

# *SEC v. Ripple Labs Inc. Garlinghouse and Larsen*

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# *The SEC Charges*

- The SEC charged the defendants with unregistered sales of a “security”
  - Issuer: Ripple Labs, Inc. (“Ripple”)
  - Bradley Garglinghouse
  - Christian Larsen
- Principal Claims
  - XRP, the token sold by Ripple, was sold in unregistered offerings
  - Under the circumstances, XRP was an “investment contract” and thus a security

## *Points of Agreement*

- No one disputes XRP was sold in unregistered transactions
- XRP, and any asset, could be a constituent of an “investment contract” and thus a “security”
- Howey is the governing case
- No assertion by the SEC of fraud in statements made by Ripple or its executives

## *Elements of the Howey Test*

- An investment of money
- A common enterprise
- A reasonable expectation of profits to be derived from the efforts of others

# *The Ripple Sales*

- “Institutional Sales”
  - Institutional buyers, hedge funds and OLD customers
  - Entered into written contracts
- Programmatic Sales
  - Both Ripple and the executives were sellers
  - Buyers presumed to be retail investors or generally less sophisticated
  - Transactions on digital asset exchanges or trading algorithms
  - Blind bid/ask transactions; anonymous on both sides
- Payments for Services
  - Employees and other service providers
  - Payment made was through other distributions, not cash

## *Judge's Description of Howey*

- A variety of tangible and intangible assets can serve as the subject of an investment contract (cites, among other cases, SEC. V. Telegram Grp. Inc., 448 F. Supp 3d 352 (SDNY 2020)).
- The subject of the investment contract is not inherently an investment contract. Whether resales of the subject constitute an investment contract depend on the totality of the circumstances surrounding the later transaction.
- Howey requires an examination of the entirety of the parties' understandings and expectations. Each transaction must be analyzed and evaluated on the basis of the contents of the instruments in question, the purposes intended to be served and the factual setting. (Quoting other cases.)
- "The inquiry [as to the existence of an investment contract] is an objective one focusing on the promises and offers made to investors; it is not a search for the precise motivation of each individual participant." (quoting Telegram)
- Howey requires an "investment of money," some "tangible and definable consideration."

# *Application of Howey to Institutional Sales*

- “Institutional Sales”
  - Institutional buyers made an investment of money
  - Horizontal commonality as money was aggregated and all buyers received the same fungible tokens
  - Buyers had expectation that they would derive profits from Ripple’s efforts in light of “Ripple’s communications, marketing campaign, and the nature of Institutional Sales”

# *Application of Howey to Programmatic Sales*

- The “undisputed record does **not** establish the third *Howey* prong”
- Programmatic sales represented less than 1% of global XRP trading volume
- “Vast majority of individuals who purchased did not invest their money in Ripple at all”
- “Speculative motive “on the part of the purchaser . . . Does not evidence the existence of an ‘investment contract’ . . .”
- Even if some buyers believed that they were relying on Ripple, the determination is an “objective one” not based on the precise motivation of each individual participant
- Ripple did not make any promises or offers to these buyers
- Many of the buyers were entirely unaware of Ripple’s existence
- Sales were not made pursuant to contracts
- Ripple’s promotional materials were not distributed broadly
- No expectation that these buyers, who were less sophisticated than institutional investors, share similar understandings and expectations and had parsed through the multiple documents and statements made by Ripple



## *Application of Howey to Payment for Services*

- Recipients did not pay money or some other tangible and definable consideration to Ripple
- The SEC did not develop the argument that these recipients were effectively underwriters and that any resales made by them in the secondary market for cash traced back to Ripple

# *Application of Howey to Sales by Executives*

- Treated in the same manner as the Programmatic Sales

# *Immediate Aftermath of Ripple*

- SEC Chair Gensler's Reaction
- Legislative Initiatives
- Judge Rakoff decision in Terraform Labs

# *What Happens Next*

- Does the SEC appeal the Ripple decision?
- What is the status of SEC rule proposals that seem to assume that status as an investment contract travels with the asset?
- Does the SEC attempt to refine its application of the Howey decision?
- How does the Ripple decision impact:
  - Founders and insiders?
  - Institutional investors?
  - Purchasers from anonymous buyers?
  - Exchanges and protocols?

# *Selected Readings*

- DECISION – [SEC v. Ripple Labs Inc. Garlinghouse and Larsen](#)
- STEVEN LOFCHIE ARTICLES
  - [SDNY Tests Whether Ripple Constitutes an Investment Contract](#) (News)
  - [By Whom Should Digital Assets Be Regulated? The Solomonic Solution](#) (Memo)
  - [The Securities Law Treatment of Utility Tokens \(Or Why It Is Past Time for the SEC to Engage with the Hard Questions\)](#) (Memo)
- AMICUS BRIEFS:
  - [BRIEF OF AMICUS CURIAE THE BLOCKCHAIN ASSOCIATION](#) Authored by Jason Gottlieb, Michael Mix and Daniel C. Isaacs
  - [BRIEF OF AMICUS CURIAE PARADIGM OPERATIONS](#) Authored by Kayvan Sadeghi, Shailee Diwanji Sharma, Michelle S. Kallen, Lewis Rinaudo Cohen, Gregory Strong, Rodrigo Seira
- LEWIS COHEN ARTICLE
  - [The Ineluctable Modality of Securities Law: Why Fungible Crypto Assets Are not Securities](#)

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