

To Be or Not to Be . . . a Security: Takeaways from the Ripple Labs Ruling

Article By:

Stephen M. Osborn

The most important part of the July 13th ruling in the SEC v. Ripple Labs: **Ripple's XRP token is not *de facto* a security. Let's not take that for granted.** It is a widely held belief that tokens issued by companies to raise money for operations are securities. A federal court in New York says not so fast.

According to the court:

1. The tokens are securities if sold directly to institutional buyers.
2. The tokens are not securities if sold in programmatic blind sales or used to compensate employees and third parties.

The apparent distinction is that the institutional buyers reasonably expected Ripple would use the capital it received from sales to improve the XRP ecosystem and thereby increase its price. This meets the third prong of the *Howey* test (namely, whether the economic reality surrounding the sale led buyers to have "a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others").

The sale of tokens on a digital asset exchange programmatically in blind bid/ask transactions are not securities because the investor does not know whether it is purchasing the tokens from Ripple or from some other party.

What about the use of tokens for compensation to employees and third parties? Ripple issued those directly.

Here, the court rules that there was no investment of money, which is required under the first prong of the *Howey* test (namely, whether an "investment of money" was part of the relevant transaction).

This is fascinating. . . and likely not the last word. Both sides are likely to appeal the court's ruling.

The SEC also has sued crypto-exchanges like Coinbase. Those courts will have to decide whether secondary sales are considered investment contracts and, likely, that would depend on the specifics of the tokens and transactions.

At the risk of a bad pun based on today's other big news (i.e., the actors' strike), **stay tuned. . . the crypto-securities market is quickly evolving.**

The crypto world was quick to celebrate Judge Torres' ruling that xrp itself was not an investment contract, with a Ripple spokesperson telling The Information that the "key takeaway here is that as of today, as a matter of law, xrp is not a security."

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