The Original Public Meaning of Investment Contract

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The SEC has failed to provide the public with any guidance on its treatment of artwork NFTs under securities law. Instead, in nonprecedential enforcement actions against two NFT projects in 2023, the SEC classified the NFTs, which involved digital artworks, as unregistered "crypto asset securities" — a term nowhere in the text of the Securities Act of 1933. But this Article explains why the SEC's overbroad treatment of artwork NFTs raises a serious First Amendment problem. For the SEC to require creators to register their artwork NFTs as securities before *they can be offered to the public constitutes an unlawful prior restraint. Courts should reject the SEC's approach and adhere to the original public meaning of "investment contract" in the Securities Act. Providing original historical research of newspapers and dictionaries before and contemporaneous with the enactment of the Securities Act in 1933, this Article shows that people used "investment contract" as early as the 1800s to refer to an investment in a contract.*

Under its original public meaning, an investment contract requires a certain type of quid pro quo: a person's investment of money, the quid, *in exchange for a* contractual *right of the investor to receive a share in profits generated solely by the offeror's efforts, the* quo. *Absent this quid pro quo, there is no investment contract. In 1920, the Minnesota Supreme Court recognized this original public meaning — "as commonly used and understood" — in* State v. Gopher Tire. *In 1933, Congress adopted the "ordinary concept of security." Then, in*

[*] Copyright © 2024 Edward Lee. Professor of Law. Santa Clara Law starting in August 2024. This Article does not constitute legal advice. Many thanks to Dave Gillespie, Steve Heyman, Hal Krent, Sheldon Nahmod, and Adrian Walters for their insightful comments. Disclosure: I own NFTs, a list of which can be found at *Disclosures*, NOU NFT, https://nounft.com/disclosures/. I do not own any NFTs involved in the two enforcement actions brought by the SEC discussed in this Article.

1946, in SEC v. W.J. Howey Co., *the U.S. Supreme Court expressly adopted the same original public meaning as* Gopher Tire *and Congress did. Indeed,* every *state and federal decision interpreting "investment contract" that* Howey *cited and* every *Supreme Court case applying* Howey *afterwards involved this quid pro quo. The federal courts have correctly rejected attempts to classify art sales as investment contracts. The reason is straightforward: even though the purchase of art is an investment, it is not an investment* contract. *The buyer of art receives no* quo, *or contractual right to receive a share in the profit generated solely by the offeror's efforts. Instead, the buyer receives art. The same holds true with the sale of artwork NFTs: the buyer receives artwork NFTs, not any contractual right to profits from the offeror.*

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[*P*]*rior restraints on speech and publication are the most serious and the least tolerable infringement on First Amendment rights*.
- Nebraska Press Association v. Stuart[1]

Without freedom, no art;
art lives only on the restraints it imposes on itself and dies of all others.
- Albert Camus

[1] 427 U.S. 539, 559 (1976).

INTRODUCTION

During the boom in the emerging market for non-fungible tokens ("NFTs"), when sales volume hit $27 billion in 2021,[2] nearly matching the total sales of books in the United States,[3] the Securities and Exchange Commission ("SEC") issued no public guidance on whether NFTs are securities that must be registered before their public sale.[4] NFTs create a new type of property in and embodiment of digital artworks and other creative expression, and offer digital artists a nascent market for their artworks.[5] The SEC's silence left people in the dark. Numerous artists and creators faced great uncertainty over how the SEC would treat the new technology of NFTs. Top law firms were understandably equivocal in their analysis,[6] unsure whether NFTs would be classified as securities, but suggested that "many NFTs

[2] *See* David Hollerith, *NFTs Explode into $27B Phenomenon as Investors With 'Bigger Bags' Put Them to Work*, YAHOO! FINANCE (Dec. 7, 2021), https://money.yahoo.com/nft-market-explodes-into-27-b-phenomenon-as-investors-with-bigger-bags-put-them-to-work-133112238.html [https://perma.cc/7KF3-637R].

[3] *See* Porter Anderson, *US Book Publishing Revenues in 2022 Were $28 Billion: AAP StatShot*, PUBLISHING PERSPECTIVES (May 31, 2023), https://publishingperspectives.com/2023/05/the-annual-us-statshot-total-2022-revenues-were-28-10-billion/ [https://perma.cc/VE46-5JN6].

[4] In 2019, the Strategic Hub for Innovation and Financial Technology of the SEC published a nonbinding "Framework for 'Investment Contract' Analysis of Digital Assets." *See Framework for "Investment Contract" Analysis of Digital Assets*, SEC, https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets#_edn2 (last updated July 5, 2024) [https://perma.cc/2CDR-GVWS]. The article, written before the explosion of NFTs, focused on initial coin offerings and did not analyze or even mention NFTs.

[5] *See infra* notes 61–78 and accompanying text.

[6] In 2021, during the height of the NFT boom, lawyers from Latham & Watkins concluded:

> As noted by the SEC staff in its 2019 Framework, "Price appreciation resulting solely from external market forces (such as general inflationary trends or the economy) impacting the supply and demand for an underlying asset generally is not considered 'profit' under the Howey test." In other words, an NFT is not a security simply because it can increase in value.

Deric Behar, Miles Jennings, Shaun Musuka & Stephen Wink, *NFTs: But is it Art (or a Security)?*, JDSUPRA (Mar. 15, 2021), https://www.jdsupra.com/legalnews/nfts-but-is-it-art-or-a-security-1053589/ [https://perma.cc/5L84-7X7D].

available on the market today appear unlikely to be considered 'securities' under the federal securities laws."[7] Without any guidance from the SEC, most artists did not register their NFTs as securities.[8]

The SEC's silence suddenly ended in 2023. In the span of just two weeks, the SEC announced the settlements of enforcement actions against two NFT projects for allegedly selling a collection of NFTs as unregistered securities to the public.[9] In both orders, the SEC concluded that the NFTs operated as "investment contracts" and were therefore securities[10] under *Howey*,[11] which sets forth the Supreme Court's

[7] An P. Doan, Mark W. Rasmussen, Courtney Lyons Snyder & D. Grayson Yeargain, *NFTs: Key U.S. Legal Considerations for an Emerging Asset Class*, JONES DAY (Apr. 2021), https://www.jonesday.com/en/insights/2021/04/nfts-key-us-legal-considerations-for-an-emerging-asset-class [https://perma.cc/YBJ9-CW2E]; *see* Kimberly A. Houser & John T. Holden, *Navigating the Non-Fungible Token*, UTAH L. REV. 891, 891 (2022) ("The lack of governmental expertise in emerging technologies accompanied by the shortage of regulatory guidance has created a frustrating environment for innovators.").

