**Capital Markets Alert**
July 2023

# Ripple Labs 'Split' Decision: Court Determines Crypto's Securities Law Status Varies by Circumstances of Issuance

In a widely watched action by the Securities and Exchange Commission against Ripple Labs Inc. and its principals, the federal district court in Manhattan held that for purposes of the Securities Act, the XRP token distributed by Ripple constituted a security when sold to financial institutions and sophisticated individuals but not when sold, retail, "programmatically."

Applying the third part of the "Howey" test prescribed in the Supreme Court case *SEC v. W.J. Howey Co.*, the district court determined that institutional sales constituted investment contracts (and thus securities) because marketing materials delivered to institutional investors and published information would lead them to believe that "Ripple would use capital from its Institutional Sales to improve the market for XRP and develop uses [for the XRP blockchain], thereby increasing the value of XRP," and to expect to profit therefrom.

Programmatic sales, by contrast, were "blind bid/ask transactions" made on digital asset exchanges, so buyers "could not have known if their payments of money went to Ripple or any other seller of XRP." Concluding that these buyers "stood in the same shoes as a secondary market purchaser," the court noted, nonetheless, that it "does not address whether secondary market sales of XRP constitute offers and sales of investment contracts." In any case, although the buyers in programmatic sales may have been speculating in the crypto asset, "they did not derive that [profit] expectation from Ripple's efforts … " because none of them were aware that they were buying from Ripple.

The court correctly noted the need to distinguish between an asset and the circumstances of its sale in determining whether a security transaction is involved. Indeed, the *Howey* case arose from sales of orange groves. It is also true, as the court remarked, that many assets other than securities are bought for speculative purposes. But in this case, the analysis appears to invert the rationale of the securities laws by requiring protection of wealthy and sophisticated investors but not of retail purchasers.

One may question the court's conclusion that programmatic buyers were not investing based on an expectation of profits from Ripple's efforts. Those buying securities in secondary markets do not expect the issuer to receive the transaction proceeds, but nonetheless, they expect to profit from the efforts of the company's management. Although, expressly, *Howey* defines "investment contract" for purposes of the Securities Act, the case is understood to more generally describe the elements of a security for these purposes. *Ripple Labs* might be seen to limit *Howey's* scope to investment contracts and require other instruments to be considered securities only if specifically defined as such in the Securities Act.

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These questions demonstrate the difficulties in applying *Howey* other than to primary transactions. It is not at all clear that the securities laws' registration and reporting regimes are necessary in all cases to protect investors in secondary digital asset transactions, regardless of the circumstances of a crypto's original issuance, but resolution of such matters requires legislative consideration rather than action by courts or regulators.

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7375 REV1 07-18-2023