SECURITIES AND REGULATORS IN THE DIGITAL AGE: RESOLVING THE 'RIPPLE' EFFECT OF CRYPTO-ASSETS

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ABSTRACT

In this technology-driven market, crypto-assets have gained much popularity globally in recent years. Crypto-assets in India are popularly recognised as 'cryptocurrencies ICOs and VDAs owing to their nature and the legal treatment under various statutes. While the high volatility has been questioned by several investors, the high return factor is indeed successful in appealing to household investors. However, the recent crypto crashes and the priority to investor safety have led the regulators to adopt a broader approach to enhance the scope of their jurisdictional powers. The battle that began between the crypto exchanges/companies and regulators culminated in the recent judgment of the US Supreme Court in the *Ripple* case where the narrow interpretation by the judiciary took over the basic objective of investor protection.

It will be contended in this paper that the judicial interpretations in the US including the *Howey* test have majorly failed to broaden the horizon of 'securities' and enhance the level of regulator protection. Rather, the rules of literal interpretations are unsuitable in the present case for accommodating technological advancement. Therefore, a different approach by the combined efforts of legislature and judiciary should be adopted. This is particularly essential in light of blanket bans on the assets by the regulators and government. Nevertheless, it will be argued at the same time that lack of judicial consensus among the market's recourse can either be found in the principles adopted in India and the EU which are comparatively more liberal or the legislature can step up to draft new regulations for the crypto-assets. This approach will give them both inclusive and differential treatment and therefore will be more effective in the coming times as well.

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I. INTRODUCTION

In a technology-driven economy, the dynamism of the market is at its new height with the investors looking for new ventures and instruments to invest in. A significant factor for such market change is the introduction of crypto assets in the global economies as an attractive investing venture among both short-term and long-term investors. Crypto-assets had initially started as a medium of exchange in the market in the form of 'cryptocurrency'. However, the scepticism as well as the lack of regulatory institutions resulted in worldwide prohibitions on such assets. In India, the Reserve Bank of India (**RBI**) which acts as a nodal agency for the regulation of currencies and the money market has already reserved its decision on banning cryptocurrencies like Bitcoin and Ethereum due to the complexity of blockchain technology.[1] Nonetheless, the concept of virtual digital assets has been accepted in a more regulated form. The crypto-assets not having governing laws have therefore

[1] Nidhi Bhardwaj, 'RBI gov calls for an outright ban on cryptocurrency as Union Budget 2023 approaches' (*India Today,* 16 January 2023) <https://www.indiatoday.in/cryptocurrency/story/rbi-gov-calls-for-an-outright-ban-on-cryptocurrency-as-union-budget-2023-approaches-2322146-2023-01-16> accessed 19 August 2023.

remained largely unregulated by both the Securities and Exchange Board of India (**SEBI**) and RBI.

In the United States of America (**USA**), the situation is not much different where the crypto assets were out of the ambit of both the central bank and Securities and Exchange Commission (**SEC**). However, the crypto exchanges are regulated as per the Bank Secrecy Act, 1970 (**BSA**) under which the exchanges are required to be registered with the Financial Crimes Enforcement Network (**FinCEN**), maintain appropriate records and submit them to the relevant authorities.[2] The recent recommendations are to amend Article 12 of the Uniform Commercial Code to include virtual currencies in the definition of 'controllable electronic records' (**CER**).[3]

The inclusion though is subjected to the inclusion of the assets under the definition of 'control' which consists of substantial benefits derivation and exclusive derivative powers of the investor.[4] The problem if simply stated, is that not all assets can be classified under this criterion leaving some digital assets to remain unregulated. In this context, the nature of the assets can be specifically called into question. The exclusive derivation of benefits from any investment is possible only on the underlying contract between the investor and the issuer. With the anonymity issue of the crypto-assets unresolved, it is highly impractical to enforce such rights under the BSA which is more intermediary-centric.

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[2] 'FinCEN issues Guidance on Virtual Currencies and Regulatory Responsibilities' (*Financial Crimes Enforcement Network*, 18 March 2013) <https://www.fincen.gov/news/news-releases/fincen-issues-guidance-virtual-currencies-and-regulatory-responsibilities> accessed 2 September 2023. See also Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets, 85 Fed. Reg. 83840 (Proposed 23 December 2020)

[3] 'Securing the Digital Bag: Newly Promulgated UCC Article 12 and Amendments to UCC Article 9 Provide Guidance on Ownership of and Security Interests in Cryptocurrency and Other Digital Assets' (*JD Supra,* 26 April 2023) <https://www.jdsupra.com/legalnews/securing-the-digital-bag-newly-8901295/> accessed 2 September 2023.

[4] Uniform Commercial Code 1952, art 12, s 12-105.

In the post-COVID world, the economic reconstruction has been largely focused on welfare programmes and boosting market sentiments. In such a case, the regulatory mechanism concerning the crypto-assets is gradually shifting towards a more inclusive approach. As has been shown by recent studies and trends, crypto-assets are one of the much sought-after investment options in majorly middle-class households which see a big opportunity in these hard times of inflation and economic recessions.[5] In this sense, the crypto-assets play an important role in the reconstruction of the economies and raising the investor sentiments in the global markets.

However, the large amounts of investments in this sector which is still largely unregulated could be risky given its highly volatile nature. The fact is not hidden from the regulators and government as well which readily seeks to bring the assets within the ambit of their regulations for the sake of a general scheme of market integrity and investor protection. Considering the risks involved, it is necessary to examine how an inclusive approach can be adopted along with the role of the judiciary to play in this regard.

A. The Tale of SEC v. Ripple

The tussle of SEC v. *Ripple* (***Ripple***) had long been in due, dating back to 2020,[6] When SEC had filed a complaint in the District Court for the Southern District of New York. The *Ripple* case is important to understand considering the recent approach by the SEC towards the crypto-assets companies like Telegram[7] and Kik.[8]

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[5] Deren Aiello and others, The Effects on Cryptocurrency Wealth on Household Consumption and Investment' (2023) National Bureau of Economic Research Working Paper No. 31445 <https://www.nber.org/papers/w31445> accessed 10 September 2023.

[6] Securities and Exchange Commission, 'SEC charges *Ripple* and Two Executives with Conducting $1.3 Billion Unregistered Securities Offering' (*Press Release*, 22 December 2020) <https://www.sec.gov/news/press-release/2020-338> accessed 21 September 2023.

[7] *SEC v Telegram Grp. Inc* 448 F Supp. 3d 352 (S.D.N.Y. 2020).

[8] *SEC v Kik Interactive Inc* 492 F Supp. 3d 169, 175–80 (S.D.N.Y. 2020).

The SEC contended that is sale of XRP tokens was represented as an Investment Contract and is coming under the ambit of the securities. However, the previous conduct of SEC with *Ripple* is in paradox with their current litigation where they had told that XRP is not a security when *Ripple* was seeking permission to list XRP. The different summary judgements have brought different findings which have drawn the effects on the token's price. The judgement accounting for all the exhibits has given two brief points. Firstly, *Ripple's* issuance of XRP tokens is partly a security. However, such kind of ruling has brought a lot of debates from different experts.

The proponents of crypto-assets are of the view that in furtherance to the proactive approach of the SEC of not embracing a culture of decentralized finance, it has tried to adjudicate on the line of investor protection. In the cases of *Telegram* and *Kik*, the approach of the SEC has been to deploy fines on the companies who are not complying with the supposed mechanism. While Judge Torres has decided that the XRP token is not a security, certain transactions fall within the foul of the investment contract which is *Ripple's* conduct to do institutional sales. Moreover, the distribution of XRP is an unregistered transaction and is subject to Securities Act registration requirements. The consequence is that the American regulator has not settled with the judgement and has decided to file an interlocutory review on the adverse question of programmatic offers and sales to XRP market participants over such platforms and another distribution channel.[9]

Considering the danger posed by the judgment on its regulatory approach, the SEC has initiated a complaint before Binance and Coinbase on grounds of

[9] Jacquelyn Malinek, 'SEC Bites Back, to Appeal Federal Court Ruling in XRP Case' (*TechCrunch*, 10 August 2023) <https://techcrunch.com/2023/08/10/sec-appeal-federal-court-ruling-xrp-case-2023/#:~:text=In%20mid%2DJuly%2C%20a%20federal,was%20a%20security%20or%20not.> accessed 12 August 2023.

operation on unregistered exchange and involvement in the trading of crypto-assets, thus presuming them as 'security'. It is interesting to note that the approach taken in the *Ripple* case has not been accepted in the case of *SEC v. Terraform Labs* wherein adopting a pro-active approach, the differentiation between the purchasers of crypto-assets and other securities has been avoided to focus on the objective analysis of "*promise of profits based on their efforts*".[10]

B. Laws and Regulations for Crypto-assets

The lacuna left by the US Supreme Court has to be filled by the SEC and other market regulators through laws and regulations. The risk posed by the crypto-assets is large and with the US, India as well as other international regimes allowing to trade in crypto, it is essential to look into this aspect on an urgent basis.[11] With trading in crypto gaining momentum and the 2020-21 bubble burst of Bitcoin, regulators from both financial and commercial sectors are trying to exercise jurisdiction over the assets.[12] The financial regulations and the RBI guidelines in this respect, have proven subpar when it comes to the investing and trading activities in the country.

The crash of 2020-21 was eventually covered under the guise of the COVID-19 market fall and the resultant reduction of investing sentiments.[13]

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[10] *Securities and Exchange Commission v. Terraform Labs Pte Ltd.,* 1:23-cv-01346, (S.D.N.Y.).

[11] Vikas Dhoot, 'G20 could pave the way for crypto regulation, financial inclusion push' *The Hindu,(*New Delhi 6 September 2023) <https://www.thehindu.com/business/Economy/g20-reaches-consensus-on-crypto-regulation-financial-inclusion/article67277900.ece> accessed 10 September 2023.

[12] Tomy Wilson, 'Bitcoin plummets as cryptocurrencies suffer in market turmoil' (*Reuters,* 12 March 2020) <https://www.reuters.com/article/us-health-coronavirus-bitcoin/bitcoin-plummets-as-cryptocurrencies-suffer-in-market-turmoil-idUSKBN20Z1GA> accessed 9 September 2023

[13] Emily Flitter, 'It's hard to tell when the crypto bubble will burst or If there is one' *The New York Times (*New York 27 January 2022)

The solution to the problem was found in a complete blanket ban on dealing in the asset in the form of strict prohibitions.[14] However, the wisdom behind the step has been questioned by several scholars and eventually, the regulator itself which changed its stance from prohibition to regulation.

