Further Comments to the Securities Exchange Commission on Amendments Regarding the Definition of 'Exchange' and Alternative Trading Systems

Secretary,
Securities and Exchange Commission,
100 F Street NE, Washington, DC
20549–1090.

File Number S7–02–22
RIN 3235–AM45

June 7, 2023

To whom it may concern:

Coin Center is an independent nonprofit research and advocacy center focused on the public policy issues facing cryptocurrency technologies such as Bitcoin. Our mission is to build a better understanding of these technologies and to promote a regulatory climate that preserves the freedom to innovate using open blockchain technologies. We do this by producing and publishing policy research from respected academics and experts, educating policymakers and the media about blockchain technology, and by engaging in advocacy for sound public policy.

In addition to our earlier comments, Coin Center submits for the record further arguments for why the proposed rule, as drafted, would not withstand constitutional scrutiny. Although there are many other likely legal defects with the proposed rule, including that it violates the First Amendment, exceeds statutory authority, and is arbitrary and capricious, this comment focuses on whether the proposed rule is insufficiently clear in its potential applicability as to render it unconstitutional under the Due Process Clause of the Fifth Amendment.

The Void-for-Vagueness and Overbreadth Doctrines

Under the void-for-vagueness doctrine, a criminal law or regulation that fails to give persons reasonable notice of what is prohibited violates the Due Process Clause.[1] This principle is

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[1] *Kolender v. Lawson*, 461 U.S. 352 (1983).

applied strictly when First Amendment activity is involved.[2] Under the related overbreadth doctrine, vague and overbroad laws that affect speech can be challenged facially rather than as-applied.[3]

The Supreme Court has held that due process requires that a law must provide fair notice of the scope of its application such that a "person[] of ordinary intelligence [has] a reasonable opportunity to know what is prohibited, so that he may act accordingly."[4] The Court has also held that laws must provide "explicit standards" to regulators, law enforcement, judges, and juries so as to avoid "arbitrary and discriminatory application."[5] Finally the Court has held that vague statutes chill protected speech by causing speakers to "steer far wider of the unlawful zone . . . than if the boundaries of the forbidden areas were clearly marked."[6]

As the Trigger for Criminal Liability, the Proposed Definition Must Comply with the Due Process Clause.

The SEC's proposed redefinition of "Exchange" alters the category of behaviors that subject US persons to a requirement to register as a National Securities Exchange or ATS.[7] Failure to register carries strict and severe federal criminal punishments.[8] Accordingly, the Due Process clause of the Fifth Amendment demands that the conduct triggering these criminal punishments be clearly defined. Therefore, the SEC must clearly define what conduct constitutes operating an "exchange." Throughout these rulemakings, it has failed to do so.

The Proposed Definition Fails to Provide Ordinary Persons with Adequate Notice

The SEC has proposed a standard for when certain conduct constitutes operating an exchange that a person of ordinary intelligence would not be able to understand. By its own admission, the SEC, arguably an organization of persons with extraordinary intelligence in their field, does not understand the scope of its own proposed standard. The SEC has revealed this lack of understanding by initially publishing an NPRM that did not mention any potential application of the standard to numerous activities performed using cryptocurrency technologies[9] and then

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[2] *NAACP v. Button*, 371 U.S. 415 (1963).
[3] *Broadrick v. Oklahoma*, 413 U.S. 601 (1973).
[4] *Connally v. General Construction Co.*, 269 U.S. 385 (1926).
[5] *Kolender v. Lawson*, 461 U.S. 352 (1983).
[6] *Grayned v. City of Rockford*, 408 U.S. 104, 92 S. Ct. 2294 (1972).
[7] 15 U.S.C. § 78c(a)(1).
[8] 15 U.S.C. § 78ff(b).
[9] "Given these comments, the Commission is issuing this Reopening Release regarding the potential effects of the proposed amendments to Exchange Act Rule 3b-16 on trading systems for crypto asset securities and trading systems using DLT, including systems commenters characterize as various forms of 'DeFi,' and requesting further information and public comment on aspects of the Proposed Rules, more generally. This Reopening Release also supplements the economic analysis in the Proposing Release by

again by subsequently reopening the comment period after publishing "supplemental information" that *does* acknowledge such an application and adjusts the number of covered entities anticipated by doubling it.[10]

