. 2021) (upholding rule where agency "acknowledged evidence" that rule could have negative effects but "deemed those costs outweighed" by rule's benefits).

2. *Effects on crypto asset market participants.* Nor did the Commission ignore comments about the rule's potential effects on participants in crypto asset markets, as plaintiffs contend (Reply 32-33). The Commission responded to comments about the rule's alleged effects on "smaller digital asset market participants" (Reply 32) by emphasizing that, even if the rule's qualitative factors are satisfied, "a person engaging with products, structures, or activities in the so-called DeFi market" that "has or controls total assets of less than $50 million" would "not be captured by the final rule[]." P.App.66 n.132. Plaintiffs complain that this threshold was not "develop[ed] … for the digital asset markets" (Reply 32) but do not explain why that makes it any less responsive to commenters' concerns. And their objection to the specific numerical threshold for the rule's exemption (Reply 32) is nothing more than an improper attempt to "re-weigh" the Commission's "technically complex trade-offs" (*Nasdaq Stock Mkt. LLC v. SEC*, 34 F.4th 1105, 1114 (D.C. Cir. 2022)).

3. *Innovation*. The Commission also responded to comments asserting that requiring certain crypto asset security market participants to register as dealers "could hinder U.S. innovation in the crypto asset market." P.App.76. Notwithstanding the costs of such registration, the Commission explained that "application of the dealer regulatory regime" to any crypto asset market participants that meet the rule's specific liquidity provision standards "will be beneficial and critical to promoting the Commission's mission." P.App.116. After all, crypto asset securities "intermediaries perform a wide range of functions, many of which may already

qualify them as dealers under the Exchange Act," and such intermediaries "may increase risks to financial stability" just as with "traditional market infrastructures and financial firms." P.App.76 n.284. Yet again, plaintiffs fail in their attempts (Reply 33-34) to repackage their disagreement with the Commission's "reasonable trade-offs" (*Nasdaq*, 34 F.4th at 1113) as claims that the Commission did not respond to comments about rule's benefits and costs.

D. Plaintiffs identify no error in the Commission's consideration of the rule's effects on efficiency, competition, and capital formation.

The Commission found that the rule would "promote competition among entities that regularly provide significant liquidity by applying consistent regulation to these entities, thus leveling the competitive playing field" between entities currently registered as dealers and those that are not. P.App.112. The Commission acknowledged that the rule "could have a small negative effect on market efficiency," but "could also promote market efficiency" by making significant liquidity providers "less sensitive to market disruptions that could otherwise reduce their capacity to provide liquidity." P.App.112. The Commission likewise acknowledged that the rule could "harm capital formation" if affected entities respond by reducing their market participation, but could also "promote capital formation" by "promot[ing] market stability, resiliency, and investor confidence." P.App.113.

Plaintiffs' challenges to the Commission's analysis of those factors all depend on the erroneous premise (Reply 38) that the Commission was required to separately "analyze the effects of the [r]ule on the digital asset markets." Under the Exchange Act's text, the Commission need only "consider … whether the action will promote efficiency, competition, and capital formation." 15 U.S.C. § 78c(f); *see id.* § 78w(a)(2). Plaintiffs identify no "textual basis" (*Chamber of Com. of U.S. v. SEC*, 85 F.4th 760, 773 (5th Cir. 2023)) for requiring the Commission to assess those factors with respect to any particular "markets" (Reply 39). Nor do

plaintiffs explain when they believe the Commission must analyze "separate markets" or how the Commission should determine which markets are "separate" (Reply 39)—particularly when, as here, both the rule and the statutory definition apply equally to markets for all "securities" (P.App.125; 15 U.S.C. § 78c(a)(5)(A)).

In any event, the Commission adequately analyzed the rule's expected economic effects on markets for crypto asset securities, especially in light of record evidence undermining plaintiffs' assertion that "digital asset markets" are "separate markets" that are "substantially different from traditional markets." Reply 39. The Commission acknowledged that the rule could "harm[] the liquidity and efficiency" of "crypto asset markets" if any significant liquidity providers for crypto asset securities are not "already … dealers under the Exchange Act" and those market participants respond to the rule by "curtail[ing] their crypto asset trading activities." P.App.112. Far from failing to engage with "commenters' concerns" about the rule's effects on efficiency, as plaintiffs contend (Reply 42), the Commission *agreed* with some of those concerns. The agency nonetheless concluded that the rule was warranted in light of the rule's expected benefits, including countervailing improvements to "market efficiency" if the rule "lead[s] to better capitalization for significant liquidity providers." P.App.112. As for competition, the Commission determined that the rule's effects on "crypto asset markets" would be "similar" to its effects on "other markets." P.App.112; *see* P.App.113 (describing rule's "mixed" expected effects on capital formation). That analysis was reasonable in light of evidence before the Commission indicating that "the way" so-called "DeFi arrangements and activities … operate does not materially differ from that of traditional financial markets." IOSCO Report, *supra*, at 9. And plaintiffs offer no support for their continued insistence (Reply 40) that the Commission could have estimated the number of crypto asset market

participants that the rule may cover simply because "other components of the U.S. Government" have been able to track individual crypto asset transactions in some cases.

III. Plaintiffs have not established that the proposal provided inadequate notice of the rule's application to crypto asset securities.

