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## Revisiting Pending Decision of SEC v. Coinbase

### Revisiting Coinbase oral arguments as ruling on motion for judgement is pending

Like many observers, we believe Coinbase has the upper hand in the case sought by the SEC. Just over a month has transpired since oral arguments before Judge Failla in the New York Southern District Court.

While we think Coinbase is likely to win, we are skeptical the Judge Failla will decide such an important case on a motion to dismiss – our base case is that the judge will deny the motion for judgement at least in part, and set a discovery schedule, which could take months. Following discovery, Coinbase may have opportunities to win on summary judgement. A positive ruling would be a tremendous material positive for Coinbase stock, crypto asset prices, and developer activity in the United States. **The impact of this ruling could be so positive, we believe COIN equity and other impacted crypto assets are worth owning though the impending decision on this motion, even if the odds of a blanket win are low.**

### The decision before Judge Katherine Polk Failla

Judge Failla seemed to side with Coinbase in many respects, seemed to find the Coinbase team more likeable, and seemed to find their arguments better constructed. **The focal point of her questioning – if the presence of a contract matters for determining if a crypto asset is a security – seems to favor Coinbase.** However, seemingly difficult questioning (directed at the SEC in this case) by a judge can be used to show impartiality and to perfect arguments in a ruling. A major objective of oral arguments is to demonstrate the impartiality of the court to the general public.

Judge Failla is faced with the decision to grant or deny the motion to dismiss the case based on the Rule 12(c) motion filed by Coinbase. While some expect the judge to rule in favor of Coinbase on the request for judgement, our conversations indicate a ruling that results in the dismissal of a case on a rule 12c motion is a very high bar. The judge identified four separate allegations that could be ruled upon in response to the recent motion –

- operation of an unregistered exchange
- prime services for institutions
- the Coinbase wallet
- and the facilitation of staking

A rule 12(c) motion is a request to the court for judgement on the pleadings – in other words, a request that the judge make a decision on the merits of the case. See Winning Without Trial by Sandberg law for a great description of 12(c). A judge must determine if the **facts of the case are in dispute** as it would be difficult to rule on matters of law if the conduct alleged is in contentious dispute. The Law of Code podcast has a great interview with a Bloomberg analyst (see the 7:30 mark) we agree with many of his takeaways.

While the SEC was somewhat resistant to admit that the facts of the case were perfectly clear and agreed upon, the judge was able to get the SEC and the defendants to clarify the relevant conduct alleged in the unregistered securities exchange allegations. In the case of staking, Coinbase agreed on the conduct alleged, but rejected the premise of the complaint, citing the absence of custody of the assets.

The court had less difficulty establishing the exchange issues. With facts in hand the court, the SEC, and Coinbase were able to argue the merits of the application of securities laws to the

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unregistered exchange allegations. The judge focused closely on whether or not a formal contract needs to exist for secondary sales of assets to be considered securities.

**In the judge's words, each side is arguing:**

- Coinbase: "unless there's some mechanism of enforcement in all of that very lovely promotional and marketing language, it just doesn't matter."
- SEC: "is that there is an implicit relationship, an implicit agreement"

**Critically, the judge was very focused on the lack of limitations inherent in the SEC's argument that an explicit contract is not required.**

In the case of staking, the judge was focused on if the staking service was ministerial or managerial. Ministerial as in acting as an agent (more favors the SEC) and managerial (more favoring Coinbase).

**We believe there is a decent chance (20-30%) the judge rules in Coinbase's favor in response to the motion.**

- Because the facts of the case were in general agreement, satisfying the requirements for a 12(c) motion.
- The judge seemed concerned with future limitations in absence of the requirements of a contract.
- Precedence set in the Ripple order regarding tokens as investment contracts
- The word in the Securities Act the SEC hopes to cover digital assets is literally "Investment Contract."
- Given the outsized importance of the case, we believe the judge is likely to resist deciding the case on a motion to dismiss, giving the SEC more time to prove their complex arguments.

**Impact on Coinbase**
The presence of a security is the single biggest legal issue for every actor in crypto – exchanges, wallets, custodians, Decentralized Apps, lending protocols, infrastructure and so on. The impact of Coinbase being labeled an unregistered security exchange cannot be overstated. If the SEC were to win, Coinbase would have to delist the named assets and promise to not violate the law again, which would call into question the entire platform. With the named crypto assets validated as securities, the biggest legal issue would be cemented in reality. A very bad outcome indeed.

If the SEC fails, and the secondary trading of tokens are not covered by securities law, much of this risk would be alleviated.

**A positive ruling would derisk Coinbase's trading business but also be a boon for the USDC partnership.** Half of Coinbase's revenue comes from a partnership with Circle, the issuer of USDC. This business is essentially a function of the amount of USDC in circulation and the prevailing interest rate.

With the secondary market derisked, we would expect trading volumes to flourish. Most trading pairs in crypto are against USDC and USDT. An expanding secondary trading ecosystem would increase volumes and demand for these stablecoins. This co-dependance makes the existence of the secondary market doubly important for Coinbase.

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**Impact on the ecosystem**
If a security is not present, the risk of developing applications using tokens decreases dramatically. We believe a sudden change to non-existent enforcement risk would reinvigorate developer activity in the US, a positive for crypto assets that live under the threat of SEC action.

Positive Impact is likely to be felt in areas like:

DeFi:
- DeFi protocols and DAOs largely operate under autonomous mechanisms and mostly in the secondary markets for digital assets
- Wallet providers likely to see growth from an expanding secondary market as well.

Infrastructure:
- Firms facilitating trading in the secondary market for crypto assets would be able to expand their offering of tokens and products and provide wider market access and additional liquidity.

Baselayer projects:
- Solid case law on the security status of tokens could help chart a well-defined pathway for primary issuance
- Scaling solutions and rollups are likely to face lower counterparty risks and have greater adoption.

Overall funding landscape:
- Finally, certainty around the security question would allow for an increase in funding from the US VC ecosystem for projects building these networks.