The SEC took this extraordinary step of publishing "supplemental information" without changing the rule only after numerous commenters to the original NPRM expressed confusion over the rule's vague and potentially overbroad application to protected speech activities. In its "supplemental information" the SEC offered some new possible alternative terminology but it did not narrow or clarify the text of the proposed rule, and failed once again to offer a convincing interpretation of the reasonable bounds and limits of its proposed standard.[11] Indeed, by direct admission in its "supplemental information" release, the SEC admits that it still does not understand the scope of its proposed rule.[12]

An ordinary person who publishes open source software used by others to trade securities would have no ability to gauge whether their mere publication of open source software qualifies as "making available a communications protocol." They may believe the SEC only intends to register persons who are deliberately and actively contracting with securities traders for specific software development, but the law as drafted has no such knowledge and intent requirement, nor does it have any requirement that the person "making available" the software be in any contractual relationship with the person using that software to make trades.

The SEC stated in the original NPRM that it intends to take a broad interpretation of the term communications protocol.[13] And it stated that merely publishing a protocol could subject persons to criminal liability even if the publisher has no active role in securities exchanges

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providing additional analysis on the estimated impact of the Proposed Rules on trading systems for crypto asset securities and those using DLT, which include various so-called 'DeFi' trading systems, and requests further comment." *See*: Securities and Exchange Commission, "Supplemental Information and Reopening of Comment Period for Amendments Regarding the Definition of 'Exchange,'" 88 FR 29448, pgs. 29448-29493, May 5, 2023,
https://www.federalregister.gov/documents/2023/05/05/2023-08544/supplemental-information-and-reopening-of-comment-period-for-amendments-regarding-the-definition-of.

[10] "the Commission is providing a rough estimate that there are 15-20 New Rule 3b-16(a) Systems trading crypto asset securities." *Id.*, at 29474.

[11] See infra

[12] "The Commission is uncertain as to the range of specific communication protocols used for trading crypto assets." *Supra* note 9 at 29474.

[13] "the Commission would take an expansive view of what would constitute 'communication protocols' under this prong of Rule 3b-16(a)." Securities and Exchange Commission, "Amendments Regarding the Definition of 'Exchange' and Alternative Trading Systems (ATSs) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities," 87 FR 15496, pgs. 15496-15696, March 18, 2022,
https://www.federalregister.gov/documents/2022/03/18/2022-01975/amendments-regarding-the-definitiOn-of-exchange-and-alternative-trading-systems-atss-that-trade-us, at page 15507.

made by others using that protocol.[14] The SEC may argue that this standard is not vague; it's just comprehensive. If so the SEC is admitting to the extraordinary overbreadth of the proposed rule. An overbroad rule triggers the same due process concerns as a vague rule because scarce enforcement resources inevitably mean sporadic and inconsistent enforcement leaving the ordinary person with no fair warning of when their conduct will in fact be subject to criminal penalties. Additionally, such arbitrary enforcement opens the door for rampant abuses of prosecutorial discretion, another factor in the Court's vagueness analysis discussed in the next section.

At times the SEC suggests that the standard will not, in fact, be broad. In its original NPRM, it claims that the rule would not include "systems that only provide general connectivity for persons to communicate without protocols" and offers examples such as "web chat providers."[15] This clarification provides little comfort. Even a person of ordinary intelligence understands that the world wide web *is a protocol* for communications. Language itself is a series of rules (a protocol) for communications. We are unaware of any forms of meaningful communication that do not involve some shared knowledge of certain preset rules (*i.e.* protocols).

In the "supplemental information" the SEC floats the idea of renaming the category of "communications protocols" to "negotiation protocols" so as to avoid these uncertainties.[16] It suggests a definition of the term: "a nondiscretionary method that sets requirements or limitations designed for multiple buyers and sellers of securities using trading interest to interact and negotiate terms of a trade."[17] While possibly less broad than "communications protocol," this standard remains vague. A dictionary contains a protocol for appropriate use of the English language (a communications protocol), but a subset of terms in that dictionary can be used by buyers and sellers of securities to interact and negotiate the terms of a trade (a negotiation protocol). One might be able to publish a dictionary that includes only these terms and successfully hew narrowly to a definition of "making available a negotiation protocol" but one would have great difficulty publishing a useful English dictionary that contained every term except the terms that buyers and sellers might use to negotiate a trade. When, if ever, does the total scope of the protocol become sufficiently general that some subset of its terms and rules, even if they constitute a negotiation protocol on their own, do not make the publisher of the set as a whole liable for regulated usage of the subset? By way of example, is Twitter's general