In this regard, the judgment given by the US Supreme Court can be said as a missed opportunity to offer the crypto-assets an inclusive treatment to a stricter regulatory framework designed for the 'securities'. Following the crypto bubble of 2021, faith in the crypto markets has severely suffered with a trickledown effect on other investing spheres as well. The Biden administration responded with the enhanced investor protection with the first-ever executive order on digital assets in 2022 which focuses on six key priorities: (1) investor protection; (2) financial stability; (3) illicit finance; (4) U.S. leadership in the global financial system; (5) financial inclusion; and (6) responsible innovation. See Executive Order, this is itself based on the premise that the government and the regulators are keen to maintain the market integrity while the judicial premise is instead towards balancing the rights and following the traditional principles of *Howey*.

For that purpose, the paper proposes insights into the interpretive value of the *Howey* test concerning the American jurisprudence on securities and market principles. Part II of the paper will specifically deal with the US jurisprudence along with the various course of interpretations which follow from the *Howey* test. The detailed analysis will lead to the conclusion that a wider and purposive interpretation keeping in mind the contemporary developments and the special circumstances in the case of *Ripple.* Part III will provide an in-depth analysis of the international outlook towards the term

<https://www.nytimes.com/2022/01/27/business/crypto-price-bubble.html> accessed 9 September 2023.

[14] Bhardwaj (n 1).

'securities. In this regard, the jurisprudence along with the legislative and regulatory framework of India as well as the European Union (**EU**) will be detailed. It will be contended in the part that though the judicial as well as the regulatory frameworks of these jurisdictions are against the complete inclusion of the crypto-assets, the broad definition given to 'securities' as well as the recent government actions has left some scope for future opportunity.

Part IV will mainly deal with the investigation of the different approaches from which the *Howey* judgment as well as the steps taken by India and EU can be seen. It is argued that the preventive approach taken by both India and the EU conforms with the international outlook towards crypto-assets. The preventive approach nevertheless, can be judged as the protectionist approach towards working a sustainable solution for such assets and the rapid technological advancements therefore, contemporary rules of interpretation as well as different factual circumstances of *Ripple* and similar assets should be taken into account. While the paper in the ultimate part presents the final thoughts over the issue along with relevant solutions, the recommendations are rather broad and conflicting with the banking regulations, the resultant possible contradictions as well as the specific regulatory suggestions are not dealt with in this paper.

II. CRYPTO-ASSETS IN THE US REGIME

Regulating the new elements in the securities market has not been a new phenomenon. With the introduction of crypto-assets in the market, the cautious US regime also reacted to control and regulate the new form of investment. Though the actions of the SEC are not any different to regulators of other nations, the approach taken differs depending on the powers and

philosophy of that market regulator.[15] Where Japan adopted to establish the Japan Virtual Currency Exchange Association **(JVCEA)** as a self-regulatory body[16] and specialised laws,[17] The Financial Conduct Authority **(FCA)** of the United Kingdom **(UK)** preferred conventional mechanisms of anti-money laundering and terrorist financing procedures to achieve the desired objective.[18] The US regime however is a different one with changing dynamics over the years and therefore has been examined in more detail to provide insights on the real intention behind devising the *Howey* test.

A. Evolution of Securities Law in the US

The US has been a major forerunner when it comes to economic development and financial markets since the dawn of the 20th century.[19] While the nation got the resources it needed to progress including efforts from the immigrant workforce, a major factor behind the success was the rising tension and scepticism among the European powers.[20] Nonetheless, the securities markets as well as trading companies were thriving in this age as well necessitating the state to regulate the huge amount of investments coming into the securities market.

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[15] Eddy Wymeersch, 'Global and Regional Financial Regulation: The Viewpoint of a European Securities Regulator' (2010) 1(2) GLOBAL POLICY 201, 203.
[16] Clark Sonksen, Cryptocurrency Regulations in ASEAN, East Asia & America: To Regulate or Not to Regulate (2021) 20 WASH. U. GLOBAL STUD. L. REV. 171, 178.
[17] Kamshad Mohsin, 'Cryptocurrency Legality and Regulations – International Scenario' (2022) 2(1) INT. J. CRYPTOCURRENCY *Res.* 19, 23.
[18] Sherena Seng Huang, 'Crypto assets regulation in the UK: An assessment of the regulatory effectiveness and consistency' (2021) 29(3) J. FIN. REG. COMPLIANCE 336.
[19] Michael Dennis and Anand Toprani, 'The financial foundations of U.S. hegemony: Rethinking modern monetary theory' (*Centre for International Maritime Security,* 14 October 2021) <https://cimsec.org/the-financial-foundations-of-u-s-hegemony-rethinking-modern-monetary-theory-part-1/> accessed 23 August 2023.
[20] Christopher Layne, 'The warning of US hegemony – myth or reality? A review essay' (2009) 34(1) INT. SECURITY 147, 168.

In this respect, the US substantive law being influenced by the high liberalist and capitalistic ideals preferred the *'contracting regime'* to facilitate the entrepreneurs and shareholders by providing a standard set of rules and regulations[21] thus reducing transaction costs and *lubricating the bargain* between the contracting parties. It may be though contended that the disclosure requirements were still in place, the mandatory disclosure mechanism for public offerings focused on hidden profits of promoters or brokers who claimed to be acting on behalf of investors.[22] The US legal position was soon altered by the Wall Street crash of 1929 and its far-reaching ramifications.

The introduction of the Investment Companies Act of 1940 marked the start of a *'regulatory regime'* where the state instead of *lubricating* began *restricting* the contracting or bargaining.[23] The result was due to the change in the ideology regarding the securities market which was then seen as highly volatile and beset by market failures, thus crashing the investing sentiments. Further, the disclosures were made more stringent making it difficult for companies to avoid these regulations without incurring the wrath of the SEC.[24] While the change in the approach has been questioned by various economists and finance experts on the grounds of its effectiveness and failure in achieving the desired objective,[25] It remained undisputed that the change brought a major

[21] Rafael la Porta, Florencia Lopez de Silanes and Andrei Shleifer, What Works in Securities Laws? (2006) 61 J FIN 1, 5-20; Paul G Mahoney, 'The Development of Securities Law in United States' (2209) 47(2) J ACCOUNTING RES 325, 325-27.
[22] Donald C. Langevoort, 'Taming the Animal Spirits of the Stock Markets: A Behavioural Approach to Securities Regulation' (2002) 97 NW U L REV 135, 142-47.
[23] Mahoney (n 21).
[24] Paul G. Mahoney, 'Mandatory Disclosure as a Solution to Agency Problems' (1995) 62 U CHICAGO L REV 1047, 1049-53.
[25] Mahoney (n 21); Gregg A. Jarrell and Michael Bradley, 'The Economic Effects of Federal and State Regulations of Cash Tender Offers' (1980) 23(2) J LAW ECON 371.

transition in the US securities law regime which was to be felt in the coming years.[26]

One of the many repercussions was the beginning of shareholder activism in the US in 1942 which was a consequence of a *regulatory* rule of the SEC which allowed the shareholders to submit proposals for inclusion on corporate ballots.[27] The movement itself saw a tremendous evolution where the domination changed from individual investors to institutional investors.[28] Thus indicating greater protection for public funds. The changing dynamics were further triggered by the '*millennium scandals'* which led to the highest levels of protection under corporate governance laws.[29] and the contentious Sarbanes-Oxley Act (**SOX**)[30] Which showcases the erroneous '*guns-blazing'* approach of the Congress.[31]

B. Howey Test and Crypto Assets: A Contemporary Approach

1. JUDICIAL INTENTIONS BEHIND *SEC* V. *HOWEY*

From the above discussion, a contemporaneous understanding of the *Howey* test can be derived which was also the victim of the *regulatory* philosophy and market scepticism. The *Howey* test which was derived in the

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[26] Allen Ferrell, 'Mandated Disclosure and Stock Returns: Evidence from the Over-the-Counter Market' (2007) 36 J LEGAL STUD 213.
[27] Stuart Gillan and Laura Sharks, 'The evolution of shareholder activism in the United States' in William Braton and Joseph Mccahery (eds), *Institutional Investor Activism: Hedge Funds and Private Equity: Economics and Regulation* (OUP 2007).
[28] ibid, 4-18.
[29] Steven Davidoff, 'Paradigm Shift: Federal Securities Regulation in the New Millennium' (2007) 2 BROOK J CORP FIN & COMP *L* 339, 339-340.
[30] Pub. L. No. 107-204, 116 Stat. 745 (2002).
[31] John Coates, 'The goals and promise of the Sarbanes-Oxley Act' (2007) 21(1) J ECON PERSPECTIVES 91. See also Christian Leuz, 'Was the Sarbanes-Oxley Act of 2002 Really This Costly? A Discussion of Evidence from Event Returns and Going-Private Decisions' (2007) 44(1-2) J ACC ECON 146; Craig Doidge, Andrew Karolyi and Rene M. Stulz, 'Has New York Become Less Competitive in Global Markets? Evaluating Foreign Listing Choices over Time' (2009) 91(3) J FIN ECON 253.

celebrated case of *SEC v W.J. Howey*[32] Is the leading authority for not only US markets but also for the European markets to define the term 'investment contract' and determine the regulatory jurisdiction of the market regulator.[33] The definition of securities in the European markets has undergone several changes concerning the regional markets and different conventions like the Hague Securities Convention. In this respect, the *Howey test* has been a major inspiration for the major European nations and their regulators to define the term While the test dates back to 1946, the flexibility given to the common law courts has made it broad enough to imbibe several instruments as securities and therefore contemporaneous exposition of the test calls for a careful analysis of the facts and reasonings given at the trial stage.

The situation before the test was not a rosy one with the absence of a statutory definition of investment contracts and higher judicial discretion and statutory critique following it. The discretion mainly followed the common law principles along with the main *regulatory* philosophy of investor protection through mandatory disclosures. An insight towards the intent behind the Howey test can be found in the observation of the US Supreme Court where quoting *State v. Gopher Tire & Rubber Co.*,[34] it stated –

"Form was disregarded for substance and emphasis was placed upon economic reality. An investment contract thus came to mean a contract or scheme for "the placing of capital or laying out of money in a way intended to secure income or profit from its employment."[35]

[32] *SEC v WJ Howey Co*, 328 US 293 (1946).
[33] Guiliano Castellano, 'Towards a general framework or a common definition security: Financial markets regulation in multilingual contexts' (2012) 17 UNIF L REV 449, 461-73.
[34] *State v Gopher Tire & Rubber Co* 177 NW 937, 938 (1920).
[35] ibid.

