

Summary of Ripple's Wells Submission

I. Introduction

- A. The SEC's theory, that XRP is an investment contract, is wrong on the facts, the law and the equities.
- B. To prove its case amounts to an unprecedented and ill-conceived expansion of the *Howey* test and the SEC's enforcement authority against digital assets.
- C. The SEC's theory that XRP is an investment contract ignores the economic reality that XRP is, and has long been, a digital asset with a fully functional ecosystem and a real use case as a bridge currency that does not rely on Ripple's efforts for its functionality or price.
- D. XRP is a currency. XRP is similar to bitcoin and ether, which the SEC has determined are not securities.
 - 1. By alleging that Ripple's distributions of XRP are investment contracts while maintaining that bitcoin and ether are not securities, the Commission is picking virtual currency winners and losers, destroying U.S.-based, consumer-friendly innovation in the process.
- E. This case is distinguishable from the Initial Coin Offering ("ICO") and/or Simple Agreements for Future Tokens ("SAFTs") cases that the Commission has brought previously, which involved no developed ecosystem or established utility for the underlying asset, and where the tokens were sold directly to purchasers by the issuer based on promises of profits and ongoing efforts that were articulated in white papers and other forms.

II. Factual Background

- A. XRP is a fully functional currency that offers a better alternative to bitcoin.
 - 1. XRP is a widely adopted digital asset based on an open-source blockchain technology, with an extremely robust, fully-functioning currency market. XRP consistently ranks among the top three virtual currencies by market capitalization—alongside bitcoin and ether, the two Chinese-controlled virtual currencies that the SEC has stated are not securities.
 - 2. XRP has been trading in secondary markets since 2013.
 - 3. The secondary market is massive—approximately \$700 billion to \$1 trillion in total trading volume since 2013—and operates separate and apart from Ripple.
 - 4. XRP is traded between fiat and other virtual currencies on more than 200 exchanges globally, the vast majority of which have no connection to Ripple whatsoever.

5. XRP transactions take place on the XRP Ledger (“XRPL”), a decentralized, cryptographic ledger powered by a network that is not controlled or owned by any one party. The XRPL has successfully recorded hundreds of millions of transactions for over eight years without error or dispute.
6. Through the consensus process, validators must agree on specific transactions for inclusion in the blockchain. During consensus, each server evaluates proposals from a specific set of trusted validators, or Unique Node List (“UNL”). Users are free to use any UNL they prefer and anyone can run a node or validator. Ripple does not control anywhere near a supermajority of validators and changes to the Ledger have been adopted despite Ripple’s dissent (*e.g.*, a recent change adding virtual checks that Ripple opposed).
7. The consensus validation process prevents any single actor from unilaterally owning or controlling the XRPL. Consensus enables XRP to serve as a faster and cheaper means of closing transactions compared to other digital assets, and largely eliminates the risk of centralized control by any one party.

B. Ripple is a responsible and transparent actor.

1. Years before the SEC’s July 2017 DAO Report, Ripple relied on expert advice and regulatory pronouncements that XRP was a virtual currency and not a security.
 - (a) In 2015, DOJ and FinCEN settled a case with Ripple and determined that XRP was a convertible virtual currency and Ripple was a money transmitter of XRP. The settlement required Ripple’s XRP transactions to comply with laws that do not apply to securities transactions.
2. Since 2017, around 90% of Ripple’s XRP holdings have been held in an inaccessible escrow, which Ripple voluntarily proposed and cannot unilaterally terminate. The escrow is intended to standardize the supply of XRP that could come from Ripple, even during times when the price and volumes of XRP have increased.
3. Ripple’s On Demand Liquidity product (“ODL”) uses XRP as a bridge currency to address inefficiencies in cross-border payments, allowing for dramatic improvements over legacy payment systems.
 - (a) Traditional cross border transfers typically take two days to complete, whereas ODL transactions complete in minutes.
 - (b) ODL provides cost savings by freeing up capital held in correspondent bank accounts and significantly reduces transaction costs associated with remittance payments.

