CECI N’EST PAS UNE SECURITY: WHEN AND WHY ATTORNEYS SHOULD ADVISE F-NFT CLIENTS TO FILE WITH THE SEC

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ABSTRACT

Non-fungible tokens’ (NFTs) market expansion has been both aggressive in scale and unencumbered by effective regulation in recent years. Consumers continue to suffer from regulatory gaps formed by innovations in crypto industries. The applicability and adaptability of the Securities Acts and relevant case law such as SEC v. W.J. Howey Co. to novel technology was already strained by cryptocurrency more generally. NFTs, which are based on the same underlying technology as more familiar cryptocurrencies, present even greater challenges. Howey interprets the “investment contract” portion of the Securities Acts’ definition of a security. Unfortunately, Howey requires a fact-intensive analysis that is currently both too ambiguous and too protracted to facilitate efficient market participation in NFT spaces. The SEC’s goals of promoting efficient capital markets while also protecting the consumers interacting therein are poorly served in NFT markets by the current regulatory scheme. This Article reviews applicable Securities laws, current actors in the NFT market and how they are using NFTs, abuses present in the market, and a detailed analysis of Howey’s application to NFT use cases. Further, this Article provides guidance for securities lawyers advising NFT offering clients.

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I. INTRODUCTION

Non-fungible\(^1\) token (“NFT”) sellers and marketplaces have run forward with reckless abandon in response to incredible increases in market demand, conducting themselves in ways that likely will cause all to look back and ask: “Where were the [NFT] lawyers?”\(^2\) One such NFT seller, Yuga Labs, recently achieved $561 million in freshly minted NFT sales in only 24 hours.\(^3\) This enormous demand crashed the platform that facilitated the NFT transactions.\(^4\) The crash cost some purchasers thousands of dollars and increased the transaction fees by 1,000%.\(^5\) Those purchased NFTs entitled their owners to virtual real estate within Yuga Labs’ upcoming corner of the Metaverse.\(^6\)

Yuga Labs is not the only NFT pioneer experiencing a high volume in sales—one projection estimates that the NFT market will

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\(^3\) Kate Irwin, Yuga Labs Sees $561 Million in Otherside Ethereum NFT Sales Within 24 Hours, DECRYPT (May 1, 2022), https://decrypt.co/c/s/decrypt.co/99156/yuga-labs-sees-561-million-in-otherside-ethereum-nft-sales-within-24-hours?amp=1.

\(^4\) See id.


\(^6\) Irwin, supra note 3.
experience $800 billion in transactions in the next two years. NFTs raise a novel question for securities lawyers and professors. Lawyers must determine what constitutes an NFT and why people are flocking to NFT retailers, like Yuga Labs, to buy them. Most relevant to this Article, securities lawyers must ask: “Are NFTs securities?”

NFTs are the next iteration of a relatively recent technology known as the blockchain. Blockchain technology, brought to popular attention largely by Bitcoin’s explosive popularization, was heralded by some to be as significant a disturbance to the market as the internet. However, unlike fungible cryptocurrency like Bitcoin or Ether, NFTs are blockchain-based tokens comprised of unique sequences of code that identify each NFT individually. Few attorneys and legal academics have

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11 DeNicola, supra note 8.
addressed NFTs specifically, but current academic discussions surrounding cryptocurrency may provide helpful guidance to securities law attorneys working with NFT, crypto, or crypto-adjacent clients.\textsuperscript{12}

The innovative nature of NFTs imbue these transactions with uncertainty, causing the SEC to scrutinize NFTs.\textsuperscript{13} According to an anonymous source cited by Bloomberg, the SEC has subpoenaed issuers and exchanges to determine whether NFTs, both fractionalized (“F-NFT”)\textsuperscript{14} and otherwise, fall within the SEC’s purview.\textsuperscript{15} NFT offerings, like unregistered “initial coin offerings” and “initial public offerings”

\begin{footnotesize}


\textsuperscript{14} See infra Section II.B.2.c.

\textsuperscript{15} Robinson, supra note 13.
\end{footnotesize}
before them, may simply be a new way for individuals to part people from their money.\textsuperscript{16} While popularity has waxed and waned for NFTs,\textsuperscript{17} declining steeply from the initial flurry of engagement,\textsuperscript{18} consumers are only beginning to explore and exploit the various NFT functionalities. Accordingly, NFT trading topped out at over $17 billion in 2021, and is expected to increase as additional functionalities are discovered and made accessible.\textsuperscript{19}

The focus of this Article is to inform securities and business lawyers regarding the way the SEC treats cryptocurrency and NFTs, and provide guidance to attorneys advising NFT and F-NFT-focused clients. Part II of this Article provides the relevant securities law framework and

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A brief background of blockchain related technology. Part III details recent market abuses, regulatory activity thus far, and how the famous Supreme Court decision in *SEC v. W.J. Howey Co.*,\(^{20}\) applies to NFTs and F-NFTs. Part IV details how attorneys should advise clients working in this space.

II. BACKGROUND

A. Securities

1. Statutory Definitions

Economic collapse incited Congress to enact laws and create an agency to regulate securities law.\(^{21}\) In the 1920’s, a combination of easy-access credit and post-World-War-I optimism spurred U.S. market activity to outpace government regulation.\(^{22}\) Subsequently, half of the new $50 billion offerings lost all value.\(^{23}\) In response, Congress passed two Acts in the early 1930s designed to safeguard market participants from both companies issuing securities and brokers or exchanges trading securities.\(^{24}\) Congress established the Securities and Exchange Commission ("SEC") in 1934 to coordinate compliance with the new Acts.\(^{25}\)

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\(^{21}\) *JAMES D. COX ET AL., SECURITIES REGULATION* 49 (9th ed. 2020).


\(^{23}\) *Id.*

\(^{24}\) *Id.*

\(^{25}\) *Id.*
The first of these Acts, the Federal Securities Act of 1933 ("’33 Act"), requires issuers of new securities in the public market to register the securities with the SEC. Registration is accomplished by filing a registration statement with the SEC that discloses certain information about the offeror.\footnote{Id. at 6.} The Securities Exchange Act of 1934 ("’34 Act") gives the SEC the authority to regulate secondary markets dealing in securities after initial offerings. Markets such as the New York Stock Exchange (NYSE) or National Association of Securities Dealers Automated Quotations (NASDAQ) must comply with certain continuing obligations.\footnote{Cox, supra note 21, at 10.}

Congress provided many sweeping regulations to deter corruption in the securities markets; importantly, Congress provided a definition for a security. “Security” is defined by the ’33 Act at 15 U.S.C. § 77b(a)(1), the ’34 Act at 15 U.S.C. § 78c(a)(1), and numerous articles and cases.\footnote{See, e.g., 15 U.S.C. § 78c(a)(1); 15 U.S.C. § 77b(a)(1); Colesanti, supra note 12, at 11.} The ’33 Act’s definition of “security” reads as follows:

The term “security” means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or
subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security”, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.29

While each Act’s definition differs slightly, the U.S. Supreme Court has “treated [them] as essentially identical in meaning.”30 Cryptocurrency is usually evaluated according to the “investment contract” (defined below) portion of these statutory definitions.31

Congress sought to provide a very broad meaning to contemplate the “countless and variable schemes devised by those who seek the use of

31 Goforth, supra note 12, at 277.
the money of others on the promise of profits.”32 However, there are downsides to broad, functional definitions. Namely, functional definitions are often over-inclusive and indeterminate, thereby spurning market expansion where every participant would otherwise be better off.33 These concerns are exacerbated in the NFT market, where the SEC once again attempts to “… fit nascent, experimental business models into decades-old rules.”34 Here, the decades-old rule in question derives from Howey and its progeny.

2. Howey

The now-famous Howey test came about when “Howey Company” and “Howey-in-the-Hills Service, Inc.” (collectively “Howey”), both under common control, offered an attractive investment opportunity.35 Howey offered to sell real property and property management in tandem, such that buyers could purchase small portions of an orange grove and recover a commensurate portion of the entire orange grove’s profitability.36 Those buyers depended entirely on the seller’s efforts to

33 Guseva, supra note 12, at 636.
34 Ori Oren, ICO’s, DAO’s, and the SEC: A Partnership Solution Notes, 2018 Colum. Bus. L. Rev. 617 at 621.
36 Id.
obtain returns on their investments. They could not elect to cultivate their sliver of property themselves.\textsuperscript{37}

The Court held that such an offering constituted an “investment contract” and fell within the purview of § 2(1) of the Securities Act.\textsuperscript{38} The Court laid down the well-known four-part test for an investment contract. An investment contract is (1) an investment of money; (2) in a common enterprise; (3) with a reasonable expectation of profit; (4) to be derived from the entrepreneurial of managerial efforts of others.\textsuperscript{39}

The \textit{Howey} test seeks to answer whether the transaction being evaluated is the type of capital-transaction that securities law is meant to cover. Thomas Hazen, in his treatise on securities law, provides as diverse a list as one can imagine: scotch whiskey, cosmetics, animal breeding programs, rabbits, recording contracts, and cryptocurrency, \textit{inter alia}—all of which have been found to be securities under the ’33 and ’34 Acts.\textsuperscript{40} A brief survey of the emerging technologies surrounding cryptocurrencies and other tokens may help illustrate why even the broad “investment contract” definition is insufficient to efficiently accommodate NFT transactions.

\textsuperscript{37} Id. at 296.
\textsuperscript{38} Id. at 300.
\textsuperscript{39} SEC v. Edwards, 540 U.S. 389, 393 (2004); W.J. Howey Co., 328 U.S. at 301.
\textsuperscript{40} THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION, 38 (8th ed. 2021).
B. Tokens

A general understanding of the technology and its iterations is needed before discussing securities concerns specifically. While an in-depth discussion of blockchain related technology is beyond this Article’s scope, an overview of cryptocurrency, NFTs, and the Metaverse is warranted.