[14] As proposed, a Communication Protocol System can still meet the criteria of Exchange Act Rule 3b-16 even if it has no role in matching counterparties nor displays trading interest. In addition, neither the current rule nor the proposed amendments require that, for a system to be an exchange, an execution occur on the system; rather, that the buyers and sellers agree to the terms of the trade on the system is sufficient. *Id*. at page 15507, note 116.
[15] *Supra* note 13, page 15507.
[16] Supra note 9, page 29460.
[17] *Id*.

communications protocol a negotiation protocol when users take advantage of the dollar sign to create a “cashtag” marking stock names and ticker symbols accompanied by a price quote or trading interest?

In another section of the revised NPRM, the SEC suggests replacing “makes available” with “establishes.”[18] While this *appears* to narrow the application of the rule, it does nothing to alleviate the vagueness of the proposed standard. In the context of communications protocols, when is something established? Most rules for speech and negotiation are emergent. They percolate up from common usage and are, if popular, eventually codified in dictionaries, grammatical treatises, or (in the narrower case of legal and commercial terms) restatements of contract law and commercial best practices. If the SEC intended to limit “establishes” to some official designation of stock trading rules by some formal body regulating professional conduct (*e.g.* FINRA), then that would be one thing, but the “supplemental information” release makes clear that this is not the intent of the standard. “Establishes” is modified by the parenthetical “whether by providing, directly or indirectly.” Just as with the earlier proposal (“makes available a protocol”) this alternate standard of “providing, directly or indirectly a protocol” is another tortured way of describing the general publication of a set of rules. A tortured way of describing speech. None of these refinements adds any clear limit to the scope of the standard and none are rules that a person of ordinary intelligence would be able to understand sufficiently in order to modify their behavior accordingly.

The Proposed Definition Fails to Constrain Regulatory Discretion

The vagueness and breadth of the proposed standard affords the SEC near unlimited discretion to pick and choose targets for enforcement in order to engage in politically motivated viewpoint discrimination. The proposed standard does not provide explicit standards for enforcement. Anyone who is making available communication protocols is, in theory, fair game for enforcement.

Thousands of persons are involved in the publication of open source software libraries that describe internet, encryption, communications, and other computing protocols. Hundreds of said libraries are used by other persons to facilitate computerized securities trading among countless other uses of computers. These libraries are often maintained by persons with strong political and ideological motivations for publishing code. Those motivations may concern advocacy for the preservation of fundamental rights such as privacy, speech, and association.

The SEC could easily use the proposed vague standard to target certain publishers of open source software who advocate for the use of that software for certain political ends. Arguably, the Commission has already displayed a pattern of behavior of using its flexible regulatory

[18] *Supra* note 9, at 29459.

power for viewpoint discrimination against developers of cryptocurrencies and privacy protecting tools. The proposed rule would afford the SEC even more leeway to "pursue their personal predilections"[19] under the guise of lawful investor protection.

The Proposed Definition Concerns First Amendment Freedoms Triggering Strict Application of the Vagueness Doctrine.

As discussed in our previous comment and in several comments from other participants in the initial comment period, the proposed definition directly describes the publication of speech as a necessary and sufficient condition for the registration requirement. Merely "making available" a "communications protocol" can, by the SEC's own admission, trigger an obligation to register. A communications protocol is commonly understood as a set of rules. "Making available" a set of rules is an awkward linguistic construction that must, at the very least, include publishing and speaking, which are core First Amendment activities. The Supreme Court has explained that

> [s]tandards of permissible statutory vagueness are strict in the area of free expression. . . . The objectionable quality of vagueness and overbreadth does not depend upon absence of fair notice to a criminally accused or upon unchanneled delegation of legislative powers, but upon the danger of tolerating, in the area of First Amendment freedoms, the existence of a penal statute susceptible of sweeping and improper application.[20]

Therefore, even if the NPRM *did* create fair notice, its potential for abusive application renders it unconstitutional.

We therefore ask that the Commission abandon this rulemaking or at least strike from its proposed standard any language that would subject the mere publishers of software to an uncertain and unconstitutional licensing regime.

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[19] *Smith v. Goguen*, 415 U.S. 566 (1974).
[20] *NAACP v. Button*, 371 U.S. 415 (1963).