If seen from the historical perspective, the SEC governed by the *regulatory* ideology has brought several actions on the same for a broad interpretation thus intending to have an inclusive definition broad enough to include a variety of financial instruments.[36] The facts of the case though simple are complicated enough for the then judicial system which was struggling to provide a definite answer. As per SEC, the facts were that –

"[T]he two companies under the same common control, with the same officers, facilities, and personnel, and substantially the same stockholders, were engaged in carrying on an investment business, to wit, the growth and cultivation of citrus trees and the marketing and sale of fruit therefrom; that by the device of deeds from the Howey Company to the groves, and cultivation and management contracts from the Service Company, they were in substance and effect selling investment contracts to customers in that, though the purchasers of groves paid their money in form as purchasers of specific tracts of land, they were, in fact, investors with the Howey Companies in a citrus growing and marketing enterprise."[37]

While claiming for violation of the Securities Act, 1933 due to the sale of unregistered securities, the SEC desired offerings to be adjudged investment contracts. In this respect, the adverse ruling of the trial court shows the ambiguous judicial thinking of the US regime where the opinion was influenced by the established nature of the industry. Based on the ideology of the trial courts along with the Supreme Court decision based on the historical interpretations, it can be inferred that the intention behind the test can be twofold. First, to protect the investors and their expectations from the corporate tactics and second, to provide a definite and inclusive test for a higher level of *lubrication* as well as *regulation*.

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[36] *SEC v CM Joiner Leasing Corp* 320 US 344, 351 (1943).
[37] *SEC v WJ Howey Co,* 151 F2d 714, 715 (5th Cir 1945).

However, if seen from the judicial history post the *Howey* judgment, the definition has given wide discretion to the common law courts of the US. Further, no clear explanation apart from the then ideals as well as judicial thinking was given by the Apex Court in determining the four prongs of the test. While each prong is a matter of concern for the courts in terms of their interpretation, the flexibility given by the '*expectation of profits solely from the efforts of others*' in addition to the bright-line tests have instead created inconsistent outcomes in contemporary times *thus* nullifying the objective. While the extensive flexibility provided by the Howey test is a major positive, the high room given to courts to manoeuvre has the potential to nullify the purpose of the law. The implied costs of the flexibility can therefore be called the potential for a very real difference in the kinds of protections offered to investors depending on where they buy the interests in question. The same can also be inferred from the instance of the Viatical Settlement industry where different interpretations of commonality by the Court of Appeals have led to an uncertain position. [38]

2. APPLICATION OF *HOWEY TEST*: TRADITIONAL APPROACH

The traditional interpretation of the *Howey* test involves segregation of the principle in four prongs i.e. (a) Investment of money; (b) Commonality; (c) Expectation of profits and; (d) Solely from the efforts of others.[39] It is pertinent to note that the traditional analysis though has been followed since the *Howey* judgment, it has been more comprehensively reiterated in the 2019 Framework

[38] *SEC v Life Partners* 87 F.3d at 549; *SEC v. Mutual Benefits Corp.* 408 F.3d 737 (11th Cir. 2005); Miriam Albert (n 46).
[39] *Howey* (n 32), 298-99.

for "Investment Contract" Analysis of Digital Assets where the SEC gave a rules-based application of the test to the Initial Coins Offering (**ICO**).[40]

The decision if the crypto-assets qualify as a security under the *Howey* test depends on the analysis of the crypto as well as the purposive interpretation of the four prongs. In this regard, the first prong is *prima facie* understood to be applicable in the case of crypto-assets based on the universally accepted interpretation,[41] it is not debatable in this article. Further, the investment in crypto-assets is in a *common enterprise.* It is pertinent to note that the commonality has been understood as both horizontal and vertical with the changing times.[42] While the former requires investors to share the risk by pooling resources,[43] the latter and more recent model concentrates on the dependence of the investment on the efforts of the promoter.[44] Over the years, the vertical commonality has been given much attention as the correct interpretation of the second prong.[45] However, the silence of the Supreme Court as well as the equal importance given to horizontal commonality by the circuit courts still makes it a valid interpretation in terms of technological and corporate advancements.[46]

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[40] U.S. Security & Exchange Commission, *Framework for "Investment Contract" Analysis of Digital Assets* (3 April 2019) <https://www.sec.gov/corpfinframework-investment-contract-analysisdigital-assets[https://perma.cc/99KD-XG4P]> accessed 15 July 2023.

[41] Larry Soderquist, 'Reach of the Securities Act Regulation' in *Securities Regulation* (St Paul, MN: Foundation Press 2005), 119.

[42] *Wals v Fox Hills Dev Corp* 24 F3d 1016, 1017 (7th Cir. 1994); Jonathan E. Shook, 'The Common Enterprise Test: Getting Horizontal or Going Vertical in Wals v Fox Hills Dev Corp' (1995) 30(4) TULSA *L J* 727, 733 (1995).

[43] *SEC v SG Ltd* 265 F3d 42, 49 (1st Cir 2001).

[44] *SEC v Goldfield Deep Mines Co* 758 F2d 459, 463 (9th Cir 1985).

[45] Christopher L Borsani, 'A "Common" Problem: Examining the Need for Common Ground in the "Common Enterprise" Element of the Howey Test' (2008) 10 DUQ BUS *L J* 1, 8.

[46] *Curran v Merrill Lynch, Pierce*; *Fenner & Smith, Inc*. 622 F.2d 216, 222 (6th Cir. 1980), aff'd, 456 U.S. 353 (1982). See also *Hirk v Agri-Research Council, Inc.* 561 F.2d 96, 101 (7th Cir 1977); *Wasnowic v Chi Bd of Trade* 352 F Supp 1066, 1070 (M.D. Pa. 1972), affd, 491 F.2d 752 (3d Cir. 1973); *Eberhardt v Waters* 901 F.2d 1578, 1580 (11th Cir. 1990); *Brodt v. Bache & Co* 595 F.2d 459, 461 (9th Cir. 1978); *SEC v Koscot Interplanetary, Inc* 497 F2d

The third prong calls for expectation of profits by the investors for which a multi-factor test or the *Munchee* analysis[47] (I know it when I see it) has been suggested in the framework by SEC as well as US courts.[48] However, the uncertainty caused due to several line-drawing problems is a hinderance. Therefore, a better mechanism will be to inspect the intentions of the seller than the scattered buyers.[49] While SEC's actions still have not resulted into certainty, the 'substantial steps test' as has been proposed by Henderson and Raskin[50] can be of great help. The focus therefore shifts from the marketing of the asset to its production, creating certainty. As long as the promoter is working on the underlying asset for which it may be redeemable in the future, it is not a security.[51] Thus, though crypto in its currency form may not be treated as security, the investments in the token treating it as an 'asset' will fulfil the test.

Nonetheless, the disadvantage of decentralised databases makes it a hard work for the regulator and thus unfavourable to give it the colour of 'securities'. Therefore, the focus of the fourth prong is to determine whether the asset is *"sufficiently decentralised."* The foundations of the *Bahamas test*

473, 479 (5th Cir. 1974); Miriam R. Albert, 'The Howey Test Turns 64: Are the Courts Grading this Test on a Curve?' (2011) 2 WM. MARY BUS. L. REV. 1, 16-17.

[47] Munchee Inc, *Securities Act Release No. 10445* (*SEC*, 11 December 2017) <https://www.sec.gov/litigation/admin/2017/33-10445.pdf [https://perma.cc/Q4JY-RD2Q]> accessed 20 August 2023.

[48] *Jacobellis v Ohio* 378 US 184, 197 (1964) (Stewart, J, concurring).

[49] Securities & Exchange Commission, *Guidelines as to the Applicability of the Federal Securities Laws to Offers and Sales of Condominiums or Units in a Real Estate Development* (Securities Act Release No. 5347, 4 January 1973), <https://www.sec.gov/rules/interp/1973/33-5347.pdf [perma.cc/U9M4-ZNA9]> accessed 15 August 2023.

[50] M. Todd Henderson & Max Raskin, 'A Regulatory Classification of Digital Assets: Toward an Operational Howey Test for Cryptocurrencies, ICOs, and Other Digital Assets' (2019) 2019 COLUM BUS L REV 443, 483.

[51] ibid.

was, indeed, laid down by William Hinman in his speech on digital assets as securities where in the second part of the speech he told:

"If the network on which the token or coin is to function is sufficiently decentralized – where purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts – the assets may not represent an investment contract. Moreover, when the efforts. of the third party are no longer a key factor for determining the enterprise's success, material information asymmetries recede. As a network becomes truly decentralized, the ability to identify an issuer or promoter to make the requisite disclosures becomes difficult, and less meaningful" [52]

A plain reading of the prong implies the managerial efforts behind the enterprise activities on which investment has been made. From a literal interpretation, the Bahamas test gives an idea of crypto-assets being securities. In this regard, as long as sufficient efforts are made by people other than promoters, it suffices the '*efforts of other*s' prong. For instance, the open-source Bitcoin network has over 600 contributors who have written code for the software.[53] The crypto-assets being working on blockchain technology and therefore not controlled by a single enterprise but decentralised databases through mining, therefore cannot be said to be influenced by the entrepreneurial or managerial efforts, not qualifying as 'securities.' Further, the crypto-assets having no official issuers and working on blockchain mining, offers no technical barrier to entry. Such a scenario may have adverse

[52] William Hinman, 'Digital Asset Transactions: When Howey met Gary (Plastic)' (*US Securities & Exchange Commission*, 14 June 2018) <https://www.sec.gov/news/speech/speech-hinman-061418> accessed 18 August 2023.

[53] 'Bitcoin Core Integration /Staging Tree' (*GITHUB*) <https://github.combitcoinlbitcoin> accessed 12 August 2023. See also Ludwig Von Mises, *Human Action: A Treatise on Economics* (4th ed., Lightning Source, Inc 2007), 290-91.

consequences on privity and disclaiming liability,[54] further proving decentralised nature of the assets.

3. CRYPTO AND ADOPTION OF CONTEMPORARY APPROACH

With the changing capital formation landscape and growing chances of fraud and exuberance, the scepticism of the investors and regulators can be seen in the recent times.[55] While the profit motive of the investors neutralises the sense of such risk, the market regulator remains adamant to the traditional approach due to regulatory difficulties. With respect to crypto, the problems are even higher. The information asymmetry due to the uncertain and volatile nature of the crypto-assets is a major hinderance to investor protection. While other financial instruments are compelled to provide optimal amount of information through disclosure regulations,[56] it is quite difficult with the crypto-assets running on decentralised blockchains. Furthermore, the police power problem which stems from the *regulatory* philosophy of the securities law coupled with the high degree of regulatory mechanism required incentives the state to instead prohibit trading in such assets.[57]

Nevertheless, the lack of regulation cannot be ignored with the increasing transactions in these assets and probability of any future mishap. In this respect, inclusion of the crypto-assets as 'securities' is useful for not only the investors but also the US market and economy. The traditional approach to interpret the four prongs of *Howey* test however has answered it in negative and thus left the state with the only option to frame a separate legal framework for the crypto-assets similar to the treatment given to the cryptocurrencies.

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[54] Henderson & Raskin (n 50), 465.
[55] Sangmi Chai, Minkyun Kim and H. Raghav Rao, 'Firms' information security investment decisions: Stock market evidence of investors' behavior' (2011) 50(4) DECISION SUPPORT SYSTEMS 651.
[56] Securities Act 1933, ch 38.
[57] Henderson & Raskin (n 50), 448.