[8] One notable exception is Republic's securities registration of NFTs representing interests to receive royalties in songs. *See* Will Gottsegen, *Securities Meet NFTs with Investment Platform Republic's New Music Vertical*, COINDESK (May 11, 2023, 12:08 PM), https://www.coindesk.com/business/2021/10/06/securities-meet-nfts-with-investment-platform-republics-new-music-vertical/ [https://perma.cc/S5BP-N67N]. However, this type of arrangement — sharing in royalties from music streaming — was not typical for visual artwork NFTs, which do not involve public performances. *See generally* EDWARD LEE, CREATORS TAKE CONTROL 240 (1st ed. 2023) ("Opulous is an exception. Most NFTs aren't registered as securities.").

[9] *See* Press Release, SEC, SEC Charges Creator of Stoner Cats Web Series for Unregistered Offering of NFTs (Sept. 13, 2023), https://www.sec.gov/news/press-release/2023-178 [https://perma.cc/3V7Z-KE4J] [hereinafter SEC Charges Stoner Cats]; Press Release, SEC, SEC Charges LA-Based Media and Entertainment Co. Impact Theory for Unregistered Offering of NFTs (Aug. 28, 2023), https://www.sec.gov/news/press-release/2023-163 [https://perma.cc/CX7H-NGME] [hereinafter SEC Charges Impact Theory].

[10] *See* Impact Theory, LLC, Securities Act Release No. 11226, ¶ 1 (Aug. 28, 2023), https://www.sec.gov/files/litigation/admin/2023/33-11226.pdf [https://perma.cc/C3S2-T4FX] [hereinafter Impact Theory Order]; Stoner Cats 2, LLC, Securities Act Release No. 11233, ¶ 1 (Sept. 13, 2023), https://www.sec.gov/files/litigation/admin/2023/33-11233.pdf [https://perma.cc/XZ6F-P5AE] [hereinafter Stoner Cats Order].

[11] SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946) (stating "an investment contract[,] for purposes of the Securities Act[,] means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party").

interpretation of the term in the Securities Act of 1933.[12] The orders described the NFTs as "crypto asset securities," a new term found nowhere in the Act but one that the SEC has also broadly applied to cryptocurrencies.[13] (In an unrelated case, Judge William Orrick

[12] 15 U.S.C. § 77b(a)(1).

[13] *See Crypto Assets*, SEC, https://www.sec.gov/spotlight/cybersecurity-enforcement-actions (last visited Sept. 3, 2024) [https://perma.cc/9NKU-XKJG] (summarizing SEC actions involving "crypto asset securities"). It goes beyond the scope of this Article to analyze whether the sale of cryptocurrencies or meme coins constitute investment contracts. Nonetheless, the legal analysis of those cryptocurrencies or tokens should follow the original public meaning of investment contract because the rule for investment contract under the Securities Act is the same. For more on the dispute over cryptocurrency's treatment, see SEC v. Coinbase, Inc., 23 Civ. 4738 (KPF), 2024 WL 1304037, at *20 (S.D.N.Y. Mar. 27, 2024) ("[T]he SEC has adequately alleged that purchasers of certain crypto-assets on the Coinbase Platform and through Prime invested in a common enterprise and were led to expect profits solely from the efforts of others, thereby satisfying the *Howey* test for an investment contract."); Complaint, LEJILEX v. SEC, No. 4:24-cv-00168-O (N.D. Tex. Feb. 21, 2024) https://storage.courtlistener.com/recap/gov.uscourts.txnd.386710/gov.uscourts.txnd.386710.1.0.pdf [https://perma.cc/7LJW-3HCA]; SEC v. Ripple Labs, Inc., 682 F. Supp. 3d 308, 328 (S.D.N.Y. 2023) ("[H]aving considered the economic reality and totality of circumstances surrounding the Institutional Sales, the Court concludes that Ripple's Institutional Sales of XRP constituted the unregistered offer and sale of investment contracts in violation of Section 5 of the Securities Act."); SEC v. Terraform Labs Pte. Ltd., 684 F. Supp. 3d 170, 196-97 (S.D.N.Y. 2023) (finding sufficient allegations of investment contract based on "the defendants allegedly coaxed investors to continue purchasing LUNA coins . . . by pointing out the possibility of future investment returns"); Matthew Bultman, *Crypto Firms Take SEC Fight to Texas, With Eye on Supreme Court*, BLOOMBERG LAW (Apr. 5, 2024, 2:00 AM), https://news.bloomberglaw.com/securities-law/crypto-firms-take-sec-fight-to-texas-with-eye-on-supreme-court [https://perma.cc/45A9-ACYR]; *Consensys Sues the SEC in Defense of the Ethereum Ecosystem*, CONSENSYS (Apr. 25, 2024), https://consensys.io/blog/pr-consensys-sues-the-sec-in-defense-of-the-ethereum-ecosystem [https://perma.cc/2H6X-VAQA]; Nikhilesh De, *Crypto Exchange Kraken Files to Dismiss SEC Lawsuit Against It*, COINDESK, https://www.coindesk.com/policy/2024/02/23/crypto-exchange-kraken-files-to-dismiss-sec-lawsuit-against-it/ (last updated Mar. 8, 2024, 2:02 PM) [https://perma.cc/CF93-2K34]; Alexander Osipovich, *SEC Warns DeFi Firm Uniswap Labs of Potential Lawsuit*, WALL ST. J. https://www.wsj.com/livecoverage/cpi-report-today-inflation-stock-market-04-10-2024/card/sec-warns-defi-firm-uniswap-labs-of-potential-lawsuit-WBbtKQFAkh12I28Ds4fm (last updated Apr. 10, 2024, 8:08 PM); Emma Roth, *Robinhood's Crypto Arm Receives SEC Warning Over Alleged Securities Violations*, THE VERGE (May 6, 2024, 7:10 AM), https://www.theverge.com/2024/5/6/24150045/robinhood-cryptocurrency-wells-notice-warning-sec [https://perma.cc/B6SV-KK7L].

