

## ***No, the SEC is (probably) not competent over the Ethereum network***

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In an enforcement procedure released on the 19<sup>th</sup> of September 2022, the SEC discussed and affirmed its competence over the entire Ethereum network<sup>1</sup>.

The use case was dealing with the potential unregistered offer and sale of cryptoasset securities in the U.S. by a crypto influencer named Ian Balina. The detail of this use case can be found on the SEC's website<sup>2</sup>.

This story is interesting on several angles, but mostly in view of the SEC's declaration regarding its competence by the mere fact that some of the validators of the transaction (i.e. nodes) were based in the USA at the time of the transfer.

The paragraph 69 of the SEC's complaints states concretely that: *"The U.S.-based investors in Balina's pool irrevocably committed to the transaction when, from within the United States, they sent their ETH contributions to Balina's pool. At that point, their ETH contributions were validated by a network of nodes on the Ethereum blockchain, which are clustered more densely in the United States than in any other country. As a result, those transactions took place in the United States"*.

We can note that this criteria existed before, as it was already mentioned in the 2018 case of Re Tezos Securities litigation<sup>3</sup>.

### ***But is this criterion actually valid?***

According to its own rules of interpretation, the SEC operates a targeting test in order to determine whether the offer of securities took place on US soil or not. The result of the test is determined on a case-by-case basis, but we can roughly mention the two following criteria for offshores issuers making solicitations over the internet.

First, the issuers must clearly disclaim that the offer does not target the USA; and second the issuer must implement procedures that are reasonably designed to guard against the sale to U.S. persons.

In Balina's case, the factual background already stated some clear jurisdictional hints that US was the targeted jurisdiction. Amongst those, we can mention that:

- Ian Balina is a US citizen residing in Austin Texas;
- the private and public sales of the project both involved US citizen,
- the project was advertised on channels that are linked to the USA and probably target US audience (YouTube, Twitter, etc.).
- Further, there is no mention that the Parties made a clear choice of law in their SAFT agreement nor took any concrete measures to avoid the participation of US investors.

Consequently, considering the facts at hand, the SEC's usual test would have probably ended up with the same result, i.e. in the targeting of the US jurisdiction for the offering. Hence, we

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<sup>1</sup> <https://www.sec.gov/news/press-release/2022-167>

<sup>2</sup> <https://www.sec.gov/news/press-release/2022-167>

<sup>3</sup> <https://corpgov.law.harvard.edu/2018/10/24/tokens-and-the-extraterritorial-reach-of-us-securities-laws/>

can note that SEC is deliberately trying to change its approach and push some new jurisdictional criteria for its competence besides the usual one.

In our view, this approach is detrimental in many regards. The first point would be to highlight the uncertainties it causes. The validators can indeed reside and run node-servers from anywhere. Further, this notion of “clustering” is not precise (e.g. 20% or 51%) neither constant over time. Furthermore, under the assumption that nodes are comparable to servers, the SEC fails to see that the place where the servers are based does not constitute a widely spread criteria for determining jurisdiction. The preferred criteria would be the choice of the parties and the place where the service provider is seated (assuming that the validation of transaction is considered as a service).

If this recent approach of the SEC was adopted over time, blockchain communities around the globe would need to take concrete measures to circumvent it. In particular, an increasing organization also at technical level seems more and more necessary in order to avoid the overreaching attempts of the US enforcement authorities to establish its competence.

Hopefully, crypto-friendly jurisdictions are still out there!