However, from a perspective of contemporary approach, the purposive interpretation can be given effect to provide a higher inclusivity to the Howey test.

The flexibility which was provided by the Supreme Court in the *Howey* test was not limited or subject to literal derivations.[58] In this respect, it is pertinent to note that the object behind the test was to give a contemporary meaning to the term 'securities' to *"variable schemes devised by those who seek the use of money of others on the promise of profits."*[59] The real meaning of the securities was brought by US Apex court where it was observed that economic reality behind the financial instrument means *"the economic realities underlying a transaction, and not on the name appended thereto."*[60] Therefore, the important economic considerations are economic substance of the transactions in the assets and expectation of profits from those investments. While the latter is the very reason for any investment, thus *prima facie* validating the point, the economic substance of investments in digital assets (security tokens) is the pooling of resources for the digitally represented investments and registered on blockchain.[61]

The economic rationale behind the digital assets therefore indicates that this categorisation of crypto was in particular intended to act as 'securities' in the market. The Courts and the Congress have remained silent on these points and instead chose to ignore the need for a contemporary approach on strict adherence of the principle of separation of powers than to protect the investors

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[58] *Howey* (n 32), 299. Commissioner, Troy A. Paredes, 'Remarks before the Symposium on "The Past, Present and Future of the SEC"' (*US Securities & Exchange Commission*, 16 October 2009) <https://www.sec.gov/news/speech/2009/spch101609tap.htm> accessed 29 August 2023.
[59] *Forman* (n 62), 849.
[60] *Howey* (n 32), 298; *Tcherepnin v Knight* 389 U.S. 332, 336 (1967).
[61] Evezen Yasman and Hossein Sharif, 'Categorisation of cryptoassets' in J. Mark Munoz and Michael Frenkel (ed.), *The Economics of Cryptocurrencies* (Routledge, 2021) 19.

by effective and unambiguous regulations., the Supreme Court while giving one of the first interpretation to the *Howey* test noted that, in defining the term "security," Congress was not attempting to:

"*[A]rticulate the relevant economic criteria for distinguishing "securities" from "non-securities".... The task has fallen to the Securities and Exchange Commission (SEC), the body charged with administering the Securities Acts, and ultimately to the federal courts to decide which of the myriad financial transactions in our society come within the coverage of these statutes*[62]

However, it is pertinent to note that the SEC has gradually realised the invalidity of the 'one size fits all' approach of the *Howey* test in technically and financially dynamic markets.[63] This was further highlighted in the Decentralized Autonomous Organization Report (**DAO Report**) of 2017 of SEC, specifically disregarding the *"form of the organization or technology used to effectuate a particular offer or sale"* based on facts and circumstances while identifying crypto-assets as securities.[64]

III. DEFINING SECURITIES: A LEGAL CHALLENGE

Every market legislation around the world provides for a definition of securities. Generally, the definition is though made from a broader perspective to enhance the scope of the regulator. However, the judicial limitations often narrow down their powers which is the bone of contention seen in every jurisdiction.[65] The solution to the problem lies only in providing a definite interpretation given to the term and therefore, it is argued in this part that apart from the definition given under the Securities Act, the term should also be

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[62] *United Housing Foundation, Inc. v Forman* 421 U.S. 837, 847-48 (1975).
[63] Securities & Exchange Commission, *Report on investigation pursuant to Sec. 21(A) of the Securities and Exchange Commission Act of 1934: The DAO* (25 July 2017), 10.
[64] ibid.
[65]Stephane Rosseau, 'Endgame: The Impact of the Supreme Court's Decision on the Project to Create a National Securities Regulator' (2012) 52 Can Bus LJ 186.

looked from two other perspectives by the US regulators. The first is the common parlance usage which gives a general meaning of the securities when it comes down to the basic understanding of the history and the law itself. The second perspective is the approach taken by other advanced marketplaces like India and EU where the legal inclusivity gives enough scope for the inclusion of crypto-assets as well.

A. Origins of 'Securities': Insights from the past

The word security has gone in different stages of evolution all around the world. A simple yet different perspective is preferred at all places where there exists such efficient market-based system. A common meaning attracted to this word is related to the evidences of obligations to pay money or of rights to participate in earnings and distribution of corporate, trust, and other property.[66] It is observed by the scholars that earlier people used to also trade in variety of transaction which resulted into nature of characteristics which were intrinsically defined under the security. Earlier nation states of Venice and Genoa and other cities such as Switzerland started to issue debt instruments to qualify citizens as tax payers.[67] Gradually a shift among such markets resulted into the creation of the secondary market for such type of trading.[68]

Under the second phase of development of securities, states used this platform to finance the state rather than benefitting it to the economy.[69] The major change occurred during the phase of industrialisation which prompted

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[66] Bryan A. Garner, *Black's Law Dictionary* (11th edn, Thomson Reuters 2023) <https://karnatakajudiciary.kar.nic.in/hcklibrary/PDF/Blacks-Law-Dictionery.pdf> last accessed 20 August 2023, 1522.

[67] Michele Fratianni and Franco Spinelli, 'Italian City-States and Financial Evolution: European Review of Economic History' (2006) 10(3) EUR REV ECON HIS 257.

[68] ibid at 264.

[69] Tony Porter, States, *Markets and Regimes in Global Finance* (Springer 2016) 24.

many companies to raise funds due to the capital-intensive corporate activities. The choice to opt for raising funds gave the market of securities a new development.[70] The legislative institutionalisation of the Companies was first done by France under the French commercial code, which took an initiative to regulate the Joint Stock Companies.[71] The formal market was not developed due to lack of infrastructure and little was known to the people. Further there was not any pro-active role played by government which suggests that there were not lot of companies who resorted to such kind of financing.

The Industrialisation phase all over the world in the Nineteenth century prompted for need to have more capital. In this regard, the need for raising funds or capital by the state was first realised in the wake of growing need of the development and state welfare.[72] While the effects of wars made the European Securities market important,[73] the rise in personal wealth coupled with rise of big companies prompted such development in the US.[74] The bank finance used to be dominant in this sphere which was changed with the increasing growth of capital market as an easier means to raise funds, thus making the west overflowing with capital and investments.[75]

The historical intention behind the securities as a replacement instrument of bank finance to raise funds, in this regard, can be looked into in two aspects. The analysis in generality leads to the conclusion that the evolution being influenced different factors give rise to different interpretations and usages. However, a common link of twin intentions of capital raising and profit can

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[70] ibid.
[71] Charles E. Freedman, 'Joint stock business organisations in France, 1807-1867'(1965) 39(2) BUS HIS REV 184.
[72] Porter (n 70), 146.
[73] Bruno S. Frey and Marcel Kucher, 'History as Reflected in Capital Markets: The Case of World War II: The Journal of Economic History' (2000) 60(2) J ECON HIS 468, 471.
[74] Sylla Richard, 'US Securities Market and Banking System, 1790-1840' (1998) 80 REV FED RESERVE BANK ST LOUIS 83, 85.
[75] Porter (n 69), 26.

be deduced in all phases over the globe and therefore should be preferred for the purpose of interpreting the term.

B. 'Marketability' Test: The Indian Solution

The securities in the Indian scenario are often seen with the same eyes as by the rest of the world. However, the Indian securities regime cannot be called as similar to that in US. If seen from theoretical perspective, two contrary observations can be made in this respect. The object behind the establishment of SEBI was to instil confidence among the investors through higher forms of protection norms.[76] Further, the appointment of an expert body for ensuring efficient dealing of market issues derives much resemblance from the SEC and Federal Exchange Commission (**FEC**).[77]

Nonetheless, the historical perspective provides a different observation regarding the regulatory philosophy of the state. Contrary to the US approach, the Indian securities law have transitioned from a *regulatory* to *developmental* framework.[78] In this regard, the highest level of protection can be seen during the aftermath of World War II in the form of the Capital Issues (**Control**) Act, 1947.[79] However, the situation changed in the wake of the Liberalisation Privatisation and Globalisation (**LPG**) policies of 1991 and the resultant growth in complexity in human affairs and trade & commerce when the state realised to hand over the control to an independent regulator.[80]

While the developments in the securities regime do not coincide with those in the US, the higher level of similarities with respect to disclosure requirements which shows investor protection objects as well as the

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[76] Securities and Exchange Board of India (SEBI), *SEBI Annual Report* (1988-89), p 1.
[77] *Swedish Match AB v SEBI* (2004) 11 SCC 641, [46], [51].
[78] Securities and Exchange Board of India (SEBI), *SEBI Annual Report* (1991-92), p 7, Securities Contracts (Regulation) Act 1956, preamble (SCRA).
[79] Capital Issues (Control) Act 1947, s 3(2).
[80] LM Bhole, *Financial Institutions and Markets* (Tata McGraw Hill 2009), 224.

interconnected markets in the globalised world makes the analysis pertinent. Unlike the US laws on the eve of the establishment of the SEC in 1930, the Securities Contracts (**Regulation**) Act, 1956 (**SCRA**) provides for the definition of securities.[81] Though in such a case, the work of the common law courts should have been affected, the high degree of inclusivity of the provision coupled with the rapid advancements in investment sectors have led to several interpretations and amendments.[82]

The frequent amendments are often considered to be discouraging and unwarranted by both practitioners and the courts.[83] However, Section 2(h) of SCRA is an exception to this behaviour given several committees report[84] and court decisions[85] recommending desired changes proving the inclusive nature of the law. The inclusivity has been provided in two ways. The first is through the declaration of the government under Section 2(h)(iia)[86] and the second is through the broad categorisation in the wordings *"other marketable securities of a like nature"* used after instruments like shares, scrips, stocks, bonds and debentures.[87] While the former is not subjected to interpretation being totally the discretion of government to avoid frequent amendments to the law, the broad wordings under clause (i) gave rise to the famous 'marketability test'.