The proposed rule satisfied the APA's notice requirement because it "adequately frame[d] the subjects for discussion" such that an "affected party 'should have anticipated' the agency's final course in light of the initial notice." *Huawei*, 2 F.4th at 447. The proposing release stated that the proposed rule "would apply to securities as defined by Section 3(a)(10) of the Exchange Act … including any digital asset that is a security or a government security within the meaning of the Exchange Act." P.App.4 & n.36. The final rule takes the same approach to crypto asset securities, explaining that the final rule "will apply with respect to any crypto asset that is a 'security' or 'government security' within the meaning of the Exchange Act." P.App.60. And the operative text of both the proposed and final rules applies to a person who buys and sells "securities"—of any kind—with the effect of providing significant liquidity to other market participants by engaging in certain enumerated trading patterns. *Compare* P.App.52, with P.App.125. Thus, the final rule's approach to crypto asset securities is not only "reasonably foreseeable" (*Long Island Care at Home, Ltd. v. Coke*, 551 U.S. 158, 175 (2007)), it is identical to the proposal's approach.

Plaintiffs principally object (Reply 44) to the proposal's reference to digital asset securities in a "footnote." But plaintiffs cite no authority holding that footnotes cannot "fairly apprise[] interested persons of the subjects and issues the agency is considering," which is all the APA requires. *Chem. Mfrs. Ass'n v. EPA*, 870 F.2d 177, 203 (5th Cir. 1989). Contrary to plaintiffs' suggestion, *CSX Transportation, Inc. v. Surface Transportation Bd.*, 584 F.3d 1076 (D.C. Cir. 2009), did not hold that "a 'mere mention' of a party or topic in a rulemaking does not

constitute fair notice" (Reply 45). In that case, the D.C. Circuit concluded that the "mere mention of the release of one-year data" in a proposed rule did not "g[i]ve notice that the amount of data … *might change*" to four years in the final rule. 584 F.3d at 1082 (emphasis added). Here, by contrast, the Commission made no change between the proposed rule and the final rule with respect to the rule's application to crypto asset securities.

The number of companies and interest groups that submitted comments about the proposed rule's asserted effects on markets for crypto asset securities (*see, e.g.*, P.App.148-155, 165-180, 196-202) further confirms the adequacy of the proposal's notice. That the proposal "in fact[] did enable" commenters to comment on the relevant aspect of the proposal is strong evidence that the proposal provided "proper[] notice[]." *Huawei*, 2 F.4th at 448; *see also, e.g.*, *Chem. Mfrs. Ass'n*, 870 F.2d at 203 (relying on "industry comments" in concluding that final rule satisfied logical-outgrowth requirement). Cases such as *Mexican Gulf Fishing Co. v. U.S. Dep't of Com.*, 60 F.4th 956, 975 (5th Cir. 2023), and *Small Refiner Lead Phase-Down Task Force v. EPA*, 705 F.2d 506, 549-50 (D.C. Cir. 1983), are inapposite, as those cases concluded that commenters' discussion of *changes* to the proposal did not supply notice that the agency might make those changes in the final rule. The Commission made no such changes between the proposed rule and the final rule with respect to crypto asset securities.

IV. Plaintiffs' requested relief is overbroad.

For the reasons above and in the Commission's motion, plaintiffs' challenges to the rule fail. But should the Court conclude otherwise, it should not "vacat[e]" the rule "in its entirety." *Contra* Reply 4, 48. Even assuming that vacatur is an available remedy, if this Court concludes

that the Commission did not adequately consider an issue or explain its decision, remand without vacatur would be warranted. *See* Opp. 49-50.

Further, if this Court agrees with plaintiffs that the Commission failed to engage in reasoned decisionmaking as to crypto asset securities (Mot. 28-43; Reply 25-44) or that the proposal did not provide adequate notice of the rule's application to crypto asset securities (Mot. 44-45; Reply 44-48), the proper remedy would be to set aside only any invalid applications of the rule and sever the rule's remaining applications. Plaintiffs make little attempt to demonstrate that the rule is unwarranted or arbitrary as applied to securities other than crypto asset securities and, more specifically, those traded on a so-called DeFi platform. Thus, setting aside the rule in its entirety would contravene the principle that a "remedy must be 'limited to the inadequacy that produced [plaintiffs'] injury.'" *Gill v. Whitford*, 585 U.S. 48, 66 (2018) (citation omitted). While plaintiffs assert that "no portion of the [r]ule … exclusively applies to digital asset markets" (Reply 50), it does not matter that "the text of the final rule is not divisible in this way," as courts may "invalidate only some applications even of indivisible text." *GPA Midstream Ass'n v. U.S. Dep't of Transp.*, 67 F.4th 1188, 1202 (D.C. Cir. 2023) (citation omitted); *see, e.g.*, *Finnbin, LLC v. Consumer Prod. Safety Comm'n*, 45 F.4th 127, 136 (D.C. Cir. 2022) ("If the rule were arbitrary only as applied to [a] narrow category of … products, we would vacate it only as so applied … .").

CONCLUSION

The Court should deny plaintiffs' motion for summary judgment, grant defendants' cross-motion for summary judgment, and enter judgment for defendants.

Dated: August 30, 2024

Respectfully submitted,

/s/ Samuel B. Goldstein

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CERTIFICATE OF SERVICE

I certify that on August 30, 2024, I electronically submitted the foregoing document with the clerk of court for the U.S. District Court, Northern District of Texas, Fort Worth Division, using the electronic case filing system of the court.

/s/ Samuel B. Goldstein