1. Cryptocurrencies

The term “cryptocurrency” refers to digital assets that utilize a “decentralized ledger technology” to afford transactors intermediary-entity-free access between accounts.\textsuperscript{41} The blockchain serves as the “ledger” recording asset ownership.\textsuperscript{42} A blockchain consists of “blocks,” where each block is ordered chronologically and contains processed batches of transactions.\textsuperscript{43}

These transactions occur between keyholders. The owner of cryptocurrency has a “private key,” which allows that owner to access their cryptocurrency or to transfer the cryptocurrency to another person.\textsuperscript{44} A “public key” is also generated when transactions occur, and that public


\textsuperscript{42} Id.


\textsuperscript{44} Chu, \textit{supra} note 41, at 2327.
key functions like an address and confirms the most recent transfer. This reassures transferees their new purchase has not been transferred twice.

Bitcoin was the first cryptocurrency to capture popular attention. In 2008, Bitcoin stepped into the market to provide an immutably transferable, intermediary-free currency. Bitcoin provided a secure alternative to bank-facilitated payments. Bitcoin accomplishes this by self-verifying—each transaction records and validates itself for the world to see.

Bitcoins are created by “mining,” which involves a “proof-of-work” validation system that pits network participants against one another to solve difficult algorithm-based problems. Once someone solves that particular problem, the winner receives the Bitcoin and that transaction is recorded onto the blockchain. This initial recording is significant because

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45 Hazen, supra note 43, at 497.
46 Id.
49 Hazen, supra note 43, at 496. But see John Reed Stark, 10 Axioms that Crypto-Shills Don’t Want You to Know, LINKEDIN (Aug. 8, 2022), https://www.linkedin.com/pulse/10-axioms-crypto-shills-dont-want-you-to-know-john-reed-stark/ (rebutting the most popular defenses of crypto, including its supposed security for transactors). However, whether cryptocurrency is valuable or feasible for society is beyond the scope of this article.
50 Hazen, supra note 43, at 497–98.
51 Id.
it creates the new “block” and validates subsequent transactions of that bitcoin. The algorithm-solving process is called “mining,” and becomes increasingly more challenging as more Bitcoin are “mined.” The increase in difficulty raises marginal cost at every new “block,” thereby creating forced scarcity and (purportedly) increasing each bitcoin’s value.

Players began entering the market following Bitcoin’s explosive popularity. New token creation and selling, “initial coin offerings” (“ICOs”), were possible via the “Ethereum” (“Ether”) blockchain, a counterpart to Bitcoin. Unlike Bitcoin, Ethereum and its affiliated currencies are gearing up to utilize “proof-of-stake” validation. Proof-of-stake validation involves individuals “staking” their cryptocurrency as a

52 Id.
54 For a helpful illustration of how each “block” builds upon previous blocks, see Patach, supra note 47 at 424 fig. 1.
56 Most new cryptocurrencies fail quickly, but market hazards are insufficient by themselves to place cryptocurrencies under securities law’s purview. See Hazen, supra note 43 at 510. However, market hazards accompanied by an absence of regulatory schemes argue in favor of securities classifications. See id.
sort of collateral for new blockchain entries. In proof-of-work validation, competitors consume large amounts of energy to “solve” the increasingly challenging algorithms in order to add a block to the blockchain. By contrast, proof-of-stake validation selects a “validator” to confirm that a new block of data comports with the rest of the blockchain. Once that validator and a select number of validating “nodes” concur in the new block’s validity, the new block is added to the blockchain. Because of the amount of stake required, “cryptocurrency pooling” is a common way for individuals to put their otherwise inactive cryptocurrency to work under the validator’s discretion. In exchange for staking currency, the staker receives yields of between 5% to 14% of their staked holdings. In this way, proof-of-stake incentivizes consumers like a bank paying interest while investing its account holders’ funds.

58 Napoletano, supra note 57.
59 Castor, supra note 57.
60 For a concise but clear summary of the proof-of-stake steps, see DELTEC BANK, A Proof of Stake Explanation, (Jul. 14, 2021), https://www.deltechbank.com/2021/07/14/a-proof-of-stake-explanation/?locale=en. This methodology of validation, known as “consensus protocols,” confirms among validators (or, “validation nodes”) that a new block ought be added. Id. If those validators validate an inaccurate or insecure new block, the cryptocurrency the validator “staked” is forfeit. Id.
63 Napoletano, supra note 57.
Some view Bitcoin as a security, but that conclusion is far from certain. One court has held that Bitcoin can qualify as a security,64 but “[t]o the extent that it gains wide acceptance primarily as a unit of exchange, the likelihood of treating Bitcoin as an investment contract diminishes.”65 While securities law questions vary based on the facts involved, Bitcoin and Ether are usually used as units of exchange rather than investment vehicles. Swaths of new “coins” necessitated exchanges to connect buyers and sellers, and this need led to the creation of “crypto exchanges.”66 Crypto exchanges often provide dual functionality: stock-exchange-esque accessibility and “private key” storage in the form of digital “wallets.”67

There are three general types of tokens in the market today: (1) utility tokens, (2) security tokens, and (3) currency tokens.68 The first type, utility tokens, confer actual functions upon their holders—some examples include a membership card to an organization or ticket to an event.69 The second type, security tokens, function more like debt or equity instruments.70 Security tokens can confer voting rights, rights to dividends,

65 HAZEN, supra note 40, at 48.
66 Sarel, supra note 53, at 400.
67 Id.
68 Id. at 403.
69 Id. at 403–404.
70 Id. at 404.
or other financial benefits. The third type, currency tokens, function primarily as a means of purchasing goods or services. However, these three categories act only as general references—many tokens cross category lines and prove more challenging to identify. For example, some tokens might provide both access to a service and a right to receive revenue; such a token might qualify as both a utility token and a security token.

NFTs blend these domains. NFT transactions have both use and investment-like natures. The versatility of NFTs proves that they may not so easily fall into the supposedly all-encompassing Howey definition of a security.

2. NFTs

NFTs represent the most recent emerging asset class to challenge the SEC. As observed by cryptocurrency commentators, fertile ground

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71 Id.
72 Sarel, supra note 53, at 405 (Adopting cryptocurrency as a unit of exchange, especially a government-sanctioned unit of exchange, has significance in several legal fields); see generally Brian McCall, Now You See It Now You Don’t – How the UCC Amendments Will Undo Bitcoin’s Brief Status as Money, ALI ADVISER (Jul. 28, 2022), https://www.thealiadviser.org/uniform-commercial-code/now-you-see-it-now-you-dont-how-the-ucc-amendments-will-undo-bitcoins-brief-status-as-money/.
73 Sarel, supra note 53, at 407.
74 See HAZEN, supra note 40, at 48.
exists for fraud when innovation outpaces regulation.  

At the very least, the current regulatory landscape ought to cause any practitioner working with clients in this market to feel that “navigating the securities laws in this area is perilous business.” SEC Director Hinman clearly stated that “simply labeling a digital asset a ‘utility token’ does not turn the asset into something that is not a security.” The question remains: should an NFT label transform that labeled item into something that is a security?

NFTs present a more challenging case than typical cryptocurrency ICOs. Ways in which NFTs are used vary widely, ranging from pure “consumption” in virtual video games to profit-sharing vehicles. An NFT is a digital asset that is tied to or represents an object in the real world. That object may include art, music, pictures, or in-game items. The process of associating a real-life object with an NFT is sometimes referred to as “tokenizing.” Virtually anything can be “tokenized.”

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76 Goforth, supra note 10, at 645.


78 Hinman’s Speech, supra note 30.

79 If people purchase merely for “consumption”, then it is unlikely that such a purchase satisfies the “investment” requirement from Howey. See discussion infra Section II.B.2.a.; see, e.g., United Hous. Found. v. Forman, 421 U.S. 837, 858 (1975).


is not limited to “real-life items”; songs, in-game items, domain names, and event tickets can be “tokenized” as well.\(^8\)

NFTs offer a proof of ownership benefit that cause some to suggest that NFT “minting” will become a standard way of proving ownership of a company, a car, or even real property.\(^8\) Resale “gas fees” provide creators with unique opportunities to obtain guaranteed, verifiable, and consistent licensing fees for each subsequent sale of any given NFT.\(^8\) “Gas fees” function like ATM fees or credit card processing fees.\(^8\) They also cost a minter small fees every time a new NFT is minted in order to offset the “computing energy . . . required to process a transaction on the Ethereum blockchain.”\(^8\) In this way, they function to prevent “spamming” of NFT marketplaces.

NFTs are regularly purchased with cryptocurrency, especially Ethereum,\(^8\) and NFT transactions can be stored on the Ethereum

\(^8\) See generally id.
\(^8\) Id.
\(^8\) What are NFT Gas Fees? How to Calculate Your NFT Gas Fees Like a Pro, ZIPMEX (Jan. 27, 2022), https://zipmex.com/learn/what-are-gas-fees/.
\(^8\) Id.
blockchain. Ordinarily, only one owner can own an NFT at a time. However, “fractionalizing” NFT ownership is possible, and this process implicates securities law more directly than unfractionalized NFT ownership.

a. NFT Functionalities

NFTs have a wide breadth of functionality; understandably, NFTs function similarly to cryptocurrencies as discussed above. Of particular consequence are the various investment and fractionalization functionalities. For example, one seller made headlines when it successfully auctioned a home linked with an NFT. There, Haven Real Estate Group sold the NFT for 210 Ether, which is the equivalent of $653,000. That NFT ownership included ownership of an LLC, which in turn owned the real property. Some herald such a model as the future more accessible fiat payment methods like traditional debit and credit cards and Apple Pay).