The debate in this respect was started between the High Courts of Bombay and Calcutta which differed on the point of necessity of listing on a stock

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[81] SCRA, s 2(h).
[82] Securities and Exchange Board of India (SEBI) Act 1992, Sch, part II. See also Securities Laws (Amendment) Act 1999, s 2; Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act 2002, s 41; and Securities Laws (Amendment) Act 2004, s 2.
[83] Nani Palkhivala, *The Law and Practice of Income Tax* (8th edn, LexisNexis 2008), vii (preface).
[84] Securities Laws (Amendment) Committee, *Report of Justice Dhanuka Committee on Securities Laws* (1997), Part I.
[85] *Sudhir Shantilal Mehta v. CBI* (2009) 8 SCC 1 [41].
[86] SCRA, s 2(h)(iia).
[87] SCRA, s 2(h)(i).

exchange for giving the instrument colour of 'marketability'.[88] The Bombay High Court in *Norman J. Hamilton v Umedbhai S. Patel*[89] (**Norman Hamilton**) applied the doctrine of *noscitur a sociis* in this respect while holding that the listing in stock exchange provides transferability to the financial instruments thus making them 'marketable' in true sense. Therefore, the 'securities' was narrowly constructed to mean only those instruments *"which enjoy a high degree of liquidity and can be freely bought and sold in open market."*[90] The Calcutta High Court on the other hand gave high consideration to the dictionary meaning equating the term 'marketable' to 'saleable' thus providing a broad and practical meaning to 'securities' as *"whatever is capable of being brought and sold in market."*[91]

The debate started in early 80's was continued by the special courts[92] and tribunals[93] with different interpretations preferred by the different judges. In this period of ambiguity, the focus was primarily on the capability principle given by the Calcutta High Court[94] and the further derivations given to the term 'open market' used by the Bombay High Court.[95] Such efforts along with the invention of the new tests and interpretation[96] gives an idea of the efforts to reach a middle ground in defining securities. However, the debate was ultimately settled by the Bombay High Court giving a different colour to the

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[88] Kaushik Laik, *Unfair Trade Practices in Securities Market* (Taxmann 2013) 83.
[89] Vasant Investment Corporation Ltd. vs Official Liquidator [1979] 49 Comp Cas 1 (Bom)
[90] ibid [25].
[91] *BK Holdings (P) Ltd v Prem Chand Jute Mills & Ors* [1983] 53 Comp Cas 367 (Cal) [21].
[92] *BOI Finance v The Custodian & Anr* [1994] 81 Comp Cas 508 (Special Court).
[93] J*agdishchandra Champaklal Parekh v Deccan Paper Mills Co. Ltd. & Ors* [1994] 80 Comp Cas 159 (CLB) [11].
[94] *BOI Finance* (n 92) [529]. See also *Karnavati Fincap Ltd & Alka Spinners Ltd. v SEBI* [1996] 87 Comp Cas 186 (Guj) [5]; *Brooke Bond India Ltd v UB Limited & Ors* 1999 (2) Bom CR 429.
[95] *Fascinating Leasing & Finance Pvt Ltd v SEBI* [1998] 17 SCL 204 (SAT – Mum) [24].
[96] *Essar Steel Ltd v Gramercy Engineering Market Fund* [2003] 116 Comp Cas 248 (Guj) [17.5].

observation made in *Norman Hamilton case*[97] along with Supreme Court denying necessity of listing for marketability,[98] thus giving present value to the 'marketability test'.

Nevertheless, the marketability test was explained conclusively in the *MCX Stock Exchange Ltd. v SEBI,*[99] where going over the history of the market as well as the debate, it was clarified that in judging the capability of marketability, the *"size of market is inconsequential"*[100] and the test mainly lies in the fact that instrument can be bought or sold in the securities market though it may not actually the case.[101] The application of the 'marketability' test has been quite inclusive with respect to the changes in the securities market and investment instruments in the market with securities like shares of private unlisted companies[102] and Optional Fully Convertible Debentures (**OFCD**)[103] covered within the ambit of Section 2(h).

From the perspective of the capability to be marketable, the crypto-assets have to satisfy two conditions for being classified as 'securities' – (a) Market for trading of crypto-assets and (b) Capability of being traded. The stock exchanges are common but not the only market and therefore general markets where buyers and sellers legally interact can also be included in the definition. In this regard, the crypto-assets are separately traded on the crypto exchanges

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[97] *Mysore Fruit Products Ltd. & Ors v The Custodian & Ors* (2005) 107 Bom LR 955 [8]. See also *Sushil Suri v CBI & Anr* (2011) 5 SCC 708 [20].
[98] *Naresh K Aggarwala & Co v Canbank Financial Services Ltd & Anr* (2010) 6 SCC 178 [20]. See also *Himachal Pradesh State Industrial Development Corp v PAMWI Tissues Ltd. & Anr* 2011 SCC OnLine HP 3519.
[99] *MCX Stock Exchange Ltd. v. SEBI* 2012 (114) Bom LR 1002 [79].
[100] *Bhagwati Developers Pvt. Ltd v Peerless General Finance & Investment Co Ltd* (2005) 62 SCL 574 (SC) [19].
[101] *MCX* (n 100) [61]. See also Whole Time Member's order in the matter of Sahara India Real Estate Corp. Ltd, Ref No. WTM/KMA/CFD/392/06/2011 dated June, 23, 2011 [14.5.3].
[102] *East Indian Product Ltd. v Naresh Acharya Bhaduri & Ors* [1988] 64 Comp Cas 259 (Cal).
[103] *Sahara India Real Estate Corp Ltd & Ors v SEBI & Anr* [2013] 1 SCC 1.

and other platforms[104] which though may not be as open as compared to stock exchanges. Further, the second condition is *prima facie* fulfilled in the event of actual transactions as the case of crypto-assets shows. Moreover, the digital instrument though may not be a physical asset, the same has garnered the interest of investors thus generating huge demand and saleability due to its rare nature.[105]

While the Indian courts have not faced any dilemma regarding the inclusion of the digital assets as well within the ambit of 'securities', the high degree of inclusivity accorded by the 'marketability' test makes it possible. In the context of the US regime, the test can be adopted either through suitable amendment in the definition of securities provided under Securities Act, 1933[106] or through wider interpretation of the *Howey* test to include the marketability test. While the former seems highly impractical in the legislative and political context, the latter shares the same case in terms of judicial unwillingness as was reflected in the *Ripple case*.

C. Treatment of Crypto under EU laws

The securities law under EU encapsulates its own requirement for the qualification of an instrument as security. While the major legislations and directives indirectly govern the securities, the qualification criteria of "transferable security" are prescribed under Article 4(1)(44) of MIFID.[107] For that purpose, the three essential tests of transferability, negotiability and

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[104] Andrea Minto, 'The Legal Characterisation of Crypto-Exchange Platforms' (2021) 22(1) GLOBAL JURIST <https://doi.org/10.1515/gj-2020-0085>accessed 28 August 2023.
[105] M. Ángeles López-Cabarcos and others, 'Bitcoin Volatility, Stock Market and Investor Sentiment: Are they connected?' (2021) 38 FIN RES LETTERS <https://doi.org/10.1016/j.frl.2019.101399> accessed 28 August 2023.
[106] Securities Act, s 2(a)(1) (US).
[107] EU Directive of Parliament and Council 2014/65/EU of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU [2014] OJ 2 173/0. (MiFID).

standardization is adopted. The transferability is interpreted with reference to the common parlance[108] and therefore is much similar to the 'marketability' test of India. Nevertheless, the difference is created through the second test of negotiability in the capital market due to which the listing in a recognized stock exchange becomes necessary.[109] The scope is further restricted through the fungibility attribute where the same class of securities should have same characteristics.[110]

The definition provided in MIFID is however not read in isolation and therefore other directives and tests to classify the crypto-assets are equally important. In this regard, it is pertinent to mention that the test is devised for the application of MIFID. With the European jurisdiction providing for other legal schemes, the analysis of these schemes will give a complete understanding. The first approach taken by the EU courts is related to the American test of *Howey.*[111] While the test has long been adopted for defining the securities, the significance of the test is not immaterial given the high movement of ICO in the European jurisdiction. However, the effect is more in negative than affirmative with the new legislations being enacted to neutralize the effect of the test and its subsequent usage by the courts.[112]

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[108] Article 2(1)(a) of Prospectus Directive. Directive of Parliament and Council 2003/71/EC of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC [2003] OJ 2 345/64; Article 2(a) of the Prospectus Regulations. Regulation of Parliament and Council (EU) 2017/1129 of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC [2017] OJ 2 168/12.

[109] MiFID, art 4(1)(18).

[110] ibid.

[111] Philipp Maume & Mathias Fromberger, 'Regulations of Initial Coin Offerings: Reconciling US and EU Securities Laws' (2019) 19 CHI J INT'L L 548, 566.

[112] ibid. at 566-68. See also Philipp Hacker and Chris Thomale, 'Crypto-securities regulations: ICOs, token sales and cryptocurrencies under EU financial law' (2018) 15(4) EUR CO FIN L REV 645.

Unlike the US, the any controversy on the classification of tokens under the ambit of security, however due to their attempt to draw a formidable market for such ICO it has made certain changes and it has enabled them to regulate the Tokens. The intention of the legislature is aligned with the global principles as enshrined in the IOSCO preamble.[113] The challenge is addressed by their launch of Digital Finance Package in 2020[114] which is the first step towards the innovation in finance sector as well as includes different strategies at the same time making it more inclined towards financial stability. The objective of the Digital Finance package can be said to be four fold – (1) removing fragmentation in the Digital Single Market; (2) adapting the EU regulatory framework to facilitate digital innovation; (3) promoting data-driven finance and; (4) addressing the challenges and risks with digital transformation, including enhancing the digital operational resilience of the financial system.[115] Moreover, the market in crypto regulations which generally calls for an affirmative action has been adopted after various companies such as telegram and facebook started to issue their own ICO.[116]

If seen from a philosophical perspective, EU has not adopted a retributive approach towards this token but rather has divided such companies in the application of such regulations by not subjecting them to the MIFID Regulations. According to this approach, there are different kind of tokens which exists in the regulations. Where payment tokens which are issued by

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[113] Technical Committee of International Organization of Securities Commission, 'Supervisory Framework for Markets' (*OICD-IOSCO*, 1 May 1999) <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD90.pdf> accessed 12 September 2023.
[114] Directorate-General of Financial Stability, Financial Services and Capital Markets Union, 'Digital Finance Package' (*European Commission*, 24 September 2020) <https://finance.ec.europa.eu/publications/digital-finance-package_en> accessed 12 September 2023.
[115] ibid.
[116] Dirk A Zetzsche and others, 'The ICO Gold Rush: It's a Scam, It's a Bubble, It's a Super Challenge for Regulators' (2019) 60(2) HARV INT'L L J 267.

the website to the users who are contributing towards the work of the company, utility token grants certain utility in terms of products or services of the issuer of the crypto-asset and cannot be substituted in form of payment in form of virtual currency.[117] However, the main bone of contention are this last kind of tokens which are known as investment token or security token which typically grants the holder property-like rights and/or claims on positive future cashflows from the issuer.[118] The classification of these three tokens has been generally referred all across Europe.[119]

In this respect, the investment tokens are separately governed under the Market in Crypto Asset regulations (MiCA) which prefers a *regulatory* approach than the *prohibitory* approach.[120] It is observed by the authors that there are different types entities who can issue crypto assets to trading on the platform, this has collaborated the power of the prospectus directive because such regulations have specifically talked about their disclosure requirements. The MiCA regulations however, make a case for gap in regulatory framework as crypto assets which are not under purview of financial instrument or E-Money directive (EMD2)[121] will not be subjected to any law. The problem persists with the regulations applicable to those ICO with the nature of

[117] Maume (n 111), 558.
[118] Benjamin Geva, 'Cryptocurrencies and the Evolution of Banking, Money, and Payments' in C Brummer (ed), *Cryptoassets: Legal, Regulatory, and Monetary Perspectives* (OUP 2019) 12.
[119] 'AMF Public Consultation on Initial Coin Offerings (ICOS)' (*Autorité des Marchés Financiers*, 26 October 2017) <https://www.amf-france.org/en/news-publications/public-consultations/amf-public-consultation-initial-coin-offerings-icos> accessed 12 September 2023.
[120] Regulation of Parliament and Council (EU) 2023/1114 on markets in crypto-assets, and amending Regulations (EU) No 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937 [2023] OJ 2 150/40.
[121] EU Directive of Parliament and Council 2009/110/EC of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC [2009] OJ 2 267/7.

investment token making them comply with burdensome regulations which would entail costs to the issuer and will only disregard to the Ease of Doing Business.

