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Client Alert

Lowenstein Crypto

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SEC Greenlights Proof-of-Work Mining

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What You Need To Know:

- The SEC's Division of Corporation Finance (the Division) has released a statement expressing its view that certain proof-of-work network mining activities do not involve the offer and sale of securities and therefore participants do not need to register transactions with the SEC under the Securities Act of 1933.

Key Points:

The Division's statement specifically addresses the mining of crypto assets that are intrinsically linked to the programmatic functioning of a public, permissionless network. These assets, referred to by the Division as Covered Crypto Assets, are those used to participate in the network's consensus mechanism or to maintain the network's technological operation and security. The mining of Covered Crypto Assets through proof-of-work networks is termed Protocol Mining.

Protocol Mining

Protocol Mining involves the validation of transactions on a network and the addition of these transactions to the distributed ledger in blocks. Miners engage in a computational competition, solving complex mathematical equations to validate transactions and propose new blocks to the network. In return for these validation services, miners are rewarded with newly minted Covered Crypto Assets.

Per the release, mining activities related to Protocol Mining do not constitute the offer and sale of securities under the Securities Act of 1933 or the Securities Exchange Act of 1934.

Investment Contracts (Howey Test)

The Division applies the "investment contract" test established in *SEC v. W.J. Howey Co*. (the Howey Test). A product constitutes an "investment contract," and therefore a security under federal securities laws, if it involves:

- An investment of money
- In an enterprise
- With a reasonable expectation of profits
- To be derived from the entrepreneurial or managerial efforts of others.

The Division concludes that Protocol Mining does not meet the final requirement, and therefore does not satisfy the Howey Test, as miners' expectations of profits are primarily derived from their own work and efforts.

Self (or Solo) Mining

Self (or Solo) Mining involves a miner using their own computational resources. The Division believes that Self (or Solo) Mining does not satisfy the Howey Test because rewards are compensation for contributing computational resources, not profits derived from the efforts of others. Miners perform administrative or ministerial activities–securing the network, validating transactions, and adding new blocks–that are essential to the networks' operations and from which the miners' expectations of profits are derived.

Mining Pools

Mining Pools involve miners combining their computational resources to increase their chances of successfully validating transactions and mining new blocks on the network. The Division considers participation in a Mining Pool to be an administrative or ministerial activity–i.e., participants do not have an expectation of profit derived from the entrepreneurial or managerial efforts of others. The efforts of a pool operator are insufficient to meet the "efforts of others" requirement of the Howey Test.

Important Caveats:

The Division's statement is limited to specific Protocol Mining activities and does not extend to proof-of-stake or other consensus mechanisms. Furthermore, variations in the compensation and participation structures of mining pools, or the activities carried out by pool operators, could affect the analysis under federal securities laws.

Contacts

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