

How A Davis Polk Atty Helped A Bitcoin ETF Across The Line

By Aislinn Keely

Law360 (January 11, 2024, 10:57 PM EST) -- Behind the landmark approval this week of Grayscale's bitcoin exchange-traded fund was a decade of work by a Davis Polk & Wardwell LLP lawyer who helped his client win a seminal court case that broke through the U.S. Securities and Exchange Commission's long-standing position of rejecting the financial instruments.

On Wednesday, the SEC approved 11 exchange-traded products holding spot bitcoin to trade in a decision long awaited by cryptocurrency advocates, who hope the product will give more traditional investors exposure to crypto's flagship asset. The moment was roughly 10 years in the making for Joseph Hall, a capital markets partner at Davis Polk, who told Law360 that up until the orders came in, he was "hopeful, but certainly not positive" that the green light was coming.



Joseph Hall

His client, Grayscale, was technically the first to market on Thursday, since the Grayscale Bitcoin Trust was already publicly quoted and an SEC reporting company prior to its conversion to an ETP. Shares of the newly converted product began changing hands at 4 a.m. in premarket trading ahead of the 9:30 a.m. opening bell, which marked the start of trading for other issuers launching bitcoin ETPs.

But aside from being the first to market, Grayscale also led the way to the approval in court when it challenged and won a new review of its previous rejection order.

In his statement alongside the approvals, SEC Chair Gary Gensler pointed to the Grayscale court decision as one of the key factors leading to approval, noting that the D.C. Circuit found the commission hadn't adequately explained why it rejected the Grayscale proposal.

"Based on these circumstances and those discussed more fully in the approval order, I feel the most sustainable path forward is to approve the listing and trading of these spot bitcoin ETP shares," the statement said.

That win came in 2023, nine years after Hall began drafting Grayscale's first registration statement in 2014.

The Beginning

Davis Polk did not design the launch of GBTC, but was brought in in 2014 after the SEC conducted an

exam into aspects of the product that made it operate similarly to an ETP, which was not permitted without approval. Davis Polk assisted with the investigation, which ultimately resulted in a settlement with the SEC, and the relationship led the law firm to begin work on compliantly converting the product to an ETP.

To make it to market, issuers need their registration statement declared effective by the SEC, in addition to the approval of a separate form 19b-4 filed by the exchange that asks to list the shares. By 2015, Hall had filed that first registration statement. He said the SEC seemed close to declaring the registration statement effective early on, but "we ran into an iceberg with the 19b-4 process."

In response, Hall filed a comment letter arguing the SEC was in a way engaging in merit regulation by stalling on products holding bitcoin, essentially deciding that the product was too risky for investors. In response, then-SEC Chair Jay Clayton said that while the SEC was not a merit regulator, it also didn't have to approve a product based on a market it believed to be rife with fraud.

"There was kind of a standoff on that," Hall said. "And I think if the SEC had continued to take that position — that the reason that we're not approving this product is because of fraud in the bitcoin market — there wasn't much recourse that we would have had."

But everything changed with the changing of the guard.

"The real turning point," Hall said, came in 2021, when Clayton's successor, Gensler, announced that the agency would consider ETPs holding bitcoin futures contracts. Hall said the minute he saw Gensler's comments, an argument formed.

The Lawsuit

If the reason the SEC rejected ETFs holding actual bitcoin was fraud in the underlying market, then it shouldn't approve a product holding futures contracts that track the price of that asset, Hall explained. That's because fraud in the underlying spot market would have a direct impact on the market for the futures product.

"You can't say, 'The reason we're denying you is fraud,' but then turn around and grant approval for a product that would be in exactly the same manner influenced by that fraud," said Hall.

Hall and Grayscale drafted a comment letter, and the bitcoin community took notice. Some of his other clients also wondered whether it was too aggressive an argument to make to the SEC, he said. But he and Grayscale went a step further when they filed a lawsuit in the D.C. Circuit based on that argument a day after receiving another denial for the ETP conversion.