With the European legal regime on crypto-asset gradually evolving, it can serve as a leading precedent for the US as well as India. In this regard, though the difference can be created from the common law nature of both the countries, the *prohibitory* approach adopted by them can be transformed into *regulatory* approach from such example. However, the definition of securities in the European jurisdiction is still at a primitive level and therefore inclusion through other laws is being tried by the legislators. In our opinion, such an approach is peculiar to the EU jurisdiction and therefore only the philosophical and not practical aspects of the steps can be taken back.

IV. ADOPTING A DIFFERENT APPROACH: LESSONS FROM INDIA AND EU

India and the EU have been largely poling apart when it comes to their legislative frameworks due to the former being a common law and the latter civil law jurisdiction. However, the veracity of the high legal transplantations between these jurisdictions cannot be challenged,[122] thus highlighting the compatibility between the common law and civil law nations in terms of substantive principles of commercial world. The similar position can be taken in respect to the securities and investment law where the status of the crypto-assets as well as the principle of 'transferability' is followed in a similar fashion.

While the legal principles adopted in both the jurisdiction with highly securities market are inspiring in interpreting the term 'securities', the

[122] Jean Louis Halpérin, 'Western Legal Transplants in India' (2010) 2(1) JINDAL GLOBAL L REV 14.

aloofness from the crypto-assets and the *preventive* approach adopted by both the jurisdictions which can also serve as good lessons to the US courts has been analysed below along with the different modes of interpretation which can be relied upon for reaching to a more contemporary solution.

A. Preventive Approach of India and EU

The legal regime in both India and EU provides for ample means to secure the rights of crypto-investors and have the potential of gaining the required inclusivity. However, the scepticism from both the jurisdictions raises several questions on the approach adopted and the impact it creates on the markets. The article discusses this preventive approach by the regulators of both the jurisdictions in terms of the steps taken and the reasons behind such "escapist" behaviour.

The attraction of the Indian investors towards the digital assets like Bitcoins and XRP is tangible. The initial reaction towards these developments was *prohibitory* due to the uncertain nature of the cryptocurrencies.[123] However, even after gradual acceptance of these changes, the Indian regulator i.e. SEBI as well as the government is shy in recognising crypto-assets as securities and rather desire to classify them as a separate class of instruments subject to different laws and regulations as was done by other nations. In this respect, the problems can be classified into two spheres – (a) Taxation and (b) Regulation.

The crypto-assets are formally classified as the Virtual Digital Assets (**VDA**) for the purposes of taxes by the government.[124] The tax regime for VDA is in this regard, quite stringent with profits from selling, swapping, or spending VDAs subjected to a flat 30% tax, regardless of a short or long-term

[123] Ministry of Finance, *Report of the Committee to propose specific actions to be taken in relation to Virtual Currencies* (28 February 2019) 41. (SC Garg report).
[124] Finance Act 2022, s 3(b).

gain.[125] Further, losses from VDAs cannot be offset against profits or carried forward.[126] The rigidity provided by the Income Tax (**IT**) Department can therefore be called an offshoot of the *prohibitory* reactions by the Ministry of Finance and thus an effort towards disincentivising investments in this unregulated sector. It is pertinent to observe that on the other hand, the capital gains are subjected to a fairly lower levels of tax and provides for greater flexibility. The securities which are classified as the capital assets is taxed quite flexibly like other assets. The long-term capital asset is taxed under the 15% tax slab while the short-term capital asset is taxed under the 20% tax slab. Moreover, the application of the taxes is subjected to the general rules of set-off in the next assessment year than the exception provided for the VDAs[127]

A change in the stance of the SEBI therefore can be highly adverse for the intentions behind the rigid and unfair tax classification. The regulatory difficulties faced by the Indian regulators due to high technical complexities and uncertain nature of the crypto-assets is the second problem. With regard to this problem, the Ministry of Finance and Reserve Bank of India are in consensus about prevention of circulation of such currencies as a redeemable or financial instrument of any other kind in the Indian market.[128] The initial recommendations of banning of the cryptocurrencies was similarly based on the lack of regulatory techniques and the resultant lack of protection measures for the investors.[129]

The case of EU is however a different one. The absence of appropriate regulations in the beginning instead led to trading of ICOs in the European

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[125] Income Tax Act 1961, s 115BBH(1)(a) (as amended by the Finance Act 2022).
[126] Income Tax Act 1961, s 115BBH(2)(b).
[127] Income Tax Act 1961, s 112(1)(b).
[128] Reserve Bank of India, *Prohibition of dealing in Virtual Currencies (VC)* (Notification no. RBI/2017-18/154, 6 April 2018); *Internet and Mobile Association of India v. RBI* Writ petition (2018) SCC OnLine SC 3554 (SC).
[129] SC Garg report (n 123), 11.

jurisdiction which were not otherwise tradeable under the US regime which makes their approach rather *liberal*. There was not complete absence of laws with MIFID II, the AIFMs directive and the ESMA guideline and the prospective directive having the ability to regulate the ICO. However, the judicial creativity was absent from the civil law courts. Further, a too creative interpretation would have defeated the objective and substance of the law.[130] With the MiCA regulation proposal, the approach was changed to that of *regulatory* with effective regulations in place for the crypto market transactions. While the approach of EU was never strictly *preventive,* the long regulatory and legislative silence can be attributed to the initial scepticism.[131]

The approach taken by the Indian regulator SEBI is though in the same direction, the scepticism is much higher. In this regard, although the blockchain technology as whole has not been rejected by any regulator, the main concern of SEBI lies within the distributed ledgers (mining of currency), leading to anonymity and high volatility in the crypto market. SEBI has reported that "*As crypto assets are maintained in decentralised distributed ledgers, which are nested in computer nodes spread all across the globe, there is a great likelihood of execution of unauthorised trades not in consonance with any regulatory framework"*.[132] In this respect, the approach of SEBI can be correctly referred to have changed from *prohibitory* to *preventive* by proposing a blanket ban or prohibitions on the crypto-assets due to technical

[130] Gikay Adimi, Asress, 'How the New Generation Cryptocurrencies Decoded the Investment Contract Code: Analysis of US and EU Laws' (2018) 10 BOCCONI LEGAL PAPERS 313, 331.

[131] Emily Nicolle and Lyubov Pronia, 'EU crypto proposal seen as de facto Bitcoin ban fails in vote' (*Bloomberg,* 15 March 2022) <https://www.bloomberg.com/news/articles/2022-03-14/eu-crypto-proposal-seen-as-de-facto-bitcoin-ban-fails-in-vote#xj4y7vzkg> accessed 19 August 2023.

[132] Sriram Srinivasan, 'Explained What are SEBI's concerns around crypto assets?' *The Hindu,* (New Delhi, 12 June 2022)<https://www.thehindu.com/business/Economy/explained-what-are-sebis-concerns-around-crypto-assets/article65517621.ece> accessed 10 July 2023.

complexities and anonymity issues rather than for the *regulatory* philosophy of the regulator like higher disclosure compliances.

Nonetheless, the approach can be modified to *regulatory* instead through separate regulations with jurisdiction conferred on SEBI to solve the peculiar problem as has been highlighted above. Further, it is important to note that the welfare of the investors is not ensured through a blanket ban which instead may be detrimental in the long run without any effective regulations in place. Therefore, the need for proper regulations as well as an inclusive definition and other additional amendments to the laws cannot be rebutted. In this respect, the approach taken by the EU by bringing MiCA regulations in 2024 for regulating the issuance and trading of crypto-assets can be a great lesson for both India and the US.

B. Protectionist Approach as the 'New' Approach

Protectionism is not new to commercial legislations and serves the central idea behind the security laws and regulations across the globe. In this respect, the US regime calls for protectionism in a conventional sense under the Securities Act for providing the disclosure requirements and prevent frauds.[133] The Indian jurisdiction on the other hand give a broader meaning to the approach by mentioning the term 'undesirable transactions'[134] which can be construed in different manner in different context. The protection offered by the state and regulators however, converge on the same object of giving higher investor protection and prevent failing of markets.

Moreover, it is hereby pertinent to analyse the importance of the preamble or the statement of objects and reasons of a statute for a higher understanding. The object of a statute represents the 'soul' of the law, highlighting the

[133] Securities Act, preamble.
[134] Securities Contracts (Regulation) Act 1956, preamble.

legislative intent behind the framework and procedure.[135] Nevertheless, the provision of a statute is not solely governed by the object behind the enactment of the law but by the objective behind the addition of that provision. In this respect, court decisions that follow give equal consideration to both objectives in a harmonious manner.[136]

The definition clause is generally construed for providing objectivity to the technical terms mentioned under the statute.[137] The traditional view therefore leads to a narrow interpretation of the definitions. The amendments in the light of the dynamic world can only be made by legislative actions or executive actions if provided. While the traditional approach seemed to be perfect given the high discretion misuse among the common law courts, the legislative inactions and need for contemporary interpretations led to further interpretations of the elements included in the definition. The *Howey* test which itself defines 'investment contracts' and not 'securities' per se therefore serves as an epitome.

In contrast, the Indian courts provide for two methods of interpretation of the definition clause. The first mechanism is the straightforward approach where the inclusivity embedded in the definition itself is given a wider meaning to keep the law in pace with contemporary changes.[138] The second mechanism involves a rather twisted mechanism involving a harmonious construction of the definition with the provisions of general legislation (e.g.

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[135] *Sussex Peerage case,* (1844) 11 Cl & Fin 85, 8 ER 1034 (HL) (Tinder CJ). See also *Commissioners for Special Purposes of Income tax v. John Frederick Pemsel,* (1891-94) All ER Rep 28, 36, 1891 AC 531 (HL) (Halsbury LJ); *Bhola Prasad v. Emperor* AIR 1942 FC 17 (Gwyer CJ).