89 Non-Fungible tokens (NFT), supra note 82; See supra Section II.B.1.
90 Non-Fungible tokens (NFT), supra note 82.
92 Id.
93 Id.
of real estate buying and selling.\footnote{Meagan Miller, \textit{Auctioning Homes as NFTs Could Be the Future of Homebuying}, \textit{ABC 7} (Mar. 3, 2022, 11:48 pm), https://abc-7.com/news/cover-story/2022/03/01/auctioning-homes-as-nfts-could-be-the-future-of-homebuying/} Haven’s real estate agents are already in the process of getting “crypto-certified” to capitalize on the anticipated shift to NFT-linked real property sales.\footnote{Id.}

Additional functionalities further cloud NFT classifications, with most being “static,” but others being “dynamic” (dNFT) or “generative.”\footnote{Paola Demichelis, \textit{Beatles, Brands and Blockchain: What Is Possible with the Next Generation of NFTs?}, \textit{DRUM} (Apr. 13, 2022), https://www.thedrum.com/opinion/2022/04/13/beatles-brands-and-blockchain-what-possible-with-the-next-generation-nfts.} DNFTs include an NFT created by interactions between the artist and some form of artificial intelligence.\footnote{Id.} With dNFTs, some artists may upload the algorithms responsible for generating portions of the NFTs, thereby allowing the eventual purchaser to make modifications that will influence the end-product.\footnote{Id.} DNFTs have certain links built into their smart contracts that enable modification long after it is minted.\footnote{Id.} A common use case for dNFTs are blockchain-based gaming, where a player’s “stats” may change during progression through various challenges.
However, attorneys ought to heed another interesting dNFT use: a dNFT representing and used to sell real property might update after every sale with the type of information a title examiner or surveyor would need. These are only a few of the myriad potential dNFT uses. Regulators need to provide preemptive guidance. As expected due to the complex nature of crypto transactions, treating crypto the same in all cases would be ill advised.

It is easy to imagine ways NFT-linked real property sales could shift into transactions that implicate securities law. For example, fractionalizing those NFTs and appointing another party to manage the property would yield something that looks Howey-esque. Indeed, the LABS Group raised $3,650,000 for its upcoming Kunang Glamping Resort. The LABS Group touts this project as the “world’s first-ever community-owned project fractionalized into Rewarding Timeshare (RTS) NFTs.” RTS NFT purchasers also get “staying rights,” which appear to function

100 See infra Section II.B.2.a.; see What Is a Dynamic NFT?, CHAINLINK (Apr. 7, 2022), https://blog.chain.link/what-is-a-dynamic-nft/.
102 Goforth, supra note 12, at 279.
104 Id.
like a timeshare.\textsuperscript{105} Included with those rights are transportation and discounts on food and drink purchases.\textsuperscript{106}

NFTs can function as a traditional crowd-funding vehicle, à la Patreon or GoFundMe.\textsuperscript{107} Interestingly, the Ukrainian government has initiated talks with a designer to sell its own NFT collection—although, Ukraine’s motivation arises out of war-time financial straits caused by the ongoing Russian aggression.\textsuperscript{108} As of April 1, 2022, the Ukrainian government has raised more than $600,000 through sales of its NFT offerings.\textsuperscript{109} These NFT sales represent only a small portion of the total crypto-related donations the government has received, which amount to over $70 million worth of crypto donations and hundreds of NFTs. Curiously, and related to the focus of this Article, the Ukrainian government plans to auction artwork for which only Ukraine-issued NFT owners may bid.\textsuperscript{110}

\begin{thebibliography}{99}
\bibitem{105} Id.
\bibitem{106} Id.
\bibitem{110} Id.
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Sometimes, NFTs function simply to declare affiliation, interest, or engagement with events or culture.\footnote{Deborah Lynn Blumberg, NFTs Can Transform Loyalty: Here Are 6 Things Brands Should Know, MASTERCARD: NEWSROOM (Apr. 14, 2022), https://www.mastercard.com/news/perspectives/2022/blockchain-nfts-and-brand-loyalty/} For example, within 24 hours of the now infamous “Will Smith Slap,” an NFT collection bearing that same name listed NFTs for up to $296,452.79 and had 721 owners.\footnote{Karandeep Oberoi, OpenSea Has a ‘Will Smith Slap’ NFT Collection with 721 Owners Already, MOBILESYRUP (Mar. 28, 2022), https://mobilesyrup.com/2022/03/28/opensea-will-smith-slap-nft-collection/ (last visited Mar. 28, 2022).} Other individuals purchase NFTs strictly as an investment vehicle. Analysts paying attention to the NFT space have even developed volatility classifications, calling certain NFTs “Blue Chip” if they are sufficiently non-volatile.\footnote{Ornella Hernandez, Blue Chip and Metaverse NFTs Propel Growth of NFT Market, says Nansen report, COINTELEGRAPH (Apr. 11, 2022), https://cointelegraph.com/news/blue-chip-and-metaverse-nfts-propel-growth-of-nft-market-says-nansen-report.} Somewhat humorously for this Article’s purposes, Securities.io published an article titled “Top 8 Upcoming NFTs to Buy Before they Blow Up,” guiding its readers to the NFT collections it deemed most lucrative.\footnote{Ali Raza, Top 8 Upcoming NFTs to Buy Before They Blow Up, SECURITIES.IO (Apr. 9, 2022), https://www.securities.io/top-8-upcoming-nfts-to-buy-before-they-blow-up/} Sometimes shockingly disappointing results follow. Sina Estavi purchased an NFT of a tweet for almost $3 million and
put it up for auction the following year, but he received a high bid of only $3,600.\textsuperscript{115}

Another example of NFTs’ multifunctionality is Cloud Yachts. Cloud Yachts has blurred the line between NFTs as a consumable experience and an investment opportunity. It experimented with an NFT that “represents a contract for the build” of custom luxury yachts.\textsuperscript{116} But, perhaps unsurprisingly, these yachts are (1) Metaverse internal,\textsuperscript{117} and (2) linked with other benefits such as luxury yacht club membership.\textsuperscript{118} Cloud Yachts’ maiden sale brought in a hefty $12 million.\textsuperscript{119}

Given the wide swath of potential uses for NFTs, it is little wonder that the SEC is hesitant to shoot from the hip when providing guidance for the public market. However, the enormous amount of damage that abusers can do in the NFT market, and that market is projected to increase


\textsuperscript{117} The Metaverse is discussed in detail \textit{infra} section II.C.


\textsuperscript{119} Micah, \textit{supra} note 116.
by a factor of 1,000 in the next 10 years, requires more proactive regulation.\textsuperscript{120}

\textbf{b. Legal Issues with NFTs}

NFTs implicate numerous areas of law. Many of these areas overlap to create a precarious mire of potential liabilities that may befall creators and exchanges.

NFTs represent new departures from the trademark law paradigm—digital and physical production of works continuing to separate “has potentially destabilizing consequences for trademark law, which overwhelmingly has been oriented toward indications of the origin of physical goods.”\textsuperscript{121} \textit{Hermés International v. Mason Rothschild}, currently pending in court in New York, involves a trademark infringement and dilution allegation brought by Hermés against Rothschild, who made over $1 million from selling Birkin-trademark-bearing NFTs.\textsuperscript{122} It is unclear whether consumers ought to presume a mark-bearing NFT’s source is the

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mark-holder, but that presumption may shift as more brands register in NFT and Metaverse trademark classes.\textsuperscript{123}

The purchases themselves do not include the underlying copyright rights to the images associated therewith,\textsuperscript{124} a fact that continues to befuddle some NFT purchasers.\textsuperscript{125} However, contrary to the default state and practice, the Bored Ape Yacht Club (“BAYC”) NFT creators, Yuga Labs, provides broad rights for each BAYC NFT purchaser.\textsuperscript{126} These rights include the right to make derivative works based on the BAYC images associated with each NFT\textsuperscript{127}—a right that some have monetized by “licensing” their NFT to other consumers.\textsuperscript{128}


\textsuperscript{127} Id.

NFTs pose problems for the IRS as well. Cryptocurrencies are taxed as capital assets, but few NFT purchasers understand that they are required to report capital gains on appreciated crypto value upon sale of an NFT. IRS Commissioner Chuck Rettig showed the IRS’s cognizance of this, saying that NFTs might become widespread vehicles for tax evasion absent proactive policing. NFT valuation is challenging enough without including keeping up with the underlying cryptocurrency used to purchase that NFT.

Others have examined the business formation and contract drafting implications for NFT-related enterprises. Using the Robotos NFT project, one law firm discussed the potential importance of forming separate entities for different NFT projects and documenting the roles of all parties involved.


133 Id.
NFTs also pose problems for securities law. Whether and when NFTs function as securities has puzzled the SEC—a question that usually results in the answer, “they might be.” In anticipation of greater SEC scrutiny, National Law Review published a brief article detailing three broad scenarios in which NFTs may implicate securities law: (1) fractionalization; (2) when NFTs represent a right to revenue stream; and (3) pre-sale of NFTs that have no current use. The first category, fractionalization, is at the center of the debate over whether NFTs are a security.

c. **Fractionalized NFTs as a Legally Significant Sub-species**

NFTs can be “fractionalized” (F-NFTs). NFTs usually use the ERC-721 Ethereum standard, which can be “locked” into a “smart
contract” and split the ERC-721 token into several ERC-20 tokens per the instructions drafted into that smart contract. Fractionalizing NFTs provides minters the opportunity to expedite high-cost NFT sales by dividing it into subparts and enabling multiple purchasers to buy in. Should a minter want to “reconstitute” an F-NFT into a whole NFT, the minter can draft a “buyout auction” reserve price as well, which functions like a tender offer to ensure the end-purchaser owns 100% of the NFT.

Fractionalization is not new, nor is the SEC ignorant of its securities implications. Indeed, the first judicial interpretation of the statutory security definition involved fractional undivided interests in oil. 

SEC Commissioner Hester Peirce specifically addressed NFTs in a discussion with Yahoo Finance, stating that “[w]hether it’s people who are fractionalized in NFTs and selling pieces of them or other types of financialization of NFTs, it’s something that we should be thinking about again and again.” One consumer-oriented website explains fractional

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139 Id.
140 Id.
141 Id.
143 Id. at 351–52.
ownership NFTs as a relatively innocuous arrangement where one might “become a shareholder in a Picasso NFT, meaning you would have a say in things like revenue sharing.” Such a description, however, should ring warning bells in a securities attorney’s ears.

d. Digital Forums

The Metaverse is the vehicle by which NFTs and F-NFTs will become “household goods” in the coming years. As such, the Metaverse warrants its own brief discussion.