- (c) Both the International Monetary Fund (“IMF”) and the Consumer Financial Protection Bureau (“CFPB”) have recognized the consumer benefits of ODL.
- (d) ODL incentives were offered to develop a better experience for customers and to drive scaling and adoption of ODL. Short-term incentives are consistent with standard practices to stimulate growth in network markets. The incentives and rebates have decreased significantly since 2019.
- (e) Extensive data analysis shows that ODL-related announcements have not impacted the price of XRP.

C. Ripple’s XRP sales were only ever a minute fraction of overall XRP trading. In the past, Ripple’s sales were mostly done through foreign market makers who brokered blind bid/ask trades on certain cryptocurrency exchanges, the vast majority of which are located outside the United States, or via OTC transactions mainly to institutional, third-party entities via contracts that did not include any promise of profits or promise to increase the price of XRP. Ripple’s sales are now limited to sales to ODL customers for use in the product.

- 1. Ripple’s sales were consistently a fraction of one percent of the overall trading volume. Throughout 2018, Ripple’s XRP sales represented only 0.095% to 0.43% of the global XRP volume, and, in the first quarter of 2019, those sales amounted to 0.22% of the overall trading volume.
- 2. Ripple took precautions not to impact XRP’s price and to minimize any perception that it would do so.
- 3. Ripple stopped all programmatic sales and almost all OTC sales in September 2019. In May 2020, Ripple began selling XRP to customers for use in connection with ODL after fully disclosing to the SEC its intent to do so.

D. XRP is used as a currency by as many as 150 third party commercial and consumer applications for a variety of purposes.

E. Extensive data analysis shows that XRP’s price correlates to that of the other leading digital assets—not to Ripple’s announcements or news about its business. The data show that XRP’s price has not been impacted by Ripple’s public announcements which means the market does not believe that Ripple’s efforts translate into an increase in the price of XRP.

- 1. Unlike prior ICO enforcement actions, this case will be the first time that the SEC has to refute years of trading data that fundamentally undermines its theory.

III. The *Howey* Test.

A. As a threshold matter, it would be unprecedented to bring a case against Ripple based on XRP sales that took place before the July 2017 DAO Report, especially in a case where the SEC is not alleging fraudulent conduct.

B. XRP is a currency, as the DOJ and FinCEN determined in 2015.

1. Currencies are excluded from the statutory definition of a security. Digital assets like XRP that operate as a medium of exchange, unit of account, and/or a store of value are properly categorized as currencies.
2. XRP's functional characteristics and longstanding utility as a replacement for fiat currency require that it be categorized as a currency and not a security. XRP trades in a robust currency market, with massive volumes of traders, the vast majority of whom have never transacted with Ripple.

C. XRP does not satisfy the *Howey* test.

1. Before even getting to the *Howey* analysis, XRP is not an investment contract because there is no “contract” underlying any “investment contract.”
 - (a) We are not aware of a single case in the more than 70 years since *Howey* that has found an investment contract absent a contract or privity between the buyer and seller. Here, the vast majority of XRP trading has taken place on the secondary market, wholly independent of Ripple, with no contract or privity with Ripple.
2. Ripple is not a common enterprise of XRP purchasers.
 - (a) Horizontal commonality requires that proceeds from sales be pooled to support the investment that will result in the distribution of profits.
 - (a) There has been no “pooling” here as required by horizontal commonality.
 - (b) Other than a small fraction of one percent, XRP trading did not and does not involve Ripple and therefore the proceeds of those sales were not, and could not be, pooled by Ripple.
 - (c) Ripple's sales of XRP into the secondary market were made to purchasers who did not know from whom they were buying (and Ripple did not know to whom it was selling) and thus there was no pooling of proceeds, as required by the law.
 - (d) The Second Circuit has rejected broad vertical commonality and has not explicitly adopted strict vertical commonality.
 - (e) In any event, there is no vertical commonality here where the fortunes of XRP holders are demonstrably not intertwined with Ripple and its efforts, but instead hinge on independent market forces as it does here, which is overwhelmingly supported by the data.
 3. There is no reasonable expectation of profits by XRP purchasers based on the efforts of Ripple.