[136] *Nga Hoon v R* (1857-59) 7 MIA 72, 4 WR (PC) 109. See also *Secy Of State for India v Maharajah of Bobbili* AIR 1919 PC 52, (1919) 46 IA 302; *Bhola Prasad v King-Emperor* AIR 1942 FC 17, (1942) FLJ (FC) 17.

[137] *Raval & Co v KG Ramachandran* (1974) 1 SCC 424 (Bhagwati J). See also *Cadija Umma v Manis Appu* AIR 1939 PC 63, 180 IC 971.

[138] Banking Regulation Act 1949, s 6(1)(a). See also SCRA, s 2(ac); Sale of Goods Act 1930, s 2(7).

General Clauses Act, 1897 or Companies Act, 2013) along with the dictionary meanings as well as meanings given in common parlance.[139] The 'marketability test' to define 'securities' is the result of the former approach. However, while the technique of such contemporary interpretation is long adopted by the US courts, the distinction is created by the role of courts in gap filling in a legal regime and the focus on *protectionism* in the market. In this respect, SEBI like SEC is though concerned with the developments in the technology and its impact on the market, the protectionism is instead sought through a separate classification, thus rejecting its capability to regulate such level of technical advancements.

A contemporary interpretation of the definition clause under the Securities Act results into a more inclusive definition which has been indicated in the previous parts of the article.[140] A harmonious meaning given to the general object of the statute thus indicates the intention behind the law to promote investor sentiments through higher level of protections. In this regard, huge amounts are being traded in the crypto exchanges by the young-minded investors in the expectation of higher returns than the conventional securities.[141] Such load cannot be disregarded by either SEBI or SEC in the guise of technical incompetencies and a "new" approach of modified protectionism can be adopted for furthering the objectives of the law.[142]

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[139] Vepa P Sarathi, *Interpretation of Statutes* (5th edn, Eastern Book Company 2018) 367.
[140] *Gollaleshwar Dev v Gangavma Kom Shantayya Math* (1985) 4 SCC 393, 401, AIR 1986 SC 231.
[141] Raynor de Best, 'Crypto Trading Volume per Day 2021-2023' (*Statista*, 10 August 2023) <https://www.statista.com/statistics/1272903/cryptocurrency-trade-volume/> accessed 20 August 2023.
[142] 'The AFM and DNB Recommend Regulation of Cryptos at an International Level' *l*, (*AFM*,1 December 2018) https://www.afm.nl/en/sector/actueel/2019/jan/adviesrapport-crypto#:~:text=an%20international%20level-,The%20AFM%20and%20DNB%20recommend%20regulation%20of%20cryptos%20at%20an,money%20laundering%20and%20terrorist%20financing. accessed 22 September 2023. See also 'Initial Coin Offerings: Advisory Letter on the Classification of Tokens as Financial Instruments' (*BaFin*, 28 March 2018)

C. Transition from 'Casus Omissus' to 'Contemporanea Expositio'

The inclusion of crypto-assets in the statutory definition of 'securities' is a legal endeavour in all three jurisdictions of the US, India and Europe. While the market regulators in such a case take the lead in giving them a separate special status in terms of regulation, the *Howey* test in the American jurisdiction still lingers on as a major hindrance in the same. In this regard, the rules of interpretation guide the courts to remain aloof in providing a higher level of inclusivity to the already broad provision to create even higher market uncertainty.[143]

A careful analysis of the definition of the term in the US jurisdiction given under the Securities Act of 1933[144] implies that the term 'digital assets' or terms of similar kind have not been inserted. Further, the explicit of mention of the other instruments, missing the terms like 'of like nature' or 'as may be notified by the government' along with no recent amendments on the matter made the inclusion of crypto-assets a lost cause in the recent judgment.[145] The same can also be inferred from the definitions provided under the Indian regime where although the law has been amended several times, the government has neither amended not notified such a change with respect to crypto-assets.[146] The European jurisdiction being already complex and strict

<https://www.bafin.de/SharedDocs/Downloads/EN/Merkblatt/WA/dl_hinweisschreiben_einordnung_ICOs_en.html> accessed 22 September 2023.

[143] AGM Duncan (ed.), *Green's Glossary of Scottish Legal Terms*, (3rd edn, 1992), 15. See also *R v Oakes* [1959] QB 350, 354 (Parker LJ); Derek Auchie, 'The Undignified Death of the *Casus Omissus* Rule' (2004) 25(1) STAT L REV 40.

[144] Securities Act, s 2(a)(1).

[145] *Reves v Ernst & Young* 494 U.S. 56, 60–61 (1990).

[146] Anirudh Gotety, 'The Future of Cryptocurrency Regulation in India' (2019) 136 BANKING LJ 481.

in terms of interpretation nevertheless do not allow court induced inclusivity.[147]

In this respect, the judgment conferred in the *Ripple case* is in perfect adherence to the laws of both common and civil law. However, a different colour can be provided to the judgment by referring to two important approaches of contemporaneous exposition and 'always speaking'. The contemporaneous exposition which is often quoted as the "interpretation rule specifically for the old laws"[148] focuses on the contextual circumstances at the time of enactment of the statute. The rule of *Contemporanea expositio est optima et fortissinia in lege* believes that a statute's or any other document's finest explication comes from contemporary authority and therefore practice or usage developed under a statute is suggestive of the meaning prescribed to it by modern opinion[149] The main assumption behind it lies in thinking that those who were alive during or immediately after that time can be reasonably assumed to have a better understanding of those circumstances than their descendants do, as well as the meaning that was at the time given to legislative expressions[150] which has also become the reason for its gradual downfall.

Nevertheless, the rule can still hold good if combined with the 'always speaking' rule which results in a more contemporary interpretation. As per the Anglo-Antipodean custom of interpretation, the law is always speaking and therefore should be constructed with assumption that even though the language's meaning cannot change over time, the context or application of the

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[147] Benito Arrunada & Veneta Andonova, 'Common Law and Civil Laws as Pro-Market Adaptations' (2008) 26 WASH U J L & POL'Y 81, 85-86.
[148] *People v Lawrence* (2000) (US) 24 Cal4th 219, 230, 99 Cal Rptr 2d 570, 6 P 3d 228 (Coke J).
[149] *Ashley v State* 757 N.E. 2d 1037, 1039-1040; Dan Meagher, 'The Principle of Legality and *Contemporanea exposition est optima fortissimo en lege*,' (2017) 38(1) STAT L REV 98.
[150] ibid. See also *Yusuf v. Obasanjo* (2003) All FWLR (Pt. 172) 1862.

statutory language may change[151] Such a combination will modify the interpretation rule to mean that the *contextual circumstances* during the time of enactment should also be understood in such colour to safeguard its *dynamic nature*. The application of such interpretation is not new in the commercial regimes where dynamism of the statute is instead inferred from its historical background in the form of 'legislative intent'.[152] In this respect, the application of the rule has been given to both the Securities Act and the *Howey* test.

The Securities Act as has been discussed earlier, was enacted in the wake of 1929 Wall street crash and in response to the change of economic ideals to Keynesian policies of state intervention.[153] However, the main objective was to safeguard market and its investors from such disastrous crisis in the future through an active disclosure system.[154] The *Howey* test on the other hand was propounded to provide flexibility to a highly stringent regulation in the age of economic reconstruction post World war II.[155] If strictly viewed from *contemporaneous exposition,* the construction should be apposite to the general view of non-inclusivity with higher focus on corporate governance and safeguards to investors in the present times.

Nonetheless, combined rule of 'a*lways speaking'* presents a different picture with dynamism added to the construction of the historic context of the

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[151] *R v Secretary of State for the Home Department; ex p Simms* [2000] 2 AC 115, 131. See also F. Stroud, *Maxwell on the Interpretation of Statutes* (5th edn, Sweet & Maxwell: London 1912), 489.

[152] Victoria F Nourse, 'Elementary Statutory Interpretation: Rethinking Legislative Intent and History' (2014) 55 BC L REV 1613.

[153] James M Landis, 'Legislative History of the Securities Act of 1933' (1959) 28 GEO WASH L REV 29, 30-31.

[154] Securities Act, preamble; Barbara D. Merino, Bruce S. Koch and Kenneth L. MacRitchie, 'Historical Analysis – A Diagnostic Tool for "Events" Studies: The Impact of the Securities Act of 1933' (1987) 62(4) ACC REV 748. See also Senate Committee on Banking and Currency, *Senate Report* (S. Rep. No. 7347, 1933), 1.

[155] Travis Stegemoller, 'Refocusing Commonality: An Economic Approach That Shares Something in Common with *Howey'* (2012) 46 VAL U L REV 657, 666-76.

law. The market crash if seen from the contemporary context is not an uncommon phenomenon. Moreover, the relaxation of the state regulations in the current context can also be attributed to the same line of object to safeguard the market and promote investments and economic growth.[156] The intentions behind the economic reconstruction do not develop in the aftermath of a crisis but after every time market failures take place. In this respect, the market failures in the millennium as well as current times are not a rare phenomenon with markets worldwide experiencing great deal of fluctuations based on the geopolitical inconsistencies (e.g. Ukraine war),[157] complex trading networks[158] and new technological innovations (e.g. Artificial Intelligence).[159]

A more comprehensive understanding of the securities market gives an implication on the consistent market failures in the current as well as future world in which economic reconstruction is repeatedly needed from both legislative and judicial efforts. In such a scenario, the application results into a more dynamic interpretation of the statute as well as the *Howey* test of investment contracts. As has been propounded in the *Howey case* as well, the economic substance of the instrument in the commercial law like Securities Act which faces a high level of dynamism is more important the form.[160] The importance thus lies not in the contextual intentions behind the law and the test but in the dynamic world in which investors as well as the regulator has to see and interpret them. Therefore, a more correct, comprehensive, and

[156] ibid.
[157] Marwan Izzeldin and others, 'The impact of the Russian – Ukrainian War on Global Financial Markets' (2023) 87 INT REV FIN ANALYSIS 102598.
[158] Spyros Galanis, 'Financial complexity and trade' (2018) 112 GAMES ECON BEHAV 219.
[159] Lenore E. Hawkins, 'What to know about the growing impact of AI in financial services' (*NASDAQ,* 13 April 2023) <https://www.nasdaq.com/articles/what-to-know-about-the-growing-impact-of-ai-in-financial-services> accessed 29 August 2023.
[160] *Howey* (n 32), 298.

dynamic approach can be adopted by the courts than giving way to the rule of *casus omissus* and thus legislative inaction.