It is noteworthy that Chair Rostin Behnam of the U.S. Commodity Futures Trading Commission ("CFTC") said that most cryptocurrencies are commodities, instead of

chastised the SEC for repeatedly using the term "crypto asset securities," which was "unclear at best and confusing at worst" because it obscured the issue of investment contract.[14]) The SEC's orders failed to explain "crypto asset securities," much less analyze each prong of the *Howey* test or provide guidance to the public. Instead, the orders required the two projects to destroy all NFTs they possessed or controlled, notwithstanding their depictions of artworks.[15] At a hearing

securities. *See* Amara Khatri, *CFTC And SEC in "Turf War" Over Crypto Regulation*, CRYPTODAILY (Dec. 14, 2023), https://cryptodaily.co.uk/2023/12/cftc-and-sec-in-turf-war-over-crypto-regulation [https://perma.cc/7V88-X856]. By contrast, SEC Chair Gensler stated that most cryptocurrencies are securities. *See* David Hollerith, *SEC Chair Gensler Says 'Vast Majority' of Cryptocurrencies Are Securities*, YAHOO! FINANCE (Sept. 8, 2022), https://finance.yahoo.com/news/sec-chair-gensler-majority-cryptocurrencies-securities-124610154.html [https://perma.cc/8C4V-5VTH]. But in July 2024, the SEC appeared to retreat somewhat from its broad stance on cryptocurrencies, dropping investigations of Ether and Paxos, after approving Ether ETFs in May 2024. *See* Daniel Ramirez-Escudero, *SEC Drops Ethereum Investigation to Avoid 'Embarrassing' Court Case*, COINTELEGRAPH (June 20, 2024), https://cointelegraph.com/news/sec-ethereum-investigation-court-consensys [https://perma.cc/6AR7-AXU6]; Leo Schwartz, *SEC Drops Key Stablecoin Investigation in a Win for Crypto Industry*, FORTUNE (July 11, 2024, 1:59 PM), https://fortune.com/crypto/2024/07/11/sec-busd-gary-gensler-paxos-stablecoin-binance/ [https://perma.cc/8D2N-W7JW]; Sarah Wynn & Elizabeth Napolitano, *SEC's Approval of Ethererum ETFs Still Leaves Some Questions on Whether ETH is a Security, Lawyers Say*, THE BLOCK (May 25, 2024, 10:01 AM), https://www.theblock.co/post/296751/secs-approval-of-ethereum-etfs-still-leaves-some-questions-on-whether-eth-is-a-security-lawyers-say [https://perma.cc/3RLJ-P2XR]. In June 2024, David Hirsch, the chief of the crypto asset enforcement division, resigned. *See* Amitoj Singh, *U.S. SEC's Crypto Enforcer David Hirsch Quits*, COINDESK, https://www.coindesk.com/policy/2024/06/17/us-secs-crypto-enforcer-david-hirsch-quits/ (last updated June 17, 2024, 7:31 PM) [https://perma.cc/3QAN-3M94]. The SEC's position on cryptocurrencies remains unclear.

[14] Order Denying Motion to Dismiss and Setting Case Management Conference at 19, SEC v. Payward, Inc., No. 3:23-cv-06003-WHO (N.D. Cal. Aug. 23, 2024), https://storage.courtlistener.com/recap/gov.uscourts.cand.421113/gov.uscourts.cand.421113.90.0.pdf [https://perma.cc/N9NN-N786]. In a different case, the SEC apologized for its confusing use of the term "crypto asset securities." Plaintiff Securities and Exchange Commission's Memorandum of Law in Support of Motion for Leave to Amend the Complaint at 24 n.6, SEC v. Binance Holdings Ltd., No. 1-23-cv-01599-ABJ-ZMF (D.D.C. Sept. 12, 2024), https://storage.courtlistener.com/recap/gov.uscourts.dcd.256060/gov.uscourts.dcd.256060.273.1.pdf [https://perma.cc/9NC8-K4NN].

[15] *See* Impact Theory Order, *supra* note 10, ¶ 17(A); Stoner Cats Order, *supra* note 10, ¶ 26(a).

in 2024 before the House Financial Services Committee, Representative Ritchie Torres questioned SEC Commissioner Caroline Crenshaw about the SEC's position: "Does requiring artists and musicians to register art and music with the Securities and Exchange Commission raise a First Amendment concern?"[16] Her reply: "I am not a First Amendment expert."[17] She gave the same response in reply to the follow-up question, "Does the destruction of artistic expression by government fiat raise a First Amendment concern?"[18]

As this Article explains, the SEC's position[19] on NFTs is overbroad and completely unmoored from the statutory text of "investment contract" in the Securities Act of 1933 and its contemporaneous public meaning.[20] The SEC did not identify any financial instruments that putatively served as the "investment contracts" offered by the two NFT projects, much less a *contractual* right of investors to receive income or profits generated solely from the NFT projects' efforts. Nor did the SEC discuss whether its two orders, penalizing the projects for publicly disseminating their NFTs without SEC registration and ordering the NFTs' destruction,[21] avoided restricting the artistic expression of the NFT projects protected by the First Amendment. By all indications, the SEC has failed even to recognize a First Amendment issue exists. In 2024, it notified OpenSea, one of the largest NFT marketplaces for digital art, that it may bring an enforcement action against the company for allowing sales of NFTs allegedly as unregistered securities.[22] By

[16] Rep. Ritchie Torres, (@RepRitchie), X (Sept. 26, 2024, 11:30 AM), https://x.com/repritchie/status/1839371957550326041?s=43&t=lIh4Jv10gAiVlRAgr7eO7w.

[17] *Id.*

[18] *Id.*

[19] Because the SEC's settlement orders are nonprecedential, one must avoid giving them too much weight. But, given the lack of any formal guidance from the SEC, the two settlement orders provide the best available indication of the SEC's position on NFTs.

