

---

# **Cryptic Regulation of Crypto-Tokens**

**By Joshua Gans**

Comments by Eric Talley (Columbia)



Columbia  
Law School

# Lots to like about this paper

- Obviously important topic
- Clearly written
- Honest about the regulatory challenge: The social value / costs of crypto-backed assets is still unclear, even to (particularly to?) regulators
- Proves I was onto something when in grad school I attempted to prod Joshua into joining me in getting a JD, too
  - (Sadly I failed, however)

# Comments / Suggestions

- Targeting your audience
- The regulation of new asset classes: Multiple strategies, each with practical challenges
- The epistemically uncertain welfare-economics case for/against crypto assets

# Targeting your audience (and message)

- The paper never comes clean about what audience it is attempting to “speak” to...
  - Economists?
  - Lawyers?
  - Regulators?
  - Laypersons?
- Or what thesis it is attempting to advance to that audience
  - Primer on Crypto? (Matt Levine has already dunked on all of us here)
  - Infomercial for a case in favor / against further development of crypto tokens?
  - Advocacy piece in favor of clearer rules (in the abstract)?
  - Attempt to offer clearer/better rules? (If so, what are they?)

# The challenge of regulating new asset classes: Alternative strategies (focus on securities reg)

## Ex Ante Regulation

- Regulator formulates bespoke rules ahead of the area's development
- Problem: If asset class is *too* revolutionary, the appropriate type/level of regulatory oversight is unclear
  - This, in fact, was/is the “spiel” of many crypto assets.
- Added Constraint: Regulator's decisions may be highly throttled by courts
  - Interpretation of mandate
  - Arbitrary/Capricious
  - Regulatory inconsistency

## Ex Post Regulation by Litigation

- Regulator issues no rules ahead of time, but relies on “standards” (rather than rules)
- Problem: Standards are almost deliberately vague.
  - Can take time to determine how new asset class fits within the standard
  - Institutional “Learning” case by case
- Over time, clear precedent may emerge or severe splits reconciled by higher courts.
  - Can take years to unfold, however, leaving providers to play a multi-year guessing game

# Ex Ante Regulation:

## Deference to agency rule-making is hardly a sure thing

- Interpreting regulatory mandate:
  - Pending US Supreme Court case challenging “Chevron” deference agencies have traditionally received in interpreting statutory mandate: *Loper Bright Enterprises v. Raimondo* (2023)
  - Statutory Ambiguity and the “Major Questions Doctrine”: *West Virginia v EPA* (2022)
- Arbitrary and/or Capricious promulgation (& repeal) of agency rules
  - Several recent cases rejecting new regulations / & roll-backs under “State Farm” doctrine because of insufficient justification. *Business Roundtable v. SEC* (2011); *Dep’t Homeland Security v. UC Regents* (2020)
- Regulatory Inconsistency
  - Very recent crypto litigation challenging inconsistent treatment of crypto-based derivatives. *Grayscale Invs. v. SEC* (D.C. Cir. Aug. 29, 2023).
  - Rejecting and vacating SEC’s refusal to allow trading of a bitcoin ETF in the light of SEC’s prior approval of trading on national exchanges of two bitcoin futures funds
  - “In the absence of a coherent explanation, this unlike regulatory treatment of like products is unlawful. We therefore grant Grayscale’s petition for review and vacate the Commission’s order”

# Regulation by Litigation

## A Different Set of Challenges

- Legal Standard for “Security” (*SEC v Howey* (1946)): contract, transaction or scheme that involves:
  1. An investment of money
  2. In a common enterprise
  3. With the expectation of profit
  4. To be derived from the efforts of a promoter or other third party
- Courts (even in the same prominent jurisdiction!) may not agree about application. See, e.g., SDNY
  - *SEC v Ripple* (2023) (Judge Torres): Finding factors 1-3 present for crypto asset, but hinging #4 on reasonable belief of parties on use of funds: institutional investors in private transactions (satisfied) versus retail investors buying/selling in anonymous markets (not satisfied)
  - *SEC v. Terraform Labs* (2023) (Judge Rakoff): Finding all four factors present, and hinging #4 on public advertising campaign in which promoter shilled the investment’s overall profitability and the promoter’s managerial and technical skills
- Second Circuit may resolve this difference, eventually(?). SCOTUS may resolve bigger splits. But that could take a decade.

# The epistemically uncertain cost/benefit case for crypto assets

- Entirely unclear (still!)
- A new kind of money?
  - Needed?
  - Digital fiat currency backed by (a) credible monetary authority vs. (b) tech-bro's Ted talk
- Anonymous Exchange?
  - Whether this is a bug/feature turns on one's view of desirability of obscuring economic activity from public view (tax evasion; trafficking illegal goods; ransom payments)
  - Not entirely anonymous
- Decentralized verification / governance?
  - Benefit of distributed-ledger-based contracting, not crypto per se.
  - Discovering that DAU governance (e.g., voting protocols) also subject to manipulation.
- In the light of this uncertainty, should our regulatory goal be...
  - To pick the best regulation we can given what we know today? Or
  - To promulgate rules that generate better information for our future selves?