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Dear Ms. Countryman, Mr. Schoeffler and Mr. Fajfar:

This letter is a response to an interpretation regarding the application of Federal securities laws to certain types of crypto assets and certain transactions involving crypto assets, File Number S7-2026-09, RIN 3038-AF67 (the “Crypto Interpretation”).

I am a professor of business law at Seton Hall Law School, and, among other things, previously practiced law in regulatory and transactional capacities at Sullivan & Cromwell LLP and Sidley Austin LLP. I teach securities law and research derivatives. I write in my personal capacity, and the views expressed in this letter represent only my personal views. The views

expressed in this letter are not the views of Seton Hall University, Seton Hall Law School, or anyone else associated with Seton Hall.

Crypto assets pose challenging interpretive questions in applying preexisting securities and commodities laws. I am grateful to the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) for seeking to provide clarity in this area.

In this comment letter, I address three portions of the Crypto Interpretation.

First, Section IV.A of the Crypto Interpretation discusses the circumstances under which a crypto asset may become the subject of an investment contract. In particular, this Section provides when, for purposes of the *Howey* test construing the term “investment contract”, communications create a reasonable expectation of profit from the essential managerial efforts of others:

“[R]epresentations or promises are more likely to create reasonable expectations of profit when they are explicit and unambiguous as to the essential managerial efforts to be undertaken by the issuer, contain sufficient details demonstrating the issuer’s ability to implement the proposed project, and explain how the issuer’s efforts will produce the profits that purchasers reasonably expect. Representations or promises by an issuer conveyed to purchasers to develop and achieve functionality for a non-security crypto asset and/or develop an associated crypto system together with a business plan containing detailed milestones, a timeline, information about personnel, sources of funding and other resources needed to meet those milestones, and an explanation of how holders of the non-security crypto asset will profit from those efforts, likely would reasonably create an expectation of profit because they speak directly to those essential managerial efforts that affect the failure or success of the project.⁹³ In contrast, representations or promises that are vague or contain no semblance of an actionable business plan, such as those lacking milestones, funding, or other plans for needed resources, likely would not create reasonable expectations of profit.”

Footnote 93 in turn provides: “This discussion addresses one example, and the presence or absence of any single activity may not be outcome determinative when determining whether any particular contract, transaction, or scheme constitutes an investment contract.”

I believe it is inconsistent with court precedent to require for purposes of establishing an investment contract that communications discuss details (a) that demonstrate the issuer’s ability to implement the proposed project, or (b) explain how the issuer’s efforts will produce profits. A prudent or experienced investor would assess whether an issuer is able to implement a proposed project from which profits are sought. A prudent or experienced investor would also inquire into how the issuer’s efforts would produce a profit. Indeed, these are questions often addressed in the course of venture capital funds investing in startups. However, securities laws do not require rigor, prudence or professionalism on the part of investors before affording them protections against fraud and the panoply of other regulatory measures in the Securities Act of 1933 and the Securities Exchange Act of 1934.

A crypto project that in conclusory terms asserts that the project will be profitable and asks for investments on the basis of those general assertions can very well be issuing an investment

contract. Traditional inquiries into the existence of an investment contract do not require the investor to show that its beliefs were based on a prudent examination of materials provided by the issuer. The history of “investment contract” litigation is littered with examples of where plaintiff-investors received cursory and inadequate disclosure but were able to use securities law to pursue fraudsters.¹ The Crypto Interpretation departs from settled law in exempting “promises that are vague or contain no semblance of an actionable business plan, such as those lacking milestones, funding, or other plans for needed resources.” For example, in *Miller v. Cent Chinchilla Grp., Inc.*, 494 F.2d 414 (8th Cir. 1974), the investors were not notified of how the defendant-promoters would generate profits from the scheme and received nothing like a business plan with milestones.² As background, the scheme involved investors purchasing chinchillas from the defendants. The investors were promised that they could resell those chinchillas at higher prices to either third parties or the defendants. The investors received no information as to how those higher prices would be obtained or how the defendants could afford to repurchase the chinchillas if third parties did not buy them at the promised price. Indeed, the defendants were relying on a ponzi-scheme and could not (and did not) disclose any business details such as milestones or business plans that could support their ability to repurchase the chinchillas. Nevertheless, the Eighth Circuit held there was an investment contract. Similarly, in *SEC v. Edwards*, 540 U.S. 389 (2004), the investors did not receive a business plan. Instead, they received documentation to enter into a transaction to temporarily own a phone booth and a promise that in that period they would make a fixed rate of return. How that rate of return would be achieved was not addressed, indeed, it could not have been discussed because the promoters were running a ponzi scheme.

