
The Crypto Exchange: Navigating the Regulatory Waters: The SEC's Wells Notice to Uniswap and its Impact on DeFi
Speakers: Ethan Ostroff and Trey Smith

Ethan Ostroff:

Welcome to another episode of *The Crypto Exchange*, a Troutman Pepper podcast, focusing on the world of digital assets. I'm Ethan Ostroff, the host of the podcast and a partner at Troutman Pepper.

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Today I'm joined by my colleague Trey Smith to discuss the recent Wells notice that the SEC issued Uniswap, which signals that an enforcement action is likely on the horizon.

We'll also talk a little about some of the potential implications this may have on the DeFi sector at large. Trey, maybe to start with, maybe we could just talk a little bit about exactly what Uniswap is and why folks in this space should be paying attention to this Wells notice.

Trey Smith:

Uniswap is the largest decentralized exchange Commonly referred to as a Dex. And unlike a centralized exchange, which will take a user's fund and use traditional orderbook systems, to facilitate trading, Uniswap allows anyone to list and create a market for a digital asset, permissionlessly.

The platform solves traditional liquidity issues by incentivizing people to essentially provide liquidity in exchange for receiving a portion of trading fees the platform itself is governed by more than 300,000 holders of the UNI token, which is the platform's governance token.

And it's important to note that Uniswap runs on the Ethereum blockchain, which the SEC recently began to investigate. And so, the timing of the Wells notice is certainly interesting.

Ethan Ostroff:

No doubt. So, high level, how would you describe the importance of Uniswap in the digital asset industry?

Trey Smith:

Uniswap is an extremely important component the digital asset space. It is the largest decentralized exchange and it's processed more than 2 trillion in total trading volume.

So essentially it facilitates a lot of the transactions in the ecosystem and therefore. It was relied on by many parties in the industry to facilitate some of the basic transactions that you would see take place on a normal exchange in the traditional financial system.

Ethan Ostroff:

Right, so maybe we could talk a little bit now about - Because some of our listeners may not really understand sort of the term of art of a Wells Notice. Could you just explain high level what that is and, why it's important, particularly in the crypto industry?

Trey Smith:

A Wells notice is a letter typically sent by the sec to notify a business or a company of charges that the sec intends to bring against it. And it essentially gives the investigatee an opportunity to submit a written statement back to the regulator, and those notices are particularly important in the industry because, historically, they've always foreshadowed or come before an enforcement action.

So, for example, last year both Paxos and Coinbase received Wells notices before ultimately the SEC brought enforcement actions against it.

Ethan Ostroff:

So what do you think is, important and different now about this Wells Notice received by Uniswap as opposed to ones that companies have received in the past?

Trey Smith:

This time the Wells Notice is indicating that the sec is pursuing Defi - decentralized finance, which is significant because it shows that the SEC is trying to target the industry's backbone going for the jugular, so to speak.

And like I mentioned, the investigation coming around the same time as the sec is investigating Ethereum just shows that, you know they're trying to cut off some of the largest avenues towards engagement with the cryptocurrency space by attacking such prominent players and such important tools.

Ethan Ostroff:

Yeah and I thought it seemed like Uniswap's response to the Wells with a public blog post accusing the SEC of being you know, Engaged in a political effort to target blockchain technology, writ large is a very aggressive response, right?

Trey Smith:

It certainly is an aggressive response and it's one that is felt by the industry at large. And there may be evidence to support - you know, there's for years now, there've been concerted efforts to pass legislation and a lot of industry support and calls for regulation that have gone unmet with compliance being virtually impossible in many areas just due to the nature of the technology.

So actors are left with little choice but to proceed in the lack of clarity and, without a clear path the SEC has just continued to enforce the laws on their books against crypto companies.

Ethan Ostroff:

You know, in the blog post, Uniswap, unsurprisingly, right, takes a position that the SEC's, contention that most tokens are securities is hogwash, right? And, express confidence in the legality of what it's doing. Could you talk a little bit more about the arguments, you know, in detail, that Uniswap outlined in the blog post.

Trey Smith:

Sure. I'll start by saying that uniswap outlined three points in response to the SEC's Wells notice. The first argument was that the SEC lacks jurisdiction over it because the SEC's jurisdiction is limited to assets that are investment contracts. Uniswap pointed to court decisions in SEC versus Ripple and Risley versus Uniswap labs to support its arguments.

In Ripple labs, the judge there, Judge Torres, held that Ripple's XRP token was not a security when sold on a secondary market, but could constitute an investment contract when sold to sophisticated investors. But the judge in a subsequent case expressly rejected that holding in Terraform labs. The other case that Uniswap pointed to was its victory in Risley versus Uniswap labs. Where a class action allegation was made that Uniswap was responsible for losses related to certain scam tokens that were listed on the platform.

But that lawsuit was dismissed. And so, Uniswap was holding both of these cases up as proof that its token is not an investment contract, and therefore the SEC is without jurisdiction to enforce against it.

Ethan Ostroff:

So Uniswap is in a little bit of a unique position given its recent victory in that class case, right? And that certainly should be incredibly helpful for it. I think the second argument was about the Uniswap protocol, web app, and wallet not meeting the legal definitions of a securities exchange or a broker, and that was something they were relying upon from the recent Coinbase decision where the court threw out the SEC's claim that crypto wallets were brokers, right, even if they take fees for transactions.

You mentioned a third argument. Could you talk a little bit about that?

Trey Smith:

The third argument is that Uniswap's token - again, that uni token I mentioned - is not a security because there's not a contract or a promise, so to speak, between Uniswap labs and its token holders. We also saw Uniswap assert that there's no common enterprise that the value of UNI depends on more than just the efforts of Uniswap labs.

So, in essence, they're saying that the UNI token does not satisfy the Howey test, and therefore is not an investment contract.

Ethan Ostroff:

Right. So very interesting as we are going to hopefully follow along publicly a little bit about the back and forth between Uniswap and the SEC, and something, I mean, I think significant for everyone in

the industry to be paying attention to as we work through the rest of this year and see if there's actually enforcement action that's brought.

Trey, thank you again for joining me today. Thanks to our audience for listening to today's episode. Don't forget to visit our blogs and subscribe so you can get the latest updates. Please also make sure to subscribe to this podcast via Apple podcast, Google Play, Stitcher, whatever platform you use.

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