

Deconstructing 'Decentralization': Exploring the Core Claim of Cryptoassets

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How We'll Proceed

- Why 'Decentralization' is relevant to law now.
- How do we know what 'decentralized' means?
- Looking for power/agency.
- Implications for law.
- Closing reflections.

SEC on ‘Decentralization’

[Speech by Commissioner Hinman, June 14, 2018]

- “If the network on which the token or coin is to function is **sufficiently decentralized** – where purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts – the assets may not represent an investment contract.
- [W]hen the efforts of the third party are no longer a key factor for determining the enterprise’s success, material information asymmetries recede. As a network becomes **truly decentralized**, the ability to identify an issuer or promoter to make the requisite disclosures becomes difficult, and less meaningful.”

SEC on ‘Decentralization’

[Speech by Commissioner Hinman, June 14, 2018]

- “[W]hen I look at Bitcoin today, I do not see a central third party whose efforts are a key determining factor in the enterprise. **The network on which Bitcoin functions is operational and appears to have been decentralized for some time, perhaps from inception.** Applying the disclosure regime of the federal securities laws to the offer and resale of Bitcoin would seem to add little value.
- **[B]ased on my understanding of the present state of Ether, the Ethereum network and its decentralized structure,** current offers and sales of Ether are not securities transactions....[A]s with Bitcoin, applying the disclosure regime of the federal securities laws to current transactions in Ether would seem to add little value.
- **Over time, there may be other sufficiently decentralized networks and systems where regulating the tokens or coins that function on them as securities may not be required.** And of course there will continue to be systems that rely on central actors whose efforts are a key to the success of the enterprise.”

How do we know what 'Decentralized' means?

- Possible Sources of Meaning.
 - Law? Political Theory?
 - Computer Science? Distributed Systems?
 - Network theory?
- How is it used in the space?
- What does SEC think?
 - Network
 - “Seeing” central people who are “key” to success

Hints about what SEC thinks it means

[Speech by Commissioner Hinman, June 14, 2018]

- As a **network** becomes **truly decentralized**, the ability to identify an issuer or promoter to make the requisite disclosures **becomes difficult**, and less meaningful
- “[W]hen I look at Bitcoin today, I do not see a central third party whose efforts are a key determining factor in the enterprise. The **network** on which Bitcoin functions is operational and appears to have been decentralized for some time, perhaps from inception.
- [B]ased on my understanding of the present state of Ether, **the Ethereum network** and **its decentralized structure**, current offers and sales of Ether are not securities transactions....
- **Over time, there may be other sufficiently decentralized networks** and systems where regulating the tokens or coins that function on them as securities may not be required. And of course there will continue to be systems that rely on **central actors whose efforts are a key to the success of the enterprise.**”

Where's the Power?

- Is power dispersed?
- Enough that there's no agents/humans to tie responsibilities/accountability to?
- Where do we look? What are we not seeing?
 - Mining concentration – Pools?
 - Software Development – Core devs? Others?
- Moving Target
- On a spectrum rather than binary. (CCAF)

Implications for Law

- Law is about channeling and constraining power/agency.
- If ‘sufficiently decentralized’ equals no power/agency, are we saying law leaves the people in the system alone?
- Not just about securities law – implications for commodities law, finance, company law.
- Is ‘sufficiently decentralized’ the new, improved, ‘corporate veil’?
- How will law treat fluidity of decentralization status? Where is threshold? Periodic measurement?

Reflections

- If 'decentralization' is relevant as a legal category, need to figure out what it means.
- Different potential sources of meaning.
- SEC appears to be using it as code for lack of agency/power. (But, are they right?)
- If this is the case, and law may be opting out if a cryptocurrency can meet this standard, big implications across many fields of law.
- Is this making new entities law through the back door?
- Broader implications for finance and other systems?

Thank you!

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