[20] *See* Securities Act of 1933, 15 U.S.C. § 77b(a)(1) (defining "security"); *see also* Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10) (same); Investment Advisers Act of 1940, 15 U.S.C. § 80b–2(a)(18) (same).

[21] *See* Impact Theory Order, *supra* note 10, at pt. IV; Stoner Cats Order, *supra* note 10, at pt. IV.

[22] *See* Aoyon Ashraf, *OpenSea Gets 'Wells Notice' From SEC, Which Calls NFTs Sold on Platform 'Securities*,' COINDESK, https://www.coindesk.com/policy/2024/08/28/opensea-gets-wells-notice-from-sec-calling-nfts-sold-on-platform-securities/ (last updated Aug. 29, 2024, 11:57 AM) [https://perma.cc/47BA-6SWA].

failing to provide public guidance but threatening enforcement actions, the SEC's approach will likely have a chilling effect on NFT artists and businesses.[23] Less than a month after the SEC's notice to OpenSea, two individual buyers of NFTs filed a class action lawsuit against OpenSea for allegedly allowing the sales of NFTs — numbering well in the millions — as unregistered securities.[24] The plaintiffs' complaint alleged that all NFTs on OpenSea are investment contracts and unregistered securities.[25] This sweeping assertion, if accepted, puts all digital artworks sold on OpenSea at risk of prohibition as unregistered securities. Indeed, because the complaint seeks injunctive relief,[26] it is not implausible that the plaintiffs seek the same remedy that the SEC did in its two enforcement actions: the complete destruction of the artwork NFTs.

The overbreadth of the SEC's position on NFTs was apparent in the SEC Chair Gary Gensler's testimony in 2023 before the House Financial Services Committee, in which he made a puzzling distinction: in response to questions from Representative Torres, Chair Gensler said a physical Pokémon card is not a security, but suggested that a tokenized Pokémon card is a security if "the investing public is anticipating profits

[23] *See* Edward Lee, *Why the SEC Is Wrong About NFTs*, COINDESK, https://www.coindesk.com/opinion/2024/09/03/why-the-sec-is-wrong-about-nfts/ (last updated Sept. 3, 2024, 9:24 AM) [https://perma.cc/S7KR-4PQC].

[24] *See* Andre Beganski, *OpenSea NFT Marketplace Hit with Class Action Suit Over Alleged Securities Sales*, DECRYPT (Sept. 20, 2024), https://decrypt.co/250564/opensea-nft-marketplace-class-action-suit-securities [https://perma.cc/PJ7E-T83X]. The gaming company Immutable also announced that it received a Wells notice from the SEC and was under investigation for possible sales of unregistered securities. *See* Immutable, *Defending Digital Ownership in Gaming: Immutable's Response to the SEC's Wells Notice*, IMMUTABLE (Nov. 1, 2024), https://www.immutable.com/blog/defending-digital-ownership-in-gaming.

[25] Class Action Complaint Jury Demand at ¶¶ 93, 110, Shnayderman v. Ozone Networks, Inc. (d/b/a OpenSea), No. 1:24-cv-23616-CMA (S.D. Fla. Sept. 29, 2024), https://storage.courtlistener.com/recap/gov.uscourts.flsd.675396/gov.uscourts.flsd.675396.1.0.pdf [https://perma.cc/RQ43-WG7R].

[26] *Id.* at ¶¶ 132(e), 134, p. 43 (seeking "all such other relief as this Court deems fair and just"). The lawsuit was voluntary dismissed without prejudice after the court allowed OpenSea to seek mandatory arbitration as required under its terms of use. *See* Jesse Coghlan, *OpenSea Users Drop Securities Suit After Marketplace Demands Arbitration*, COINTELEGRAPH (Nov. 11, 2024), https://cointelegraph.com/news/opensea-users-drop-suit-arbitration-demand.

based upon the efforts of others and they're exchanging funds, that's the core of the *Howey* test."[27] That distinction not only defies logic: paper Pokémon collectibles aren't securities, but digital Pokémon collectibles somehow are? It also exposes the sheer breadth of the SEC's approach, which threatens to sweep in artworks and other collectibles within the purview of securities just because money exchanged hands and the investors anticipated profits based on the efforts of others, such as the artists. In an unrelated case the SEC brought against Coinbase for its allowance of sales of thirteen cryptocurrencies (not NFTs), Judge Katherine Polk Failla questioned the SEC's position: "I want to understand how your standard does not sweep in the collectible market or commodities. It is a real fear that I have that your argument is just sweeping too broadly."[28]

In both NFT actions, SEC Commissioners Hester Peirce and Mark Uyeda dissented, disagreeing with the SEC's overbroad classification of the NFTs as unregistered securities.[29] Offering a comprehensive list of important questions for the agency's consideration, they admonished: "The Commission should have grappled with these questions long ago

[27] Kate Irwin, *Is a Tokenized Pokémon Card a Security? SEC Chair Gary Gensler Responds — Kinda*, DECRYPT (Sept. 27, 2023), https://decrypt.co/199009/tokenized-Pokémon-card-security-sec-chair-gary-gensler-responds-kinda [https://perma.cc/W9JJ-VTNV]; *see also* GOPFinancialServices, *Hearing Entitled: Oversight of the Securities and Exchange Commission*, YOUTUBE (Sept. 27, 2023), https://www.youtube.com/live/7tnv9MRh0GM?si=BkwPyvfiB0MH0xsw&t=10315; Leo Schwartz, *So Why Isn't a Pokémon Card a Security?*, YAHOO! FINANCE (Dec. 6, 2023), https://finance.yahoo.com/news/why-isn-t-pokemon-card-143742057.html [https://perma.cc/2ZUG-2YHZ].

[28] Dave Michaels & Vicky Ge Huang, *Judge Questions SEC's Claim to Regulate Coinbase*, WALL ST. J. (Jan. 17, 2024, 5:57 PM), https://www.wsj.com/finance/regulation/judge-questions-secs-claim-to-regulate-coinbase-ae2f240c.