D. Possibility of Reasonable Classification in Ripple case

The case of *Ripple* issued XRP as a cryptocurrency is quite unique when it comes to a comparison from other counterparts. In this respect, the system of working as well as issuance can be taken into account while noting the differences which are more similar to any other digital token currency issued by the centralised bank (**CBDC**) like e₹ or 'Digital Pound'.[161] While ensuring a faster mode of payment*, "the solution offers a cryptographically secure, end-to-end payment flow with transaction immutability and information redundancy."*[162]

In this instance on application of the first prong of the *Howey* test can still be satisfied with investments being made in the currencies with the intent of getting higher returns.[163] However, the literal reading of the substantial steps test provides for the differentiation between investing in currencies and securities. The test essentially requires two elements – (a) Underlying asset and (b) Redemption. In this regard, the functioning of the XRP depends on the ledgers (blockchain technology) and therefore should be noted to be similar to the other crypto-assets. With no asset backing, the redemption of such currencies can be made in respect to any other asset. From a different angle therefore, XRP can be called as a financial instrument issued by the Ripple Labs which also has a redeemable value in other markets.

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[161] V and Innet S, 'Blockchain Application for Central Bank Digital Currencies (CBDC) - Cluster Computing' (*SpringerLink*, 16 January 2023) <https://link.springer.com/article/10.1007/s10586-022-03962-z> accessed 7 April 2025.
[162] 'XCurrent: A Brief Technical Overview for Financial Institutions on Ripplenet' (*Ripple,* 2017) <https://ripple.com/files/xcurrent brochure.pdf> accessed 4 December 2024.
[163] *Uselton v. Commercial Lovelace Motor Freight* 940 F.2d at 574; *SEC v. Shavers* No. 4:13-CV-416, 2014 WL4652121.

Moreover, Ripple provides for the missing piece of centralization to provide additional security.[164] In this respect, the reliance of management in the operations of XRP and not being sufficiently decentralised satisfies the second prong and the Bahamas test with respect to the fourth prong of the *Howey* test. While the reasoning of the US Supreme Court can be termed as erroneous in analysing XRP from the eyes of the other crypto-assets like Bitcoins and Ethereum, a reasonable classification could have been made. In Furtherance, Doctrine of Reasonable Classification is essentially a constitutional law principle mainly used to interpret state's power to make reasonable differentiation on the basis of Right to Equality, the spirit behind the principle can be applied beyond state actions to the court interpretations in commercial and investment issues where public interest is involved.[165] The purview of the doctrine mainly rests on the *arbitrariness* of the state action. The arbitrariness in this regard can be tested in two stages – (a) Purpose Identification Stage where decision's purpose has to be identified and (b) Relation Evaluation Stage where the relation between the differentiation and the people affected is analysed.[166]

On the first stage, the purpose of the securities law across the globe is quite uniform to protect the interests of the investors and market integrity to keep pace with the economic developments. The same can also be safely concluded for the *Howey* test and the approach of Supreme Court even in the case of

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[164]'Ripple Escrows 55 Billion XRP for Supply Predictability' (*Ripple: Insights*, 7 December 2017), <https://ripplc.com/insights/ripple-escrows-55-billion-xrp-for-supply-predictability/> accessed 29 August 2023. See also 'The Ripple Story' (*BitMex: BitMex Research,* 6 February 2018) <https://blog.bitmex.com/the-ripple-story/> accessed 29 August 2023.

[165] J.K. Mittal, *Right to Equality in India: An Introduction* (1st edn, Satyam International 2012).

[166] Marcus Teo, 'Refining Reasonable Classification' (2023) 2023 SING J LEGAL STUD 83, 84.

Ripple.[167] Further, high levels of investments in XRP suggests a profit motive relation between differentiation and the investors[168] coupled with the security measures taken by the *Ripple* Labs. The relation in this case is of an ordinary investor and company or establishment which is motivated by the returns from both the sides. From this lens, the court had the discretion to give a different observation with respect to XRP. Moreover, the higher level of protection given by the *Ripple* could therefore have been a major game-changer which was unfortunately ignored by the Supreme Court.

V. CONCLUSION AND RECOMMENDATIONS

In the recent years, crypto-assets have been a major investing option for both the household and commercial investors. Even after the crash of 2021, the cryptos are likely to strive and thrive with the markets being highly volatile. While the safe haven conferred to the investors comes at the cost of the macro risks weighing heavily on them. The same is applicable not only on the token coins backed by the central bank but also coins out of the formalised system which are more volatile in nature and has caused the recent crash of FTX exchange.[169] From an Indian perspective, the demand of the crypto has got affected from the resultant government reactions in terms of tax liabilities and prohibitions. However, the importance of digital assets and the quantum of investments cannot be ignored in the light of the technological advancements and dynamism.

In this respect, the recommendations can be divided into three segments. From a specific perspective of *Ripple* case, the lacuna left by the US Supreme

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[167] Lewis D. Lowenfels, 'Recent Supreme Court Decisions under the Federal Securities Laws: The Pendulum Swings' (1977) 65 GEO L J 891.
[168] *Oconer v. Ripple Labs, Inc.* No. 18CIV03332 (Cal. Super. Ct. filed June 27, 2018).
[169] Kalley Huang, 'Why did FTX collapse? Here's what to know' *The New York Times,* (New York, 18 November 2022) <https://www.nytimes.com/2022/11/10/technology/ftx-binance-crypto-explained.html> accessed 15 September 2023.

Court has instead created a lose-lose situation for both regulator and asset company. The opportunity lost by the court can be therefore referred to as the mislead judgment with wrong terms of interpretation used to partially include the crypto-assets as 'securities. While the obvious solution is to correct the judicial approach through a different case with similar facts, a proper and more definite rectification can instead be made through the legislative framework. For that purpose, it is proposed that the framework may include both legislative amendments in the existing codes as well as passing of new executive orders by the government as well as the SEC. Even India can adopt this strategy for not only assets backed by fiat currencies by also informal assets as well rather than waiting for a judicial pronouncement. It is further suggested that the proposed framework should provide for different classification with a sense of inclusivity. In this respect, a reference instance can be taken from the Companies Act, 2013 where it provides the mixed aspect of stringency and inclusivity for filing an application for oppression and mismanagement under the Companies Act 2013, s 241[170]. Further, a same kind of stance can also be seen in IBC where debenture holders are treated as financial creditors subject to the fulfilment of the provided condition. Insolvency and Bankruptcy Code 2016, s 7(1) proviso.[171]

However, the existing regulations against crypto-assets in both India and US are still comprehensive with all regulators having different perspectives including central bank, market regulator, tax authorities, anti-money laundering (**AML**) department, etc. With many players at the ground, it is important that the efforts are harmonised and synergised to produce greater outcomes. Considering the different jurisdictions of different regulators, the second set of suggestions is based on the differential treatment offered based

[170] The Companies Act 2013, s 241.
[171] The Insolvency and Bankruptcy Code 2016, s 7(1).

on purpose for which the asset is issued and used and not technical nature. The classification should not be done as per formal and informal category which is based on technical characteristics. For that purpose, the classification suggested by the EU legislations can be taken as an imperfect example. Nonetheless, the classification should be more refined to the purpose without considering the technical nature like tokens, currencies, assets, etc which will be further classifiable[172] Moreover, special rules can be made for the crypto exchanges to confer relevant powers and supervision over the assets and prevent a crash like FTX.

The final suggestion is more relatable from a worldwide perspective and the role of countries like India, the US and EU for an inclusive treatment of crypto-assets. In this regard, the report of International Organisation of Securities Commission (**IOSCO**) can prove to be a uniform guiding principle for regulations. The report has encouraged to analyse the applicability and adequacy of their regulatory frameworks, and the extent to which: (1) crypto-assets are, or behave like substitutes for, regulated financial instruments, and (2) investors have substituted other financial instrument investment activities with crypto asset trading activities.[173] The report also deals with the disclosure requirements with respect to both, exchanges and issuers which is necessary and therefore in consonance with the basic feature of capital market.[174] While such a soft approach may be objected on several grounds, the consensus built by the report cannot be undermined. It has been noticed that the Consultation paper on Digital Finance by the IOSCO has incorporated under them a survey wherein it asked responses from member regulators to respond under the

[172] Yasman and Sharif (n 61).
[173] International Organisation for Securities Commission, 'Policy Recommendations for Crypto and Digital Asset Markets Consultation Report' CR 01/2023 (IOSCO-OICD, May 2023) 14.
[174] ibid at 15.

questionaries. Most of the member regulators have said that if the crypto asset is a financial Instrument, the existing regulations will be applied and there will not be need for a new legislation to deal with ICOs[175]

The countries like US and India have a huge role to play in this respect. The superiority of the US in the sphere of financial services is unarguable with the country responsible in the establishment of the IOSCO itself.[176] On the other hand, India having one of the largest investment base and biggest and fastest stock markets shares the responsibility. In the regulatory sphere, India has even surpassed the US with IOSCO being more inclined towards the practices of SEBI than SEC.[177] However, the implications of such appreciation come with an expectation at a global stage where the financial regulators as well as international bodies look forward to a more advanced approach from both SEBI and SEC on the issue of implementing efficient regulations for crypto inclusion. Therefore, it is proposed that the regulations should be framed in conformance with the seven principles provided by the IOSCO to ensure global uniformity and transplant ability.[178]

The cynical mechanism of investment multiplier has been an apparent phenomenon for a quite long time among the scholars and practitioners. While

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[175] International Organisation for Securities Commission, 'Policy Recommendations on Decentralised Finance (DeFi) Report' CR 04/2023 (IOSCO-OICD, September 2023).

[176] Janet Austin, 'The Power and Influence of IOSCO in Formulating and Enforcing Securities Regulations' (2015) 15 ASPER REV INT'L BUS & TRADE *L* 1, 3.

[177] 'SEBI Has Robust Measures for Proper Functioning of Securities Market: Iosco Report' (*The Economic Times*, 13 February 2019) <https://economictimes.indiatimes.com/markets/stocks/news/sebi-has-robust-measures-for-proper-functioning-of-securities-market-iosco-report/articleshow/67973559.cms?from=mdr> accessed 12 September 2023.

[178] International Monetary Fund, 'India: Financial Sector Assessment Program-Detailed Assessments Report on Basel Core Principles for Effective Banking Supervision' CR 2013/267 (*IMF*, August 2013). See also MS Sahoo, 'Securities law and Markets - Global benchmarking' (2013) 33rd national conference of companies secretaries <https://www.icsi.edu/media/webmodules/programmes/33nc/bck-33pilotpaper-mssahoo.pdf> accessed 12 September 2023.

the multiplier can go both ways flowing with the market sentiments, the responsibility on the lawyers and regulators is to think of ways of minimal damage and ways to prevent the potential threats of tomorrow. For that purpose, a global framework to ensure trans-border uniformity in the laws and perception towards the digital assets and similarity in the legal framework to provide effective control to regulators for every possible situation is the key. It is important to mention that the development of law as a social engineer is an all-time function and the history has at times, manifested the distance covered by the law from share certificates to depositories as an essential market investment institution. In this sense, a long road awaits the unavoidable differential inclusion of crypto-assets requiring harmony between lessons of past and actions and needs of present.