The Metaverse is a virtual environment, like any number of video games in which its players can purchase items, build things, and interact with others. Saying something exists “on the Metaverse” is comparable to saying something exists “on the Internet”—there may be certain servers or systems that facilitate activity, but the consumer’s interaction rarely is concerned about such specifics. However, the Metaverse evades a concrete analogy, as it will probably develop more like early-internet

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145 Non-fungible tokens (NFT), supra note 82.
146 See generally Takyar, supra note 138.
instant messengers vying for market dominance.\textsuperscript{149} Eventually, those disparate platforms developed into agreed-upon protocols and compatible technology that developers use to provide competing ecosystems.\textsuperscript{150} Businesses can sell products, buy storefronts and “real estate,” invite in customers, and provide environments for socialization and business, all within the digital space made possible by virtual reality and the blockchain.\textsuperscript{151} “Metaverses” are by no means a new concept, but 2022 saw the most effective centralized effort to manifest ideas that have appealed to consumers for decades.\textsuperscript{152}

The widely publicized Metaverse and its NFT integration will likely transform NFTs and their sales into household transactions. “NFT is the product—it’s the what,” says Olivier Moingeon, NFT company Exclusible’s CCO, “and metaverse is the how and where . . . .”\textsuperscript{153} One NFT exchange, Portion, showed its confidence in the Metaverse when it


\textsuperscript{150} Id.

\textsuperscript{151} Id.

\textsuperscript{152} Ashleigh Hollowell, \textit{Why the Metaverse Must Be Open But Regulated}, VENTUREBEAT (Jan. 26, 2022, 6:00 AM), https://venturebeat.com/2022/01/26/why-the-metaverse-must-be-open-but-regulated/.

purchased a digital “52-parcel plot” of land for $1.25 million.\textsuperscript{154} Portion plans on operating a virtual NFT store, claiming that the plot’s proximity to the “center of Decentraland [, one development in the Metaverse]\textsuperscript{155}\textsuperscript{9} justifies the high price tag.\textsuperscript{156}

Utilizing already owned hardware, like an Oculus headset, provides new users easy access to the Metaverse with relatively low entry costs.\textsuperscript{157} Further, while pre-pandemic producers may have doubted consumers’ interest in walking around virtual environments to socialize, COVID-19-mandated quarantine showed businesses how much consumers enjoy virtual worlds and purchases therein.\textsuperscript{158} The Metaverse and its NFT utilization, paired with blockchain-based internet’s


\textsuperscript{155} Id.


\textsuperscript{158} Joanna E. Lewis et al., \textit{New Social Horizons: Anxiety, Isolation, and Animal Crossing During the COVID-19 Pandemic}, FRONTIERS IN VIRTUAL REALITY, Mar. 30, 2021, at 1, 1, 2 (2021).
(“Web3”)\textsuperscript{159} impending impact on the market, means that attorneys with clients anywhere close to the technological cutting edge need to equip themselves for entry into this rapidly expanding market space.

Industry leaders are heading to the Metaverse in droves; preemptive trademark registrations for Metaverse internal marks signal their approach.\textsuperscript{160} Each company’s choice to engage lends an air of legitimacy to what some call merely a scam\textsuperscript{161} or worse.\textsuperscript{162} These entrants

\textsuperscript{159} “Web3” or “Web 3.0” represents the newest iteration of the internet. Web 1.0 included early HTML-only internet efforts and Web 2.0 signified developments into user-generated content and interaction, while Web 3.0 includes blockchain innovations and decentralization. See Web 3.0 Explained, Plus the History of Web 1.0 and 2.0, INVESTOPEDIA (Oct. 23, 2022), https://www.investopedia.com/web-20-web-30-web-30-5208698.


include giants like Chevron, McDonald’s, Skechers, Nike, Walmart, Monster Energy, the NBA, Mastercard, UPS, and JPMorgan. Universities are jumping on board, taking “virtual learning”


171 U.S. Trademark Application Serial No. 97347016 (filed Apr. 5, 2022); U.S. Trademark Application Serial No. 97347020 (filed Apr. 5, 2022); U.S. Trademark Application Serial No. 97347006 (filed Apr. 5, 2022); U.S. Trademark Application Serial No. 97347013 (filed Apr. 5, 2022).


JPMorgan projects that the Metaverse will be a $1 trillion market opportunity in the coming years, which prompted it to open the first virtual bank location in “Decentraland.”\footnote{Lau, supra note 172.} Commentators are optimistic about the Metaverse’s future, partly because of the moves companies are making to register Metaverse-related trademarks and hire Metaverse-focused executives.\footnote{See Hannah M. Mayer, \textit{The Future of The Metaverse: What 2022 Has in Store for the Immersive Digital World}, FORBES (Jan. 24, 2022, 3:26 AM), https://www.forbes.com/sites/hannahmayer/2022/01/24/the-future-of-the-metaverse-what-2022-has-in-store-for-the-immersive-digital-world/?sh=26b248be335a.} Many registrants may encounter resistance from the United States Patent and Trademark Office, however, as Metaverse/NFT trademarks force examiners to adapt the Trademark Manual of Examination Procedure to ill-fitting specimens.\footnote{See generally Bored Ape Yacht Club Trademark App Sheds Light for Brands, THE FASHION LAW (Apr. 1, 2022), https://www.thefashionlaw.com/bored-ape-yacht-club-bayc-trademark-application-sheds-light-for-brands/ (discussing the difficulty faced by NFT offerors to present acceptable specimens of use if their proposed classes include things
NFTs will serve as the backbone of Metaverse functionality. Individual avatars, “real estate,” and all sorts of virtual items are all represented and sold by NFTs.\(^{178}\)

III. PROBLEM

a. Abuses In the Market

The SEC has provided insufficient guidance for NFT issuers and exchanges, resulting in a plethora of abuses. NFTs and NFT consumers are susceptible to the types of abuses that prompted increased securities regulation in the ’33 and ’34 Acts, such as insider trading and wash trading.\(^{179}\) Several high-profile examples of abuse have cast a “black cloud over the NFT market . . . [B]ad actors have clearly taken the bloom off the rose.”\(^{180}\)


\(^{180}\) *Id.*
On February 4, 2022, Reuters reported that “the Department of Justice has yet to bring a criminal case involving NFT markets, but that will change.”181 Reuters further reported that “[i]n the wake of reports about insider trading in NFT marketplaces, manipulation of NFT prices, and NFT creators embezzling funds, the DOJ [was] likely already looking for opportunities to bring prosecutions in [NFT spaces].”182 The DOJ filed a criminal complaint against the “Frosties” offerors only a month later.183 As a result, OpenSea announced a hard limit on how many NFTs minters could create on its platform, apparently in response to widespread abuse.184 These abuses prompted John Stark, the founder and former chief of the SEC Office of Internet Enforcement, to say that “in the NFT marketplace, market manipulation is not only rampant and tolerated, but also encouraged; fraud not only accepted and rewarded, but also taught.”185

182 Id.
183 See infra Section III.A.4.
1. Issuing Unregistered Securities

As securities lawyers well know, section 5 of the ’33 Act requires that transactions offering securities be registered.\(^{186}\) On May 12, 2021, a class action was filed against Dapper Labs for allegedly violating the ’33 Act when it sold NFTs without complying with securities law disclosure requirements (“Dapper Labs Complaint”).\(^{187}\) Dapper Labs, a platform utilizing the proof-of-stake minting model,\(^{188}\) started minting NFTs of short video highlights from NBA games. These “NBA Top Shot” NFTs were available in three tiers: (1) common, (2) rare, and (3) legendary, based on the number of NFTs minted in that category.\(^{189}\) Thereafter, the “NBA Top Shot” Twitter account, hosted by Dapper Labs, began touting the enormous price tags associated with these NFTs.\(^{190}\) However, much to the chagrin of some purchasers, Dapper Labs held on to consumer funds for months after withdrawal requests—a fact that garnered national attention.\(^{191}\) In its complaint, the SEC worked through *Howey* and explained that the NBA Top Shot NFTs, and the underlying custom-

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\(^{186}\) 15 U.S.C. § 77e(a), (c).


\(^{188}\) *See supra* II.B.1.

\(^{189}\) Dapper Labs Complaint, *supra* note 187, at 8.

\(^{190}\) *Id.* at 9.

\(^{191}\) *Id.* at 15–17.
minted cryptocurrency upon which these NFTs were built, qualified as securities upon their issuance. The SEC considered very significant the way Dapper Labs continually tweeted about the “growth potential” and value increase predictions in the future, and as of this Article’s drafting, the parties are still in dispute.

2. Insider Trading

Insider trading is prohibited under SEC Rule 10b-5, which specifically precludes trading based on material, non-public information. In its March 16th, 2022 post, “Insider Trading Claims Arise, as the NFT Space Starts to Consolidate,” “The Fashion Law” blog, which has published content at the cutting edge of Metaverse and NFT legal implications, drew attention to allegations of “insider trading” on NFT marketplaces made in September 2021. Reuters echoed these concerns, citing an instance occurring in September 2021 of an NFT marketplace employee buying up certain NFTs immediately before those NFTs were featured on the marketplace’s homepage, only to sell those NFTs after they drastically appreciated in value.

3. Wash Trading

192 Id. at 10–15.
194 Insider Trading Claims Arise, as the NFT Space Starts to Consolidate, supra note 88.
195 McGinley, supra note 171.
NFT marketplaces are also at risk of “wash trading,” where individuals, either alone or acting in concert, buy and sell NFTs to create the mere appearance of demand. Wash traders will self-finance seemingly independent buyer addresses to increase an NFT’s value, sometimes with exponential gains at the eventual legitimate buyer’s expense.\textsuperscript{196} For example, in October of 2021, one individual sold and purchased CryptoPunk #9998, one NFT from a popular collection, just to elicit higher bids.\textsuperscript{197}

Some marketplaces incentivize as many transactions as the sellers can accomplish. When this is the case, wash trading makes up the majority of these marketplaces’ trading volume.\textsuperscript{198} Like other cryptocurrency, NFTs are susceptible to money laundering abuses as well. Wash trading can also be used to launder money via “‘self-financed’ addresses.”\textsuperscript{199}

4. Rug-pulling


\textsuperscript{197} McGinley, supra note 171.