[29] *See* Hester M. Peirce & Mark T. Uyeda, *Collecting Enforcement Actions: Statement on Stoner Cats 2, LLC*, SEC (Sept. 13, 2023), https://www.sec.gov/news/statement/peirce-uyeda-statement-stonercats-091323 [https://perma.cc/77D5-872S] [hereinafter Peirce & Uyeda, *Dissent in Stoner Cats*]; Hester M. Peirce & Mark T. Uyeda, *NFTs & the SEC: Statement on Impact Theory, LLC*, SEC (Aug. 28, 2023), https://www.sec.gov/news/statement/peirce-uyeda-statement-nft-082823 [https://perma.cc/3Z58-HWC2] [hereinafter Peirce & Uyeda, *Statement on Impact Theory*].

and offered guidance [to the public] when NFTs first started proliferating."[30]

This Article undertakes what Commissioners Peirce and Uyeda rebuked the SEC for failing to do: provide a detailed examination of whether the sale of NFTs constitute "investment contracts" under the Securities Act. As explained below, the sales of NFTs do not constitute investment contracts when they embody artworks (as they commonly do). The SEC's analysis is flawed for two fundamental reasons.

First, the SEC ignored the First Amendment problem that arises when the SEC regulates NFTs involving artworks or creative expression protected by the First Amendment. Indeed, both NFT projects subject to the SEC orders involved artistic works: their artworks were embodied in their NFTs, which included pictorial and graphical images (keys depicting various symbols, and numerous cat characters for an animated series, respectively). And both NFT projects had plans to create artistic expression as their business: Impact Theory was developing an online game, and Stoner Cats, an animated web series featuring the cat characters.[31] To require securities registration of artwork NFTs *before* an artist can distribute them to the public raises a serious First Amendment problem — and most likely constitutes an unlawful prior restraint in violation of the artist's freedom of expression. A digital

[30] Peirce & Uyeda, *Statement on Impact Theory*, *supra* note 29. A change in the Chair of the SEC is expected with Donald Trump's election as President in November 2024. Trump is expected to appoint a Chair who is far more receptive to cryptocurrency. Commissioners Uyeda and Peirce have both been mentioned as potential candidates for the Chair. *See* Eleanor Terrett, *SEC Commissioner Backs Trump's Plan to End Crypto Crackdown*, FOX BUSINESS (Nov. 7, 2024, 7:05 PM), https://www.foxbusiness.com/markets/secs-uyeda-backs-trumps-plan-end-crypto-crackdown [https://perma.cc/EL4B-ABUJ]; Helene Braun, COINDESK (Nov. 7, 2024, 10:38 AM), https://www.coindesk.com/policy/2024/11/07/heres-how-quickly-gary-gensler-could-lose-his-sec-chair-gig-under-trump/ [https://perma.cc/UF3G-2GUD]. Even if the SEC changes its position with respect to cryptocurrencies or NFTs and scales back its enforcement actions, the courts must still decide the meaning of "investment contract" in the Securities Act in the NFT cases brought by private parties. *See* sources *supra* note 25 and *infra* note 183 (collecting NFT lawsuits). Given the Republican majority, Congress may also enact more crypto-friendly legislation. *See* Owen Tedford, *The Outlook for Crypto Under Trump and a Republican Congress*, FORBES (Nov. 8, 2024, 9:42 AM), https://www.forbes.com/sites/owentedford/2024/11/08/the-outlook-for-crypto-under-trump-and-a-republican-congress/.

[31] *See infra* notes 169–170 and accompanying text.

Pokémon NFT is just as much protected expression as a physical Pokémon card. Restraining the sale of either until the government approves its publication is a prior restraint.

Second, the SEC's approach to NFTs is overbroad under the original public meaning of the Securities Act of 1933 in regulating "investment contracts."[32] The SEC apparently concluded that NFTs can operate as investment contracts *without* any contractual right of the NFT owners to receive profits generated solely from the efforts of the offeror.[33] That overbroad — and ultimately untenable — view of "investment contract" omits a key element of an "investment contract," a *contract* to secure an investment in the potential profits generated by the offeror.[34] As the Supreme Court explained, at the time of the Securities Act of 1933's passage, "An investment contract thus came to mean *a contract or scheme* for [1] 'the placing of capital or laying out of money in a way intended [2] *to secure income or profit from its employment*.'"[35] In sum, the contract involved a quid (money) pro quo (a contract to secure profit from the money's employment).

Noticeably absent in both SEC orders against NFT projects is any identification of the financial instrument(s) that allegedly constituted the investment contract under *Howey*,[36] much less a contract that effectuated this quid pro quo, entitling the owners of the NFTs to a share in the profits solely generated by the projects' efforts. That glaring omission is at odds with the Supreme Court precedent, which has consistently centered on the financial *instruments* involved, both their terms and operation, to determine if an investment contract was formed.[37] As the Supreme Court recognized: "The [Securities Exchange] Act was adopted to restore investors' confidence in the financial

[32] *See* 15 U.S.C. § 77b(a)(1).

[33] *See* Impact Theory Order, *supra* note 10, at ¶¶ 1–2; Stoner Cats Order, *supra* note 10, at ¶¶ 1–4.

[34] *See* SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946) (investment contract has a "promise of profits" derived solely from the offeror's efforts in exchange for a person's investment of money).

[35] *Id.* at 298 (quoting State v. Gopher Tire & Rubber Co., 146 Minn. 52, 56, 177 (1920) (emphasis and bracketed numbers added)).

[36] *See* Impact Theory Order, *supra* note 10, at ¶¶ 10–12; Stoner Cats Order, *supra* note 10, at ¶¶ 14–16.

[37] *See* SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344, 352-53 (1943).

markets, and the term 'security' was meant to include 'the many types of *instruments* that in our commercial world fall within the ordinary concept of a security.'"[38] Every Supreme Court case finding an investment contract involved contracts or agreements offering the investor a right to share in the profits made by the offeror.[39]

Part I explains why NFTs consisting of artworks are protected speech under the First Amendment. When NFTs are used as embodiments of art (hereinafter "artwork NFTs"[40]), as NFTs commonly are used by artists, the NFTs constitute the artistic expression of their creators. Therefore, for the government to prohibit creators from publicly distributing artwork NFTs without registering them as securities and without the pre-approval of a government agency such as the SEC constitutes an unlawful prior restraint, equivalent to a government licensing system that is fundamentally at odds with the freedom of speech.