The Crypto Interpretation conflates disclosure sufficient for an investment contract with disclosure prudent or experienced investors ask for. This is a mistake because the concept of “investment contract” is partly aimed at protecting the most vulnerable investors, such as those that fall for ponzi schemes and other designs that do not resemble economically plausible ventures. In this vein, it is important to note that negligence on the part of the investor is rarely a defense to securities fraud suits. Adopting the language copied above from the Crypto Interpretation would, in effect, move the comparable fault assessment from a defense to a prima facie case of securities fraud to a threshold question of whether a security (specifically, an “investment contract”) is involved.³

¹ Indeed, *SEC v. Howey*, 328 U.S. 293 (1946) discusses cases where “individuals were led to invest money in a common enterprise with the expectation that they would earn a profit solely through the efforts of the promoter or of some one other than themselves.” *Id.* at 298. This opinion and its progeny discuss investors as being “led to” or “induced” to expect profits, recognizing that the investment process is not always screened through independent deliberation on the part of investors. *See, e.g., Friel v. Dapper Labs*, 657 F. Supp. 3d 422, 442 (S.D.N.Y. 2023) (explaining that while the *Howey* test is objective, it is based on what “purchasers were led to expect” and subjective intent is probative). While the assessment of investors’ expectations is objective, it is not based on practices among professional investors and recognizes that many Americans bring little rigor to investment decisions.

² The case also demonstrates that the reasonableness of investors’ beliefs is not stress tested. In this case, the investors were promised the chinchillas were easy to raise. Although reasonable investigation would have discovered that the chinchillas were difficult to raise and often died before becoming mature enough to be resold, the Eighth Circuit held that the plaintiffs were entitled to rely on the defendants’ misrepresentations however unrealistic those misrepresentations were.

³ *See* James D. Cox et al, *SECURITIES REGULATION: CASES AND MATERIALS* (Tenth Edition 2022) at 687-88 (explaining how courts have shifted from assessing the reasonableness of a plaintiff’s reliance on a defendant’s

In the absence of clarification or guidance on the part of the SEC, the language from the Crypto Interpretation quoted above can mislead market participants. There is a substantial risk that courts will not require anything like an “actionable business plan” or similar disclosures prior to finding that a crypto project’s communications formed an “investment contract”.

Second, Section IV.B.2 of the Crypto Interpretation states that a “non-security crypto asset that was offered and sold subject to an investment contract” would no longer be subject to that investment contract if “a sufficiently long period of time [has] passed since the issuer’s offer and sale . . . and, during this time period, it has become clear to investors that the issuer has neither conducted the essential managerial efforts it represented . . . nor indicated that it still intends to conduct such efforts.” This guidance again places the burden of being prudent on investors. This guidance also introduces substantial indeterminacy into the question of whether an investment contract is present. There should not be a responsibility placed on investors to determine when they should no longer believe an issuer’s representations. As discussed above, even naïve investors are due the protection of securities laws.

Third, Section VII of the Crypto Interpretation discusses “airdrops.” The interpretation leaves an important question unaddressed. In some cases, issuers receive personally identifiable information (PII) about recipients in the course of an airdrop. This PII may be valuable and may include details such as the name, e-mail address, and other contact information for the recipient. In cases where the consideration for the airdrop includes potentially valuable PII, are the risks of it involving an investment contract the same as when it involves monetary or service consideration on the part of the recipient? Clarifying this question would help the industry understand when airdrops can be used, whether as part of promotional efforts or other business strategies.

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The evolution of crypto products poses a classic case of where law struggles to keep up with markets. Changes on various dimensions have prompted products that challenge assumptions securities and commodities regulation are built on. The SEC and CFTC have difficult jobs in updating law for crypto products. I applaud your work and appreciate the difficult decisions that have to be made. I would be glad to hear from you at ilya.beylin@shu.edu to discuss these and related matters further whether via setting up a call or through correspondence.

Sincerely,


Professor Ilya Beylin