NFT “rug pulling” is another form of abuse that can trick purchasers out of millions of dollars. In fact, “rug pulls” represented nearly 40% of crypto-related scams in 2021.201 In a “rug pull,” NFT issuers may sell NFTs that purport to provide value in a system that is not yet operationalized.201 Once the issuers have solicited sufficient investment, they “pull[] the rug out from under the victims,”202 abandoning the project and retaining investor funds—thereby defrauding investors.203

The “Frostie” example is illustrative. Following an investigation, a US Attorney, the IRS, and the Department of Homeland Security charged Ethan Nguyen and Andrew Llacuna (the “Offerors”) with conspiracy to commit money laundering after they were going to “pull the rug” in their second NFT collection sale.204 The Offerors offered a set of NFTs known

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201 Id.


as “Frosties” and were preparing to offer a set known as “Embers.”\textsuperscript{205} The Offerors solicited Frosties purchases with the promise of future holder-only rewards, such as “giveaways, early access to a [M]etaverse game,” and first-purchase rights in future Frosties releases.\textsuperscript{206} After raising over $1 million, the Offerors abandoned the project, deactivated the website, and transferred the funds to various crypto wallets under their control, allegedly to disguise the funds’ original source.\textsuperscript{207} The Offerors were charged shortly after advertising a second NFT project—the “Embers” project—which the Department of Justice believed to be a similarly fraudulent enterprise.\textsuperscript{208} The “Frosties” situation is but one of many.\textsuperscript{209}

\textit{b. Examples of NFT Offerings}

The following cases provide an interesting yet limited cross section of NFT offerings. While there are many uses of NFTs,\textsuperscript{210} the following are particularly relevant to securities discussions.

\textsuperscript{205} Two Defendants Charged, \textit{supra} note 204.
\textsuperscript{206} Id.
\textsuperscript{207} Id.
\textsuperscript{208} Id.
\textsuperscript{209} See McGinley, \textit{supra} note 171 (describing another “rug-pull” in which NFT purchasers in the “Evolved Apes” virtual fighting game were similarly deceived).
1. The Bored Ape Yacht Club

The Bored Ape Yacht Club (“BAYC”) NFTs have remained among the most expensive and sought after NFTs available,\(^\text{211}\) serving as a status symbol for crypto connoisseurs.\(^\text{212}\) Twitter increased BAYC’s visibility to the average consumer by implementing a verification system\(^\text{213}\) for BAYC NFT profile pictures, enabling owners to flaunt their NFT to any who visit their feed.\(^\text{214}\)

Part of the BAYC’s appeal is that, “[i]n contrast to other NFTs that offer only investment possibilities, BAYC NFTs offer additional perks and entertainment opportunities.”\(^\text{215}\) As part of that system of incentives, owners of BAYC NFTs recently received a staggering aggregate $810 million worth of “ApeCoin,” a freshly minted cryptocurrency.\(^\text{216}\) While such a distribution may have been innocently intended, it represents what might be considered a heavily disguised dividend given to “shareholders,”

\(^{211}\) Fox, supra note 18.


\(^{213}\) Will Gottsegen, Twitter Launches NFT Profile Picture Verification, COINDESK (Jan. 21, 2022, 3:54 PM), https://www.coindesk.com/business/2022/01/20/twitter-launches-nft-profile-picture-verification/.

\(^{214}\) Sudhakar, supra note 212.

\(^{215}\) Id. (emphasis added).

i.e., BAYC owners.\textsuperscript{217} In a bizarre turn of events, the owner of BAYC NFT #6184 opened a BAYC themed restaurant, which accepted the recently distributed “ApeCoin” as payment.\textsuperscript{218} Unfortunately, in what crypto-skeptics might call poetic, there have been inconsistencies in the restaurant’s acceptance of cryptocurrencies as payment.\textsuperscript{219}

2. Home Equity Slice Purchases

“Slices” of home equity are another example of fractionalized NFTs (“FNFTs”) that are almost definitely a security. One offeror appears to understand that risk. Vesta Equity, a real estate startup, has developed a service on the Algorand blockchain for selling fractionalized real estate interests.\textsuperscript{220} Interestingly, these fractional ownership interests convey only a right to profits, and do not permit any kind of timeshare-esque residential arrangement.\textsuperscript{221}

\textsuperscript{217} See id.


\textsuperscript{220} Morgan Chittum, Investors Can Now Buy Home Equity Slices Via Fractionalized NFTs, BLOCKWORKS (Feb. 23, 2022, 4:13 PM), https://blockworks.co/investors-can-now-buy-home-equity-slices-via-fractionalized-nfts/.

\textsuperscript{221} Id.
Other offerors are not being as careful. Jared Kenna, a building owner in California, has started auctioning off NFTs for the rights to an apartment in that building.\textsuperscript{222} Interestingly, the same article reporting on that offering recognizes that “[f]ractionalized ownership or a building is already possible without technology. The legal mechanism, whether on paper or through crypto, is for owners to sell securities . . . ‘[b]ut . . . the reporting is too onerous.’”\textsuperscript{223} These burdensome reporting requirements are one of the reasons cited for electronic fractionalization being a more convenient alternative for consumers.\textsuperscript{224}

3. Casino NFTs

Blue sky laws came to consumers’ rescue in Texas and Alabama in a recent cease-and-desist order.\textsuperscript{225} There, Sand Vegas Casino Club offered 11,111 NFTs to raise revenue for a Metaverse casino, assuring consumers that the NFTs they were purchasing were not securities.\textsuperscript{226} Included in the deal was a profit-sharing promise once the Metaverse casino was up and

\begin{footnotes}
\item[223] Id.
\item[224] Id.
\item[226] Id.
\end{footnotes}
running. People could enter the casino at its Decentraland location in the Metaverse and gamble. NFT owners would share in the profits obtained by that casino. Unsurprisingly, OpenSea, which is not registered with the SEC as a securities exchange, delisted the NFTs after the cease-and-desist letters from the state securities authorities were publicized. While this is a small scale and limited example, one commentator expressed hopes that this state action will prompt federal action, as it often does.

Abuses and examples like those above have prompted at least some reactions from regulatory agencies—the relevant responses and notable absences are detailed below.

c. Recent Regulatory Action (or Inaction)

Because the main applications of NFTs are “founded almost entirely on financial speculation and regulatory arbitrage[,]” the Financial Times implies that there will be little opportunity left once regulators

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227 Id.
229 Id.
231 Prentice, supra note 225.
“decide it’s time to close the loopholes.”

The following sections detail the SEC’s published reactions to crypto thus far.

1. SEC Responses to Cryptocurrency

Cryptocurrency and blockchain technology are remarkably fast moving; regulators have appeared to play catch up in recent years. A string of new developments and abuses has led John Stark, former Chief of the SEC Office of Internet Enforcement, to state that “[w]e may be in the midst of a sudden U.S. crypto-regulatory awakening – and not a moment too soon.”

The SEC first spoke about cryptocurrency in The DAO Report, issued on July 25, 2017, and clarified that “[t]he automation of certain functions through [blockchain] technology, ‘smart contracts,’ or computer code, does not remove conduct from the purview of the U.S. federal securities laws.”

“The DAO’ project” was a specific decentralized autonomous organization (“DAO”)—wherein DAOs are entities governed by smart contracts and structured on the blockchain, thereby

232 Richard Waters, Web3 is Yet to Take Off Despite the Hype, FIN. TIMES (Apr. 8, 2022), https://www.ft.com/content/16eaf1b9-08fb-4454-4aeb-ae662ed3d850.


enabling decentralization and automation. Within the DAO project, DAO token ownership granted voting and profit sharing rights. The SEC concluded that the DAO project’s tokens were securities offered in violation of the ’33 Act, but it did not impose penalties because the DAO project cooperated so readily with the investigation.

SEC Chairman Gary Gensler, in his personal remarks to the Penn Law Capital Markets Association, reiterated the SEC’s position that “[t]here’s no reason to treat the crypto market differently just because different technology is used.” Gensler pontificated that “these [crypto exchange] platforms likely are trading securities. While each token’s legal status depends on its own facts and circumstances, . . . the probability is quite remote that any given platform has zero securities.” Gensler addressed concerns regarding trading and lending platforms, stablecoins, and tokens. Regarding tokens, Gensler remarked, “my predecessor Jay Clayton said it, and I will reiterate: Without prejudging any one token,

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236 Goforth, supra note 12, at 280.
237 Id. at 283.
239 Gensler’s Speech, supra note 134.
240 Id.
most crypto tokens are investment contracts under the Howey Test.”

Such broad statements have led many to declare that “[Clayton’s] comments... reflect[] at least a rebuttable presumption that all ICOs involve[] the sale of securities.”

In 2018, the SEC conceded that Bitcoin and Ether are most likely not securities. Director Hinman referenced the decentralized nature of each token, explaining that “purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts.” SEC Chairman Clayton reiterated Hinman’s sentiment saying “there are different types of cryptoassets” and “[a]s a replacement for currency, [Bitcoin] has been determined by most people to not be a security.” Commentators have noted that classifying Bitcoin and other cryptocurrencies as currencies make little practical sense, given

241 Id.


243 Goforth, supra note 12, at 285 (quoting Hinman’s Speech, supra note 30).

how seldom cryptocurrencies are accepted “in lieu of [traditional] fiat currency.”246 However, several high-profile examples of cryptocurrency being accepted as currency may signal more widespread acceptance and make its non-security classification more sensible.247 Other industry leaders only embrace blockchain technology in a piecemeal fashion—receptive to selling NFTs but not to accepting cryptocurrency as a payment method.248

Cryptocurrency’s volatility poses an interesting problem.249 Some suggest that the entire crypto “bubble” will burst, showing that the cryptocurrency craze was no more than an opportunity for “unlicensed gambling.”250 A particularly glaring example of crypto volatility is the


249 See Guseva, supra note 12, at 631 (noting the “robust but highly volatile” cryptoasset demand as seen when Bitcoin traded at record highs in early 2021).

