

U.S. Appeals Court Orders the SEC to Revisit Digital Asset Rulemaking

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The Third Circuit Court of Appeals held that the SEC's denial of Coinbase's petition for rulemaking clarifying how and when federal securities laws apply to digital assets was arbitrary and capricious. The Court ordered the SEC to provide a more complete explanation for its denial of the petition.

COINBASE'S PETITION FOR RULEMAKING

- In July 2022, Coinbase petitioned the SEC for new rules tailored to digital assets, pointing to numerous ways in which the current framework is incompatible with the practical operations of digital assets.
- In December 2023, the SEC denied Coinbase's rulemaking petition in a two-page letter, asserting that the existing securities laws are sufficient.
- Coinbase petitioned the Third Circuit Court of Appeals to review the SEC's denial of its rulemaking petition, seeking an order from the Court forcing the SEC to initiate notice-and-comment rulemaking.

REMANDING THE PETITION TO THE SEC

- The Court **did not order the SEC to institute rulemaking proceedings**, reasoning that "it is only in the rarest and most compelling of circumstances that courts have acted to overturn an agency judgment not to institute rulemaking."
- Instead, the Court determined that the proper remedy was to **remand to the SEC for a sufficiently reasoned disposition of Coinbase's petition**.

CONCURRING OPINION

- In a concurring opinion that will be celebrated by the digital assets industry, Judge Bibas articulates reasons why the "old regulations fit poorly with this new technology."
- The opinion also emphasizes that the SEC's "enforcement strategy raises constitutional notice concerns."

- “The SEC repeatedly sues crypto companies for not complying with the law, yet it will not tell them how to comply.”
- “By combining regulatory uncertainty with unpredictable enforcement against the infrastructure for trading crypto, it can get near-total deterrence.”
- Judge Bibas directed the SEC, on remand, to not “give yet another poor explanation in an already-long line of them.”

IMPLICATIONS FOR THE DIGITAL ASSETS SPACE

- The incoming SEC administration is widely expected to take a more collaborative and productive approach to the regulation of the digital assets industry.
- The SEC will need to determine whether it will reverse course and initiate rulemaking -- or to provide “a sufficiently reasoned” explanation of its decision for denial.
- At the same time, the incoming Congress is expected to consider legislation that could dramatically alter the regulatory environment, including by potentially divesting the SEC of jurisdiction over many types of digital assets and digital asset market participants or by expressly vesting regulatory jurisdiction with the SEC or another administrative agency.

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