June 13, 2023

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: **Notice of Proposed Amendments to Exchange Act Rule 3b-16 Regarding the Definition of "Exchange" (File Number S7-02-22)**

Dear Ms. Countryman,

The Hedera Council ("Council") is a coalition of twenty-nine (29) independent and unaffiliated organizations who collectively operate and govern a Distributed Ledger Technology ("DLT") network based on the hashgraph consensus algorithm (the "Hedera Network"). As with other DLT networks, the Hedera Network provides a network-native digital asset for application developers and users to utilize when making the micropayments required whenever they consume a Hedera Network service, i.e., whenever their application makes an API call to the network. In the case of the Hedera Network, that digital asset is called an "hbar." This is a fundamental requirement of any public implementation of digital asset technology because anyone can use such APIs to build Web3 applications with high throughput, fair ordering, and low-latency consensus finality in seconds without relying on centralized infrastructure, but only if there is a cryptographically secure method of fairly compensating all of the decentralized infrastructure providers responsible for making these services available to the public. In the case of the Hedera Network, our coalition of independent network node operators provides these services in an environmentally and financially sustainable manner, as documented in a 2021 study from University College London.[1] This is partially due to the fact that the Hedera Network uses a proof-of-stake security model, which is an increasingly popular and environmentally sustainable method of securing a distributed public ledger.

We welcome the opportunity to provide the Securities and Exchange Commission with our feedback to the proposed amendments to Exchange Act Rule 3b-16 regarding the

[1] http://blockchain.cs.ucl.ac.uk/blockchain-energy-consumption/

definition of "exchange." We appreciate the mission of the commission to protect investors and ensure orderly markets, and understand that these are complex issues in the decentralized finance context. However, we have significant concerns with the proposed amendments, as described below.

<p align="center">*   *   *</p>

We strongly believe the proposal to amend Exchange Act Rule 3b-16(a) to include within the definition of "exchange" a group of persons that "makes available… communications protocols" will have unintended negative consequences for the development of the DLT industry in the US and will ultimately run counter to the SEC's goals for this new rule by implying that validator node operators should be regulated as exchange operators. The proposal does not yet reasonably define the regulated actor nor the scope of liable actors nor does it provide a clear or obtainable path for potentially regulated actors to comply with the requirements of the rule. As a result, the adoption of the proposal would undermine the vast benefits of distributed ledger technology ("DLT") to US citizens and stifle or eliminate technological innovation.

1. **The proposed amendment does not yet reasonably define the regulated actors nor the scope of liable actors for activities on a DLT network.**

The creation and operation of a decentralized financial application that appears to be captured as a Rule 3b-16(a) System may involve contributions from uncoordinated actors such as developers, protocol governors, DLT network validators, internet service providers, digital asset creators, liquidity providers, IT service providers, and many others. However, the proposed amendment does not clarify which contributors qualify as the "group of persons" who "make available" a "communications protocol" that acts as an exchange.

For example, decentralized financial applications may be built leveraging usage-neutral software that may be a component of a system that brings together buyers and sellers of securities, but may also be used for bringing together counterparties to non-securities transactions such as event tickets or collectibles. The software component utilized by a decentralized financial system may not even be constrained to use in an exchange environment. However, the proposal appears to potentially capture the developer of the software component as a liable member of the "group of persons" if the component is later used to exchange securities, even if under an open-source license.

In addition, decentralized financial applications may be operated by usage-neutral infrastructure providers, such as internet service providers or public DLT network validators. The proposal does not meaningfully distinguish which infrastructure providers may be captured by as a liable member of the "group of persons" if their infrastructure is later used to exchange securities.

2. **The proposed amendment inadvertently extends liability for securities activities to underlying infrastructure providers, such as DLT network validators.**

The proposal appears to extend liability for securities exchange activities to infrastructure providers such as DLT network validators, which has no parallels under existing laws and regulations. For example, it would be the equivalent of requiring parties running SMTP email protocols to intermediate all messages processed by the system to understand their purpose and effects and to restrict emails that are prohibited because the user failed to comply with a regulation applicable to the contents of their email, which may even contain an indication of interest in a securities purchase or the effectuation of a securities purchase itself.

The proposal would fundamentally change the role of DLT network validators from message recording systems to intermediaries of network activities. Today, DLT network validators passively record and distribute information across the distributed database they maintain. In some cases, the details of a message may be encrypted or may be in reference to a separate, private database that leverages the public DLT network to timestamp or record off-network activities. It is not possible for DLT network validators to understand or intermediate the purpose or effect of each network transaction. An obligation to prevent securities exchange activity on the network, if possible, would result in significant compliance costs to infrastructure providers as well as users of the technologies, who otherwise benefit from DLT networks due to their fast and inexpensive disintermediated peer-to-peer activity.

3. **The proposed amendment does not yet offer a reasonable or defined path to registration and compliance with the rule.**

The proposal does not meaningfully define the member of the "group of persons" that is required to register the "exchange." As described earlier, the vagueness inherent in the "group of persons" definition may include drastically different parties, such as developers, protocol governors, network validators, etc. Each party may have information about or control over different aspects of the decentralized financial application, or none at all. Not only does this create confusion among contributors, it also creates inefficiencies in the quality or accuracy of disclosures and other compliance measures undertaken by the registrant, which are tailored to traditional, centralized exchanges rather than whichever role each contributor is playing within the "group of persons."

The proposal also does not suggest a serious solution for infrastructure providers such as DLT network validators to register and comply with the regulatory requirements. The Commission states that, in the case of New Rule 3b-16(a) Systems that use smart contracts to automate portions of their operations, "validators and miners may choose to take actions to form a single entity, like an organization, and register with the Commission." Validators do not have control over smart contracts implemented by developers and could not register with meaningful information on behalf of the

developers, governors, or promoters of such smart contract systems. In addition, many various groups of smart contract developers may deploy functionality on any given DLT network, and it is not clear whether the Commission expects registration once for each DLT network that supports smart contract functionality, or registration for each smart contract deployed that could potentially qualify as a New Rule 3b-16(a) System.

Finally, the commission suggests that to avoid liability for "making available" an exchange without registration, "validators or miners may discontinue processing transactions resulting from trading interest matched by the New Rule 3b-16(a) System." As described above, this is not possible due to the disintermediated nature of DLT networks and the inability to discern the purpose and effects of each message or transaction the network processes. Rather, the only viable option for a validator to prevent liability is suggested by the Commission: "validators could choose to cease processing transactions of a blockchain." In other words, the proposed rule may require the termination of DLT validation services in the United States on public networks supporting smart contracts.

<center>*   *   *</center>

For the reasons described above, Hedera strongly believes that if validators of peer-to-peer networks that support smart contracts are required to assume liability for activities on the network and be subject to regulation without a clear and defined process for compliance, validators will no longer be able to operate or offer services to the United States and developers will not be able to contribute to software which may be used in non-compliant ways. The proposed amendment will deny US citizens the pivotal benefits of the technology and push away high-value technology jobs and expertise to other jurisdictions. We strongly encourage the commission to reduce the scope of the definition of exchange and clarify with precision, and in compliance with their legislative authority, any regulated entities under the rule.

Sincerely,

DocuSigned by:

Brett McDowell

F2198EB77B14471...

Brett McDowell, Chair
Hedera Hashgraph, LLC