Part II shows why the courts should reject the SEC's overbroad approach. Indeed, Supreme Court precedent interpreting the provision *already* provides the narrowing principle. The original public meaning of "investment contract," contemporaneous with the Act's passage, requires an *investment* of money, the *quid*, in exchange for a *contractual* right to receive future profits made solely from the offeror's efforts, the *quo*. Tracing the origin of "investment contract," a term people used dating back to the 1800s, Part II provides extensive historical examples of investment contracts before and contemporaneous with the Securities Act of 1933 — all of which indicate that the original public meaning of the term denoted an investment in a particular *contractual* relationship, which this Article encapsulates in the quid pro quo described above. As the amici brief of six securities law professors (Stephen Bainbridge, Tamar Frankel, Sean Griffith, Lawrence Hamermesh, M. Todd Henderson, and Jonathan Macey) (hereinafter

[38] Marine Bank v. Weaver, 455 U.S. 551, 555-56 (1982) (quoting H.R. Rep. No. 85, 73d Cong., 1st Sess., 11 (1933)) (emphasis added); *see also* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 847-48 (1975) (same).

[39] *See infra* Table 1 in Part II.A.

[40] I use the term "artwork NFTs" broadly to refer to NFTs that include art of any kind, including visual art, photographs, music, literary works, sculptures, and audiovisual works.

"Amici Securities Law Professors") explains, in a case involving the SEC's enforcement action against the cryptocurrency exchange Coinbase,[41] "[i]n short, by 1933, the state courts had converged around a standard for interpreting the term investment contract to mean a contractual arrangement that entitled an investor to *a contractual share* of the seller's later income, profits, or assets."[42] Accordingly, NFTs are not investment contracts: NFTs do not entitle, by contract, their holders to share the profits solely generated by the NFT project. Instead, they typically convey artworks.

And the mere expectation of appreciation in the value of artwork, whether embodied in NFTs or canvas, doesn't establish an investment contract any more than the appreciation in Barbie dolls, Birkin bags, Nike sneakers, Pokémon cards, Rolex watches, and Picasso paintings. Even if people who invest in these collectibles reasonably expect an appreciation in value — or profits — from their respective makers' efforts, such as in developing their brands and continually returning value to their collectors,[43] that speculative expectation of profit doesn't

[41] *See* Brief of Securities Law Scholars as Amici Curiae in Support of Coinbase's Motion for Judgment on the Pleadings at 12, SEC v. Coinbase, Inc., No. 1:23-cv-04738-KPF (S.D.N.Y. Aug. 11, 2023), https://storage.courtlistener.com/recap/gov.uscourts.nysd.599908/gov.uscourts.nysd.599908.59.0.pdf [https://perma.cc/Z3LT-AH58] [hereinafter Amici Brief of Securities Law Scholars].

[42] *Id.*

[43] Hermès' extreme control over its Birkin bags, limiting the total supply of bags and who can purchase them, provides a perfect example of how a producer's efforts to return value to their purchasers can result in profits for the purchasers. *See* Madeline Berg, *How Hermès Became the Ultimate Status Symbol*, BUSINESS INSIDER (Feb. 24, 2024, 4:15 AM), https://www.businessinsider.com/hermes-became-ultimate-status-symbol-2024-2 [https://perma.cc/Q48G-KUJR]. Hermès' efforts in cultivating Birkin bags as a status symbol have made them "a better investment than gold," according to a comparison of the value of the bags and gold over the past ten years. *See* Shannon Thaler, *Birkin Bags Can Double in Value in 5 Years — Some Styles Up to $450K — and Are a Better Investment Than Gold: Luxury Expert*, N.Y. POST (Mar. 28, 2024, 9:52 AM), https://nypost.com/2024/03/28/business/hermes-birkin-bags-can-double-in-value-in-5-years-expert/ [https://perma.cc/NEE9-7KPL]; *see also* Andrea Figueras, *Hermès Bucks Luxury Slowdown With Higher Sales but Flags Weakness in China*, WALL ST. J., https://www.wsj.com/business/earnings/hermes-bucks-luxury-slowdown-with-higher-sales-but-flags-weakness-in-china-3aa5de06?st=ct03jl3ynls4y9w&reflink=desktopwebshare_permalink (last updated July 25, 2024, 1:46 PM) (company reported increased

turn these collectibles into investment contracts.[44] The economic realities of buying collectibles are different in kind from investing in investment contracts: the former lacks the contractual right to profits that the latter has. Buying a rare Barbie or Birkin bag is different from buying a right to a business's profit. But this result under securities law does not leave consumers unprotected. Federal wire fraud law has already been used to prosecute NFT projects that have defrauded consumers,[45] and tort law applies to fraudulent sales of artworks as well.[46] And NFT projects' own terms of use may caution their collectors about the speculative values of NFTs.[47]

I. THE PRIOR RESTRAINT OF SECURITIES REGISTRATION OF ARTWORK NFTS

This Part explains why the SEC's overbroad classification of NFTs as securities is untenable — and unconstitutional. The First Amendment protects artwork NFTs as the creative expression of the artists. The SEC's treatment of artwork NFTs as securities that cannot be disseminated to the public before they are registered and approved by the SEC — a lengthy administrative process requiring months — constitutes an unlawful prior restraint in violation of the First Amendment rights of the artists.

sales revenue in second quarter of 2024 that "def[ied] a global slowdown in luxury demand" suffered by other companies).

[44] *See* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 852 (1975) ("By profits, the Court has meant either capital appreciation resulting from the development of the initial investment, as in *Joiner*, . . . (sale of oil leases conditioned on promoters' agreement to drill exploratory well), or a participation in earnings resulting from the use of investors' funds, as in *Tcherepnin v. Knight*, . . . (dividends on the investment based on savings and loan association's profits).").

[45] *See infra* note 131 and accompanying text.

[46] *See infra* note 133 and accompanying text.

[47] *See infra* note 138 and accompanying text.