250 See generally BOB SEEMAN & ROGER SVENSSON, BITCOIN: UNLICENSED GAMBLING (7th ed. 2022) (discussing how bitcoin does not operate as currency but instead has all the characteristics of a high-stakes gambling game and enables illegal activities).
incredible fluctuation Bitcoin experienced. An entertaining pastime was to check Bitcoin prices every few days, observe substantial price spikes either up or down, and survey technology and world news reports to speculate about the cause of the spikes. For example, Tesla accepting Bitcoin to purchase vehicles caused a significant jump in Bitcoin prices, followed by a comparable dip when Tesla removed that option citing environmental concerns.251

The 2019 “Framework for ‘Investment Contract’ Analysis of Digital Assets” from the “Strategic Hub for Innovation and Financial Technology” (“FinHub Framework”) provides the SEC’s more thorough guidance on evaluating crypto-adjacent securities issues.252 The FinHub Framework defines a “digital asset” as “an asset that is issued and transferred using distributed ledger or blockchain technology, including, but not limited to, so-called ‘virtual currencies,’ ‘coins,’ and ‘tokens.’”253


253 Id. at 1 n.2.
However, even after the FinHub Framework was issued, Commissioner Hester Peirce expressed a sentiment echoing attorneys’ probable thoughts: “Pages worth of factors, many of which seemingly apply to all decentralized networks, might contribute to the feeling that navigating the securities laws in this area is perilous business.” Cryptocurrency adds additional complexity to an already inconsistent and unsettled area of law.

Recent scholarship provides a useful set of tables in which Professor Guseva, an experienced professor and author in capital markets, details SEC responses to crypto related issues using dollar amounts, actor classifications, and year-by-year comparisons. The article posits that the SEC has been more than willing to threaten and bring administrative actions against crypto exchanges and issuers alike. Significantly, it points out that almost every action brought against “issuers of digital-asset securities” involved violation of the registration provisions from Section 5 of the Securities Act. The author concludes, inter alia, that “fear of enforcement alone could be a potent incentive to comply . . . [and] this fear should be magnified twofold due to the scale and scope of the

254 Peirce, supra note 77.
255 Cox, supra note 21, at 47.
256 Guseva, supra note 12, at 643-47.
257 Id. at 647.
258 Id.
Commission’s actions and the breadth of the functional *Howey* test.” Moreover, attorneys should expect the SEC to pursue enforcement aggressively because reputation and economic damage increases absent active enforcement. Consumers are hyper-aware of SEC action against NFT-related actors while the status of NFTs is unresolved. Uncertainty as to the SEC’s perspective on NFTs may provide an open door to people with ill intentions. If NFT actors engage in fraud, lack of enforcement would both harm investors and “make other crypto-projects tainted by association. . . .”

2. A Proposed New Asset Class

Some have called for a new “class” or “safe harbor” for digital assets, in which NFTs might reside. Such a “safe harbor” would exempt tokens from securities regulations for an initial growth period, provided their network becomes sufficiently decentralized or functional. A new “class” could mimic the proposed “controllable electronic records” UCC classification and function similarly to the hard-and-fast securities

259 Id.
260 Id. at 652.
262 Id. at 297.
263 See Rizzo, *supra* note 246 (discussing the proposed new category for cryptocurrency in the UCC: “controllable electronic records”).
designations for other asset types as laid down by *Landreth Timber Co. v. Landreth*. 264

However, Professor Guseva postulates that the ambiguity suffered by the *Howey* functional definition may represent the “Nash equilibrium”265 of the SEC regulatory “game,” as frustrating as that conclusion might be for securities attorneys. 266 Despite higher barriers to entry, i.e. players “remain on the sidelines for fear of making the wrong choice,” 267 it is unlikely that the SEC will provide the kind of concrete declaration for NFTs hoped for by some no-action letter requests.268 Instead, to use economic language, the issuer/actor “cooperates” by initially over-disclosing through traditionally available means such as no-action letter requests. 269


265 A “Nash equilibrium” exists when parties to an exchange are no longer incentivized to alter their respective positions absent some change by the other party. Guseva, *supra* note 12, at 653 n.130 (citing Ian Ayres, *Playing Games with the Law*, 42 STAN. L. REV. 1291, 1297 (1990)).

266 *Id.* at 653.


268 See *supra* Section III.C.1.

269 Guseva, *supra* note 12, at 663. “Cooperate” is a term widely used by economists to reference interpersonal trust, commerce, psychology, Game Theory, and “Prisoner’s Dilemmas.” See generally Steven Kuhn, *Prisoner’s Dilemma*, in *STAN. ENCYC. OF PHIL.* (Edward N. Zalta et al. eds., Winter ed. 2019), https://plato.stanford.edu/archives/win2019/entries/prisoner-dilemma/ (last visited Mar 15, 2023). In some scenarios, parties may be pitted against one another in a “game” (i.e. the marketplace), and each party must determine the optimal choice to make based on predictions of how the opposing party will respond. *Id.* Sometimes the optimal choice involves the parties acting in tandem to accomplish certain goals for
Indeed, the SEC repeatedly has invited communication and engagement with its staff regarding “close calls” like these emerging crypto assets.\textsuperscript{270} The actor cooperates because it expects the SEC to cooperate by prosecuting noncompliance.\textsuperscript{271} In return, the SEC may afford the actor a chance to escape without civil penalty even if they violated the Securities Acts.\textsuperscript{272} In order to promote disclosures and communication, the SEC may reward attempted pre- and post-sale cooperation with leniency.\textsuperscript{273} This asks the question: how do actors cooperate with the SEC?

3. No-action Letters

Actors cooperate by over-communicating their intentions and requesting guidance before acting.\textsuperscript{274} The SEC prefers the broad “investment contract” definition and “lack of definitional clarity” for two reasons. First, it “incentivize[s] market participants to request assurances from the SEC concerning which course of action to take to avoid violations.”\textsuperscript{275} Second, it fosters a “separating equilibrium” which illuminates the quality of assets and developers before a sale takes place.

their common good. \textit{Id.} The term, cooperate, refers to the later instance—parties working together to achieve a mutually beneficial goal. \textit{Id.}

\textsuperscript{270} Finhub Framework, \textit{supra} note 252.

\textsuperscript{271} Guseva, \textit{supra} note 12, at 653.

\textsuperscript{272} \textit{Id.} at 660 (citing Munchee Inc., Securities Act of 1933 Release No. 10445, 2017 WL 10605969, at *2 (Dec. 11, 2017)).

\textsuperscript{273} \textit{Id.} at 660–61.

\textsuperscript{274} \textit{Id.} at 664.

\textsuperscript{275} \textit{Id.} at 666.
thereby militating against purchase confusion, future lawsuits, and SEC enforcement.\textsuperscript{276} The SEC affords market participants this \textit{ex ante} opportunity via no-action letter requests.\textsuperscript{277}

No-action letters serve an important preventative role in the SEC’s regulatory framework. In short, no-action letters are a promise from SEC staff to “recommend \textit{no action} to the Commission” against the requester if she follows the guidance detailed in that letter.\textsuperscript{278} No-action letters are an important \textit{ex ante} mechanism of “cooperation” that furthers the SEC’s goals.\textsuperscript{279} \textit{Ex ante} disclosure mechanics best serve securities law’s underlying philosophy: “[s]unlight is said to be the best of disinfectants: electric light the most efficient policeman.”\textsuperscript{280}

An SEC response to NFT usage proliferation has been long anticipated. Some are more optimistic than others about how such regulation will impact the market.\textsuperscript{281} One particularly NFT-enthusiastic legal thinker is Brian L. Frye, who has sent not one, or two, but three separate no-action letter requests to the SEC Commissioners, in which he, 

\begin{flushleft}
\textsuperscript{276} Id. at 666–67.
\textsuperscript{277} Id. at 664.
\textsuperscript{278} COX, supra note 21, at 14–15.
\textsuperscript{279} Guseva, supra note 12, at 664.
\textsuperscript{280} COX, supra note 21, at 6 (quoting L.D. BRANDEIS, OTHER PEOPLE’S MONEY 92 (1914)).
\end{flushleft}
inter alia, humorously proposes to sell “50 editions of the work of conceptual art ‘SEC No-Action Letter Request 3: Securitized NFTs.'”

From the end of 2021 and well into 2022, SEC guidance seemed inevitable. However, the SEC has remained unresponsive to the putative cooperation extended by market participants thus far.

d. Howey applied to F-NFTs

The SEC has begun investigating F-NFTs in particular. While certain use cases fall outside SEC jurisdiction, Jeremy Boldman, co-chair of the Blockchain Technology Group at Frankfurt Kurnit Klein & Selz, states that “[t]he SEC could take the position that these [tens of thousands of NFTs offered up by issuers] . . . are just another way to raise money for a project or venture where people are making an investment.” There are arguments for and against SEC jurisdiction over F-NFTs, but it is clear that more explicit guidance is needed.

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284 Insider Trading Claims Arise, supra note 88.