- (a) Ripple does not and has not promised to increase XRP’s prices in public statements. Ripple’s overall messaging regarding XRP has been entirely consistent with that of a company that uses a currency for payment solutions. Ripple has made clear that its efforts relate to increasing the liquidity of the XRP market *for ODL’s benefit* and not to increase the price of XRP.
 - (i) The SEC’s focus has been on the subjective intent of the XRP purchaser. But subjective intent does not control. Rather, courts consistently hold that the test is an objective inquiry into what the purchasers were actually offered or promised.
 - (ii) In other words, the mere fact that a purchaser believes a party may undertake efforts to drive an asset’s value is not enough to satisfy the *Howey* test, especially when that other party is not obligated to act in the way that the purchaser hopes and especially when the purchaser is a downstream, secondary market participant with no relationship or privity with the other party.
- (b) Ripple’s interaction with the third party XRP community does not constitute “efforts of others.”
 - (i) The XRPL’s decentralized nature precludes XRP purchasers from reasonably relying on Ripple’s efforts to increase the price of XRP.
- (c) Ripple’s promotion of ODL—and other products—is related to its business, not to XRP. Ripple is trying to increase demand for its products, some of which use XRP and others which do not, not the price of XRP.
 - (i) Extensive data analysis demonstrates that XRP purchasers neither rely on Ripple’s efforts nor reasonably view XRP as an investment in Ripple.
 - (ii) Most ODL transactions are demand-neutral (each involves the purchase and sale of the exact same amount of XRP in a short time) and therefore do not impact the price of XRP.
- (d) Ripple’s sales to its customers for use in ODL do not, and cannot, violate Section 5. When a purchaser is not “attracted solely by the prospects of a return’ on his investment . . . [but] is motivated by a desire to use or consume the item purchased . . . the securities laws do not apply.” *Forman*.
- (e) Ripple’s XRP holdings do not convert XRP into an investment contract nor do they mean that XRP holders have a right to rely on Ripple’s efforts or that any such reliance is reasonable.

- (i) Many entities own large amounts of commodities and participate heavily in the commodities markets—Exxon holds large quantities of oil, De Beers owns large quantities of diamonds, Bitmain and other Chinese miners own a large percentage of outstanding bitcoin. And all three have an interest that may be aligned with purchasers of the underlying asset. But no one credibly argues that those substantial holdings convert those commodities or currencies into securities.

D. Information asymmetries are not part of the *Howey* analysis, but in any event, there are no material asymmetries between Ripple and XRP holders.

- 1. Ripple has been transparent about its activity in the XRP market by publishing quarterly XRP Market Reports, disclosing its incentive programs, and being incredibly transparent in other respects.
- 2. Extensive data analysis demonstrates that Ripple's disclosures and press releases do not move the price of XRP, indicating the market does not consider news about Ripple material.

IV. Policy reasons counsel against finding XRP to be an investment contract.

- A. Innovation in the cryptocurrency industry will be fully ceded to China. The Bitcoin and Ethereum blockchains are highly susceptible to Chinese control because both are subject to simple majority rule, whereas the XRPL prevents comparable centralization.
- B. An expansive application of *Howey* will have a chilling effect on the entire blockchain industry. This would make it impossible for any company to develop and promote a digital asset without running afoul of the securities laws, even where the company has never sold the asset as an investment, like Ripple.
- C. No foreign regulator has determined that XRP is a security. In fact just the opposite is true. The U.S. would be the unfortunate outlier.