A. Artwork NFTs Are Protected Expression Under the First Amendment

1. The First Amendment Protects Artistic Expression

The First Amendment protects the freedom of expression, including artistic expression. The Supreme Court has long recognized that the First Amendment protects creative expression of all kinds.[48] The First Amendment protects, for example, the "painting of Jackson Pollock, music of Arnold Schöenberg, or Jabberwocky verse of Lewis Carroll."[49] It protects "[e]ntertainment, . . . motion pictures, programs broadcast by radio and television, and live entertainment, such as musical and dramatic works."[50] It protects "pictures, films, paintings, drawings, and engravings."[51]

As the Supreme Court recently reaffirmed, "[a]ll manner of speech — from 'pictures, films, paintings, drawings, and engravings,' to 'oral utterance and the printed word' — qualify for the First Amendment's protections; no less can hold true when it comes to speech like [a website designer's] conveyed over the Internet."[52] Artistic expression serves a vital role in a democracy because it "may affect public attitudes and behavior in a variety of ways, ranging from direct espousal of a political or social doctrine to the subtle shaping of thought which characterizes all artistic expression."[53]

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[48] *See* Brown v. Ent. Merchs. Ass'n, 564 U.S. 786, 790 (2011) ("Like the protected books, plays, and movies that preceded them, video games communicate ideas — and even social messages — through many familiar literary devices (such as characters, dialogue, plot, and music) and through features distinctive to the medium (such as the player's interaction with the virtual world). That suffices to confer First Amendment protection."); Ward v. Rock Against Racism, 491 U.S. 781, 790 (1989) (music); Joseph Burstyn, Inc. v. Wilson, 343 U.S. 495, 501-02 (1952) (movies).

[49] Hurley v. Irish-American Gay, Lesbian & Bisexual Grp., 515 U.S. 557, 569 (1995).

[50] Schad v. Borough of Mount Ephraim, 452 U.S. 61, 65 (1981).

[51] Kaplan v. California, 413 U.S. 115, 119-20 (1973).

[52] 303 Creative LLC v. Elenis, 600 U.S. 570, 587 (2023) (alteration in original) (quoting *Kaplan*, 413 U.S. at 119-20).

[53] *Joseph Burstyn, Inc.*, 343 U.S. at 501; *see also* Ashcroft v. Free Speech Coal., 535 U.S. 234, 248 (2002) ("Art and literature express the vital interest we all have in the formative years we ourselves once knew, when wounds can be so grievous, disappointment so profound, and mistaken choices so tragic, but when moral acts and self-fulfillment are still in reach.").

Given the importance of expression to democracy, the government must not decide what content is permissible for public consumption. "[I]t is largely because governmental officials cannot make principled distinctions in this area that the Constitution leaves matters of taste and style so largely to the individual."[54] Even when applying copyright law, courts must refrain from making artistic judgments "outside of the narrowest and most obvious limits."[55] Moreover, creative expression that "is 'sold' for profit" is entitled to the same First Amendment protection as works that are not sold.[56]

The First Amendment is technology neutral. It protects speech created through new and old technologies alike. Artistic expression does not lose First Amendment protection when it is embodied and disseminated by a new technology. As Justice Scalia recognized in a case involving video games, "[W]hatever the challenges of applying the Constitution to ever-advancing technology, 'the basic principles of freedom of speech and the press, like the First Amendment's command, do not vary' when a new and different medium for communication appears."[57] Indeed, the freedom of the press is technology-protective and originates from the Framers' recognition that the printing press should not be subject to any prior restraints on what can be published, as was the case under the licensing acts in England.[58] As Justice Gorsuch explained, "At the founding, the freedom of the press generally meant the government could not impose prior restraints preventing individuals from publishing what they wished."[59] After publication, the government can punish unprotected speech, such as defamation or fraud, that violates the law, but it cannot do so before.[60]

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[54] Cohen v. California, 403 U.S. 15, 25 (1971).

[55] Bleistein v. Donaldson Lithographing Co., 188 U.S. 239, 251 (1903).

[56] Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, Inc., 425 U.S. 748, 761 (1976) ("Speech likewise is protected even though it is carried in a form that is 'sold' for profit . . . .").

[57] Brown v. Ent. Merchs. Ass'n, 564 U.S. 786, 790 (2011) (quoting *Joseph Burstyn, Inc.*, 343 U.S. at 503); *see also* Reno v. Am. C.L. Union, 521 U.S. 844, 868-70 (1997) (reviewing regulation of Internet under full First Amendment scrutiny).

[58] *See* Near v. Minnesota *ex rel.* Olson, 283 U.S. 697, 714 (1931) (discussing history).

[59] Berisha v. Lawson, 141 S. Ct. 2424, 2426 (2021) (dissenting from the denial of certiorari).

[60] *See id.*

2. Artwork NFTs Are the Creative Expression of Artists

Artwork NFTs are entitled to the same First Amendment protections as traditional artworks. Under the First Amendment, a Pokémon NFT is just as much protected expression as a Pokémon card — or a Picasso painting.

To understand NFTs, one must understand not only the technology, but, even more importantly, the problem they solved for digital artists. For artwork NFTs, the basic components are (1) a short computer program called a smart contract that has a unique identifier (a "token ID"), which is created and stored on blockchain to facilitate decentralized transactions of the NFT; and (2) an embodiment of the artwork of the NFT creator.[61] The NFT purchaser's rights to exploit the artwork NFT is typically determined by a separate content license (or terms of use) of the NFT creator.[62] To draw an analogy, just as the buyer of a Pokémon card has some rights to use the artwork on the card, such as framing it and displaying it in one's office, the buyer of an artwork NFT typically receives some rights to use the artwork embodied in the NFT, such as displaying it as one's profile picture on social media[63] or as artwork in an online or physical gallery.[64] Thus, when people buy NFTs of a digital artwork, they are buying the *art itself*. The NFT is a unique (aka "nonfungible") embodiment of the digital artwork, akin to an original painting of an artwork on canvas.

NFTs solved a longstanding problem for digital artworks: "Why would investors buy a digital artwork they could copy for free online?"[65] NFTs solved this problem by creating a way for artists to create a unique version of their digital artworks — an original that is equivalent to an authentic painting.[66] As Professor Amy Whitaker and Nora Burnett

[61] *See* LEE, *supra* note 8, at 89-90.