Hall is primarily a capital markets attorney, but the Grayscale suit allowed him to take on some litigation work, something he dabbled in when he was a junior associate. Unlike some capital markets attorneys, Hall's practice focuses on issuers and companies, which he said enables him to be "a bit more than a spectator" on a lot of litigation.

With topics so technical, Hall said there was concern the courts would defer to the SEC's judgment. But during oral arguments before the D.C. Circuit, the three-judge panel showed a level of interest and questioning that Hall said was promising. In August, the court decided unanimously in Grayscale's favor, ruling that the SEC had to conduct a new review of the product, and could not deny it on the same basis.

The Waiting

Despite the win, the path to approval was still murky. There had never been a case where the SEC had been challenged on a form 19b-4, said Hall, and that left a lot of questions as to how to move forward.

"All sorts of things were unclear about what the SEC could do, what we should be doing," he said. "There was no process and no precedent."

Grayscale took the stance that its previous 19b-4 was still active, and urged the SEC to act on it as quickly as possible, rather than making a new submission that would restart the clock for the agency's decision. While there were concerns the agency might take a different approach and request Grayscale start the process over, Hall said, the firm had responses ready.

"A lot of the effort in the past four to five months has been gaming out every possible way that this could unfold, making sure that we had a strategy to counter if it was going in a way we thought would leave us in an unfair position," Hall said.

Meanwhile, other issuers were waiting in the wings for their own decisions from the SEC. While Grayscale was still awaiting a decision from the D.C. Circuit, the Nasdaq Stock Market filed a request in June to list a bitcoin ETP issued by BlackRock Inc. The news that a household name was seeking to launch a bitcoin product set off a wave of resubmissions.

"We were quite concerned that one of those competitors, even though they had filed their 19b-4s a year or more after we had originally filed ours, might get their 19b-4 approval before we got ours," Hall explained.

Grayscale told the commission that while it supported the approval of other funds and the competition that would come with that, the SEC should approve Grayscale first, or at least concurrently with the others.

The Launch

As the next deadline for an SEC response on one of the many bitcoin ETP proposals approached, experts wondered whether the commission would use the opportunity to approve all the products in one go. Crypto advocates and ETP fans watched SEC channels with bated breath in the days ahead of Jan. 10, the decision date for the ARK 21Shares offering.

On Tuesday evening, the SEC's account on X, formerly Twitter, posted a false message touting the approval of bitcoin ETFs before Gensler swiftly informed the public that the agency's account had been compromised and there had been no decision on the products. The FBI is investigating the matter, and members of Congress rushed to send pointed questions to Gensler about his agency's cybersecurity practices.

After the false start, a Wednesday statement from the SEC reminded the public that any answer on bitcoin ETPs would come through the public register.

Amid the excitement, Hall said he and his clients had the sense things were going well, but "right up until the approval was posted yesterday, we were not 100% sure by any means," he said.

The SEC did approve the 11 19b-4s before it in one order on Wednesday, and soon after declared the parallel registration statements for each product effective. In his statement, Gensler said the simultaneous review of the registration statements would "help create a level playing field for issuers and promote fairness and competition, benefiting investors and the broader market."

Hall's name is listed on Grayscale's registration statement, but he was clear that a capital markets attorney alone does not launch a product. Davis Polk's Zach Zweihorn, a regulatory lawyer focused on broker-dealers, was "indispensable," as was tax counsel Patrick Sigmon, Hall said.

He also credited Grayscale for being willing to go the distance. Most corporate transactions get done in a matter of weeks, he said; a 10-year road to launch coupled with a lawsuit against a regulator is unusual.

Now that a bitcoin ETP has made it to market, Hall said he expects those focused on crypto financial products will turn their attention to issuers proposing to hold ether, the token underpinning the ethereum blockchain.

"The challenge there is the SEC has still never said that they agree that ethereum is not a security," he noted, "and so that I think is where the focus is going to be now."

--Editing by Alanna Weissman and Lakshna Mehta.