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HOWEY, *RALSTON PURINA* AND THE SEC'S DIGITAL ASSET FRAMEWORK

The SEC's digital asset Framework summarizes and extends the traditional Howey *analysis for determining when an investable asset is a security. The author suggests that the Framework foretells a shift from* Howey*'s attempt to distinguish between investable assets that are, and are not, subject to federal securities regulation, to a more expansive concept that finds a security whenever investors may need Securities Act protections.*

By Joseph A. Hall *

In 1946, the Supreme Court addressed a basic question under federal securities law: when does the Securities Act of 1933 regulate the offer and sale of an investment opportunity? In *SEC v. W.J. Howey Co.*,[1] the citrus-grove case, the Court articulated a test for determining when the sale of an investment opportunity involves an "investment contract" and thus a "security" under the Securities Act. Instead of concluding that an investment opportunity is a security when particular offerees need the protection of the Securities Act, the Court set forth an objective (if somewhat difficult to apply) analysis that later courts have generally broken down into four separate prongs: "The test is whether the scheme involves [I] an investment of money [II] in a common enterprise [III] with profits to come [IV] solely from the efforts of others." Focusing on the essential characteristics of what makes a security and a securities transaction, the *Howey* test plainly aimed to distinguish securities from myriad other forms of investments, and transactions regulated by the Securities Act from other investment and commercial transactions generally.

Nearly three-quarters of a century later, the *Howey* test remains the touchstone for determining whether a particular investment opportunity is an investment contract and thus a security. And so, in 2017, the SEC applied it to a blockchain-based digital token distributed by an unincorporated organization called The DAO.[2] Proceeding via a "report of investigation" rather than an enforcement action, the SEC explained that the DAO token was in fact a security and that the unregistered token offering was therefore an illegal unregistered securities offering. The Commission analyzed the token and the circumstances of its distribution under the *Howey* test and explained why it was satisfied.

Although experienced securities lawyers were not surprised by the Commission's handling of the DAO token, some wondered whether the federal courts would be inclined to look at digital assets through the same lens — after all, the SEC does not have an unblemished record when it comes to asserting jurisdiction over novel

[1] 328 U.S. 293 (1946).

[2] SEC, *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO*, Rel. No. 34-81207 (2017).

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