The law is settled that “the analysis of whether something is a security is not static and does not strictly inhere to the instrument. Even digital assets with utility that function solely as a means of exchange in a decentralized network could be packaged and sold as an investment strategy that can be a security.”²⁸⁶ The item being offered matters less in this analysis than how it is being presented or received.²⁸⁷ In sum, substance matters over form.²⁸⁸

SEC Director Hinman stressed that, “strictly speaking, the token – or coin or whatever the digital information packet is called – all by itself is not a security . . .,” because “[c]entral to determining whether a security is being sold is how it is being sold and the reasonable expectations of purchasers.”²⁸⁹ The SEC and courts have identified many securities that are fractionalized interests of non-security assets, such as fractional tenancy in common interests, fractional oil and case interests, and fractional ownership interests in oil wells.²⁹⁰

F-NFTs are probably securities), with Thomas Mack & Richard Widmann, Enabling Nonsecurity Fractional Ownership of NFTs, Law360 (May 4, 2021, 4:36 PM), https://www.law360.com/articles/1381061/enabling-nonsecurity-fractional-ownership-of-nfts (concluding many F-NFTs are probably not securities and detailing ways market participants can structure deals to avoid securities implications).

²⁸⁶ Hinman’s Speech, supra note 30.
²⁸⁷ HAZEN, supra note 40, at 41.
²⁸⁹ Hinman’s Speech, supra note 30.
As discussed in Section II.A.2., Howey held that an investment contract is (1) an investment of money; (2) in a common enterprise; (3) with a reasonable expectation of profit; (4) to be derived from the entrepreneurial or managerial efforts of others. This Section details what the SEC has said about F-NFTs so far, and puts F-NFTs through the familiar Howey test to determine whether they qualify as investment contracts.

1. Investment of Money

This first element, investment of money, includes more than just fiat currency. The inquiry hinges on whether value is offered. SEC v. Shavers showed that cryptocurrencies easily satisfy the “money” portion of the Howey analysis because those parties treated Bitcoin as a cash-equivalent. Purchasers usually offer Ether or Bitcoin in exchange for their NFTs, so this element is satisfied easily.

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292 See COX, supra note 21, at 33.
294 Id. at 14.
2. In a Common Enterprise

Next, *Howey* looks to see whether there is a common enterprise. There are two generally recognized forms: horizontal commonality and vertical commonality. 

Horizontal commonality exists when each investor’s success is “pooled” with other investors’ success. It usually involves multiple investors with a variable rate of return. However, horizontal commonality can exist with a fixed rate of return. It may even exist in an arrangement with only one investor, provided the offering contemplated multiple investors.

While circuits are divided on the proper description, vertical commonality may be assessed according to either of two standards: broad vertical commonality or strict vertical commonality. Broad vertical

295 *W.J. Howey Co.*, 328 U.S. at 301.
296 Hazen, *supra* note 42, at 503.
298 *Cox*, *supra* note 21, at 42.
299 *Id*.
300 SEC v. Infinity Group Co., 212 F.3d 180, 189 (3rd Cir. 2000).
301 SEC v. Lauer, 52 F.3d 667, 670 (7th Cir. 1995).
commonality, adopted by the Fifth and Eleventh Circuits, is present when the investment success is linked to the promoter’s efforts.\textsuperscript{302} Strict vertical commonality, a more narrow approach adopted by some circuits, requires that the investment success be linked to the promoter’s fortunes.\textsuperscript{303} More plainly, this requires, but is not fully satisfied by,\textsuperscript{304} some risk-sharing component between investor and promoter.\textsuperscript{305} The FinHub Framework provided a very limited discussion of this element, saying that “investments in digital assets have constituted investments in a common enterprise because the fortunes of digital asset purchasers have been linked to each other or to the success of the promoter’s efforts.”\textsuperscript{306}

F-NFTs are susceptible to satisfying this element. F-NFTs almost always represent partial ownership of a larger underlying NFT, thereby satisfying horizontal commonality.\textsuperscript{307} For example, F-NFTs include fractionalized ownership of blockchain-based videogame items, Metaverse “virtual land” or assets, and real property “minted” as an

\textsuperscript{302} COX, supra note 21, at 42.

\textsuperscript{303} Id.


\textsuperscript{305} COX, supra note 21 at 42 (citing Marini v. Adamo, 995 F.Supp. 2d 155, 186 (E.D.N.Y. 2014), aff’d on other grounds, 2016 U.S. App. LEXIS 5611 (2d Cir. Mar. 23, 2016)).


\textsuperscript{307} Colesanti, supra note 12, at 16; see supra Section II.B.2.c.
NFT. Some minters of particularly inflated NFT collections might opt to fractionalize to raise additional revenue and increase the owner pool. Therefore, this element will likely be satisfied.

3. With a Reasonable Expectation of Profit

The expectation of profit requirement from *Howey* requires a showing that investors had a “substantial profit motive,” even if it is only one motive among many for purchasing the asset in question. Several more nuanced questions help answer the above question, and each will be addressed in turn: “[h]ow do marketing and promotional materials characterize the asset?,” “[h]as the issuer made efforts to increase demand or value?,” “[i]s there a secondary market for the asset?,” and “[w]ho is the target buyer?”

First, how do marketing and promotional materials characterize the asset? The more an offeror characterizes an F-NFT as an “investment opportunity,” the more likely it is that it satisfies this element. For

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308 Takyar, *supra* note 139.
310 Hazen, *supra* note 42, at 504.
311 King & Spalding articulated these excellent additional questions when evaluating this *Howey* element. See KING & SPALDING, *supra* note 87.
312 *Id.*
313 *Id.*
instance, F-NFT listings that mention how much that F-NFT might appreciate in value or how much the issuer will promote future sales likely indicate a substantial profit motive. Similarly, fractionalization indicates that the offerors may be driven by a substantial profit motive. One need not look far to identify “fractionalization how-to” guides for offerors that cite “[making] NFTs more appealing to investors”\footnote{Takey, supra note 139.} and “[making] purchase[s] on secondary markets by a greater number of investors [easier]”\footnote{INCA, supra note 309.} as key reasons to fractionalize. However, it is possible that F-NFTs could be securities in the initial offerings but cease to be securities if their primary uses shift after the fact.\footnote{Compare Hazen, supra note 43, at 510, with Sarel, supra note 53 at 410-11 n. 111 (citing Michael J. O’Connor, Overreaching its Mandate: Considering the SEC’s Authority to Regulate Cryptocurrency Exchanges, 11 DREXEL L. REV. 539, 566 (2018)) (arguing some token offerings qualifying as securities at launch might lose that status once said tokens are subsequently traded on exchanges).}

Second, has the issuer made efforts to increase demand or value? Issuers advertising promotional efforts and actually making such efforts are separate questions. The more an issuer has actually made such efforts, the more likely that there is a reasonable expectation of profit with regard to the F-NFT. Such efforts may include attempts to bolster the “ecosystem” in which the tokens operate or are used.\footnote{KING & SPALDING, supra note 87.} For example, in
the now-infamous “Munchee” arrangement, the issuer developed a limited number of tokens that could be used for restaurant purchases and advertising. Munchee proceeded to advertise aggressively about the inherent scarcity and value in purchasing up these tokens, touting their investment utility. The SEC issued a cease-and-desist order, citing such activity as grounds for purchasers to “reasonably believe they could profit by holding or trading MUN tokens, whether or not they ever . . . participated in the MUN ‘ecosystem.’”

Third, is there a secondary market for the asset? The existence of a secondary markets for purchasers increases the instrument’s liquidity and the investor is more likely to have a reasonable expectation of profit. Thus, as the number of NFT exchanges continues to increase, it becomes more likely that the investors have a reasonable expectation of profit.

Fourth, who is the target buyer? A useful “rule of thumb” distinguishes between end-users in the virtual environment in which the NFT may operate and purchasers who have no involvement in whatever

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318 COX, supra note 21, at 49.
319 Id.
320 Id. (quoting Securities Act Release No. 10445 (Dec. 11, 2017)).
321 KING & SPALDING, supra note 87. Secondary markets, such as OpenSea, reduce “search and information costs” for would-be purchasers—see generally Sarel, supra note 53, at 424 n. 196.
322 See discussion Infra Section IV.
environment the NFT operates. For example, some video games operate on the blockchain and issue a limited number of NFTs that function as “characters” or items in-game.323 Those NFTs can vary in value based on the rarity or desire for the represented item.324 So, a gamer purchasing an NFT in a video game for in-game purposes may not be purchasing a security, since the gamer’s purpose is primarily utilitarian. Conversely, an investor purchasing that same NFT via a game-external marketplace like OpenSea may be doing so for possible investment gains, which suggest that NFT may be a security.

4. To Be Derived from the Entrepreneurial or Managerial Efforts of Others

This element hinges on whether “the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.”325 Howey originally required profits be expected “solely from the efforts of the promoter,”326 but subsequent case law clarified that the real inquiry is whether the profits are derived “primarily” or “substantially” from the

323 Ryan Browne, Cash grab or innovation? The video game world is divided over NFTs, CNBC (Dec. 20, 2021), https://www.cnbc.com/2021/12/20/cash-grab-or-innovation-the-video-game-world-is-divided-over-nfts.html.
325 SEC v. Glenn W. Turner Enters., 474 F.2d 476, 482 (9th Cir. 1973).
efforts of others. The court in SEC v. Arcturus Corp. articulated three factors for evaluating this Howey element: (1) the extent to which the investors have the power to control the venture, (2) the extent to which investors are inexperienced and lack expertise in the type of business involved, and (3) ‘whether the investors are so “dependent on some unique entrepreneurial of [sic] managerial ability of [the Managers] that [they] cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.’

This is a more challenging question than the prior three in the F-NFT context. Per Arcturus Corp.’s first question, there are many cases in which the NFT issuer has no control over the venture after minting the NFTs. For example, a fractionalized NFT of a painting may have “gas fees,” royalty distributions, and conditions for a “buyout” clause all drafted into the “smart contract” governing the NFT as a whole. In the case of a smart contract, the fractionalized Mona Lisa would operate as it was minted without any further involvement by the minter. NFTs may

327 HAZEN, supra note 40, at 44.
328 Id. at 45-46 (quoting SEC v. Arcturus Corp., 912 F.3d 786 (5th Cir. 2019) (quoting Williamson v. Tucker, 645 F.2d 404 (5th Cir. 1981))).
329 Mack & Widmann, supra note 285.
330 Id.
also have royalty payments built into their smart contracts, which pay out to the issuer or prior owner every time the NFT changes hands.\footnote{James Kelly, \textit{NFT Royalties Explained: What Are They and How Do They Work?}, NFT GATORS (Dec. 26, 2021), https://www.nftgators.com/nft-royalties-explained/}\

Compare the NFT painting to a fractionalized NFT tied to an interest in receiving profits from rental properties.\footnote{\textit{King} & \textit{Spalding}, supra note 87.} There, the arrangement would undoubtedly require continued involvement by a managing party, and the F-NFT begins to look much more like that familiar grove of orange trees in\textit{ Howey}. F-NFTs begin to look less like securities when an F-NFT involves a smart contract governing its future activities, transferability over a ledger that operates independent of the promoter, and the ability of owners to consolidate their ownership via things like buyout clauses drafted into the smart contract.\footnote{Mack, supra note 285.}

LLC interests as securities undergo a similar analysis as discussed herein. LLCs can be structured as either member-managed or manager-managed, and that determination often decides whether any membership interest sold qualifies as a security.\footnote{\textit{Hazen}, supra note 40, at 55.} That governance distinction ordinarily signals a difference in the centralization of the LLC’s management.\footnote{\textit{Id.}} On one hand, a membership interest in a member-
managed LLC likely is not a security. This is because each member necessarily has some form of control over the LLC’s activities, thereby failing this “managerial efforts of others” Howey element. On the other hand, a manager-managed LLC may significantly distance each member from the LLC’s management, thereby turning an otherwise non-security LLC interest into a security.\(^\text{336}\)

If developers are diligent about their smart contracts, it may eliminate “reliance upon promoters” and remove F-NFTs from the SEC’s purview.\(^\text{337}\) This is ideal for start-ups and small business clients who may not have the resources to register with the SEC.

IV. PROPOSAL

The SEC has delayed concrete declarations of NFTs classification as securities so far. But the SEC is ideally positioned to issue clearer guidance for NFT exchanges, with new NFT exchanges ever in the works—undue delay will cause considerable expense to exchanges building out frameworks and budgets.\(^\text{338}\) OpenSea takes the lion’s share of

\(^{336}\) Id. at 55 n. 411, citing SEC v. Friendly Power Co., 49 F. Supp. 2d 1363 (S.D. Fla. 1999) (where LLC interests were securities, since they functioned more like a corporate stock and insured no LLC control to their owners).

\(^{337}\) Mack, supra note 285

NFT trading, but new exchanges are regularly announced. The recent NYSE trademark registration for an NFT marketplace of its own lends an air of legitimacy to NFT marketplaces in general, but other upcoming marketplaces may counteract any good feelings. Coinbase, one of the leading cryptocurrency marketplaces, announced a forthcoming standalone NFT exchange arriving in 2022. A limited-access version of the exchange became available for a small number of users on April 20, 2022, with more waitlisted users to be added in the weeks following. Coinbase’s CEO, Brian Armstrong, expressed confidence that “[NFTs] are going to be much larger than just digital artwork or something . . . there’s citizenship and governance and . . . various novel fundraising mechanisms. So this segment is going to be really big.”


SEC Chairman Gay Gensler addressed exchanges like Coinbase and Blockfi, saying that “[i]t’s a question of whether they’re registered or they’re operating outside of the law...” Mr. Gensler implored these marketplaces to voluntarily register with the SEC, pointing to the widely publicized $100 million Blockfi settlement.

There, Blockfi was charged with failing to register security offerings in violation of the Investment Company Act of 1940. Blockfi operated a crypto-based lending company, where individuals could lend crypto assets to Blockfi for a high interest rate. However, that enterprise was cut short when the SEC instigated a lawsuit against the company, alleging that Blockfi sold unregistered securities under both an investment contract analysis and a notes analysis. Without conceding liability, Blockfi agreed to pay $50 million in fees to the SEC, another $50 million to settle related investigations by 32 different state attorney generals, and

345 Id.
347 Id.
348 Id.
promised to avoid selling unregistered securities in the future.\textsuperscript{349} Coinbase planned to offer a service comparable to Blockfi’s lending program, but subsequently cancelled that plan once the SEC threatened Coinbase with a punishment similar to Blockfi’s.\textsuperscript{350} The Blockfi settlement should serve as a cautionary tale to institutions that, absent more concrete SEC guidance, flippantly disregard securities concerns.

Despite repeated pleas from attorneys and businesses alike,\textsuperscript{351} SEC Commissioner Hester Peirce does not expect the commission to provide clearer guidance.\textsuperscript{352} In the interim, she suggested that a traditional \textit{Howey} analysis is the proper guide for crypto sellers to avoid suffering a fate similar to Blockfi.\textsuperscript{353} However, others have observed that overly-broad regulatory schemes involving crypto result not in protection for consumers but in out-sourcing offerings to other countries instead.\textsuperscript{354} Particularly enthusiastic crypto/NFT purchasers might just use VPNs to buy from unsecure overseas marketplaces instead of regulated US markets,

\textsuperscript{349} \textit{Id.}
\textsuperscript{350} \textit{Id.}
\textsuperscript{352} Werschkul, \textit{supra} note 344.
\textsuperscript{353} \textit{Id.}
thereby foiling the SEC’s goal of protecting consumers via the *ex-post* enforcement discussed in Section III.C.1.  

One guide for business executives provides useful advice for community engagement, digital wallet infrastructure, and Web3 integration. However, in its section on legal positions, it says only that “[r]egulatory guidance is still sparse in this field. Major organizations have taken a variety of different internal stances and positions on their appetite for participation and their tolerance for ambiguity. My (non-legal) advice, is to convey the commercial opportunity to your lawyers ASAP and put them to work in developing your organization’s position.” For the attorneys, the question is clear: what ought the company’s position be?  

Attorneys representing NFT or NFT-adjacent clients, such as issuers, exchanges, artists, investors, etc., ought to be particularly diligent about recommending SEC registration to their clients. As observed, most SEC proceedings involving digital-asset securities relate to registration violations. If there is any question regarding why potential customers will purchase or the goal of any particularly NFT collection sale, clients

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357 Id.  
358 Guseva, *supra* note 12, at 647.
would be well-advised to err on the side of caution and register. However, registration implicates additional issues, such as the challenges associated with valuing some of the most volatile commodities in recent years. Market abuses like the wash trading and rug pulling discussed above only exacerbates NFT volatility.

Alternatively, developing smart contracts correctly may eliminate “reliance upon promoters” sufficiently and remove F-NFTs from the SEC’s purview, as discussed above in Section III.D.4. Resolution in the Dapper Labs case may provide sufficient guidance for issuers in the coming months, depending on how thoroughly the court discusses each Howey element. If the NFT market responds comparably to the crypto market’s response, then SEC enforcement against a few first movers such as Dapper Labs should be sufficient to spur offerors and exchanges alike to preemptive “cooperation.”

In summary, trying to sneak NFT projects past the SEC is asking for trouble. NFT exchanges or offerors with any F-NFTs should register

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359 17 CFR § 270.2a-5.
361 Id.
363 Dapper Labs Complaint, *supra* note 187.
with the SEC. Attorneys working at the cutting edge of FinTech should specialize in compliance with securities regulation, not avoidance.\footnote{365 John Reed Stark, \textit{Where Are the (Crypto) Lawyers?}, LINKEDIN (Nov. 10, 2021), https://www.linkedin.com/pulse/where-crypto-lawyers-john-reed-stark/} Lastly, attorneys should keep an ear to the ground for any resolution in the Dapper Labs case, the numerous no-action letter requests, or published results from the SEC’s investigations.

\textbf{V. CONCLUSION}

The NFT market moves quickly. Sections of this Article were written and re-written dozens of times over a span of a few weeks as new market information came to light. Lawsuits were filed, massive amounts of money changed hands, market crashes impended,\footnote{366 \textit{See generally} Ruholamin Haqshanas, \textit{Sales of Blue-NFTs Plunge Amid Crypto Market Crash}, CRYPTO\textsc{NEWS} (May 11, 2022), https://cryptonews.com/news/sales-of-blue-chip-nfts-plunge-amid-crypto-market-crash.htm; Paul Vigna, \textit{NFT Sales Are Flatlining}, THE WALL STREET JOURNAL (May 3, 2022), https://www.wsj.com/articles/nft-sales-are-flatlining-11651552616.} and offerors made a fortune artificially inflating the price of offerings.\footnote{367 \textit{See supra} Section III.A.}

“[I]t is important that we start providing clear and timely answers,” says SEC Commissioners Peirce and Roisman.\footnote{368 Roslyn Layton, \textit{The SEC’s Fair Notice Farce, Starring William Hinman}, FORBES (July 19, 2021), https://www.forbes.com/sites/roslynlayton/2021/07/19/the-secs-fair-notice-farce-starring-william-hinman/?sh=7e93da7d2f4f.} The Commissioners also recognized that the persistent ambiguity in the crypto and NFT markets causes significant hardships for issuers. Providing guidance via punishing
noncompliance after the fact greatly inhibits early movers, which is particularly harmful in a market as fast moving as NFTs.\textsuperscript{369} The Commissioners recognize that laying down clear rules \textit{ex ante} is better for the market than the “clue-by-enforcement approach that [the SEC] ha[s] embraced to date.”\textsuperscript{370} The \textit{Howey} test’s lack of "crystal [clarity]"\textsuperscript{371} reduces the usefulness of both it and its progeny in resolving NFT securities concerns.

While NFT market participants await additional guidance, this Article provides an overview of the technology, the applicable law, the abuses that showcase the need for more thorough SEC guidance, and how the \textit{Howey} test ought to be applied to F-NFTs. Despite the likelihood that regulatory uncertainty will continue to dominate crypto markets,\textsuperscript{372} this Article attempts to clear the muddy regulatory waters.

\textsuperscript{369} \textit{Id.}
\textsuperscript{370} \textit{Id.}
\textsuperscript{371} \textit{Id.}
\textsuperscript{372} Bull, \textit{supra} note 12, at 34.