[62] *See id.* at 91.

[63] *See id.* at 46.

[64] *See id.* at 134.

[65] *Id.* at 30.

[66] *Id.*; *see also* Andrew R. Chow, *NFTs Are Shaking Up the Art World — But They Could Change So Much More*, TIME (Mar. 22, 2021, 12:38 PM), https://time.com/5947720/nft-art/ [https://perma.cc/25EZ-767G] ("Digital art has long been undervalued, in large part because it's so freely available. To help artists create financial value for their work, NFTs

Adams, the Director of MCA Denver, explained in their book, *The Story of NFTs: Artists, Technology, and Democracy*:

> [T]okenization . . . functions as a way to capture a single image out of a sea of copies. Art historians have engaged in debates regarding the originality of artworks for centuries, notably since mechanical reproduction afforded by the camera allowed for multiple copies of the same image to circulate at the same time. Rosalind Krauss deftly debunked the idea of valuing originality in her essay . . . and in doing so made clear the challenges that modern technology brings to bear on how we process and value a copy versus an original. . . . NFTs move in the opposite direction: they single out an image and preserve it as an entity to be owned and valued distinctly from its digital brethren.[67]

Or, as Cassandra Hatton, a senior vice president at Sotheby's, explained, the sale of an NFT can be likened to the sale of a rare book — they are "original collectibles."[68] Because the provenance of NFTs are recorded on blockchain, which operates as a public ledger or record, NFTs also help to establish if the artwork is authentic and comes from the artist.[69] This public record, in turn, addresses a major problem of

add the crucial ingredient of scarcity. For some collectors, if they know the original version of something exists, they're more likely to crave the 'authentic' piece.").

[67] AMY WHITAKER & NORA BURNETT ABRAMS, THE STORY OF NFTS: ARTISTS, TECHNOLOGY, AND DEMOCRACY 45 (2023).

[68] *Id.* at 84; *see also* Mitchell Clark, *NFTs, Explained*, THE VERGE, https://www.theverge.com/22310188/nft-explainer-what-is-blockchain-crypto-art-faq (last updated June 6, 2022, 5:30 AM PDT) [https://perma.cc/R9FH-834F] ("NFTs are designed to give you something that can't be copied: ownership of the work . . . . To put it in terms of physical art collecting: anyone can buy a Monet print. But only one person can own the original."); Shanti Escalante-De Mattei, *As Sales Exploded on Art Blocks, Its Founder Looked for Ways to Cool the Fervor*, ARTNEWS (Sept. 17, 2021, 1:51 PM), https://www.artnews.com/art-news/news/erick-calderon-art-blocks-1234604108/ [https://perma.cc/E7GS-UQNL] (discussing Erick Calderon's founding of Art Blocks marketplace and how NFTs create a "one-of-a-kind piece" for generative artworks).

[69] *The Innovation of NFT: Preserving Authenticity and Ownership in Creative Arts*, WORLD ART NEWS (June 23, 2022), https://worldart.news/2022/06/23/the-innovation-of-nft-preserving-authenticity-and-ownership-in-creative-arts/ [https://perma.cc/2BTN-TBAV].

forgeries and establishing the provenance of any artwork.[70] For these reasons, NFTs ushered in a promising new market for digital artists. As Robert Alice, the artist and editor of the book *On NFTs*, explained, "[O]nly 5 years ago, there was $0 of art being traded on the blockchain, and now, despite [an] 80% drawdown, the blockchain is host to billions of [dollars] of art transactions per year."[71]

Another benefit NFTs provide to artists is that their sale bypasses the traditional gatekeepers of the art world (e.g., art galleries, auction houses, and museums). The nascent market for digital art that NFTs created is open to all artists. It is more inclusive and democratic for artists because NFTs can be sold through decentralized marketplaces[72] without the need for admittance or backing from the gatekeepers of the art establishment. And, through NFT resale royalties, visual artists finally found a potential way to sustain themselves.[73] As the artist FEWOCiOUS explained: "A new democratization of art & a new world where artists *finally* found a way to get paid from their works on an ongoing basis."[74]

Recognizing the rise of digital art precipitated by NFTs, the leading institutions of the art establishment — such as Christie's and Sotheby's auction houses, the Los Angeles County Museum of Art, Centre Pompidou in Paris, and the San Francisco Museum of Modern Art —

[70] *See id.*

[71] Ravail Khan, *Interview: Robert Alice's 'On NFTs' is the Largest Art Historical Survey of Blockchain-Based Art*, DESIGNBOOM (Apr. 27, 2024), https://www.designboom.com/art/interview-robert-alice-on-nfts-art-historical-survey-blockchain-based-art-taschen-04-27-2024/ [https://perma.cc/5QBS-BFJL].

[72] *See* WHITAKER & ABRAMS, *supra* note 67, at 46.

[73] *See* Edward Lee, *Decentralized Collaboration Through Private Ordering*, 73 AM. U. L. REV. 67, 106-10 (2023) (discussing popularity of resale royalties among top NFT projects) [hereinafter *Decentralized Collaboration*]; Edward Lee, *NFTs as Decentralized Intellectual Property*, 2023 U. ILL. L. REV. 1049, 1098-99 (2023) (discussing why NFT resale royalties are attractive to artists). Even during the major downturn in NFT sales in 2024, millions of dollars in royalties were going back to artists. *See* wale.moca (@waleswoosh), X (July 17, 2024, 7:20 AM), https://twitter.com/waleswoosh/status/1813579605455819157 [https://perma.cc/9TK2-SSCV].

[74] FEWOCiOUS (@fewocious), X (Nov. 7, 2022, 12:02 PM), https://twitter.com/fewocious/status/1589710002545397760 [https://perma.cc/Q5PY-QYHE] (emphasis added).

have auctioned or acquired artwork NFTs.[75] Both Christie's and Sotheby's launched their own NFT marketplaces.[76] The third highest sale of an artwork at auction (for $69 million) by a living artist is an artwork NFT by Beeple, a digital artist, who was unknown in the art establishment before NFTs.[77] Only David Hockney and Jeffrey Koons had higher auctioned sales for living artists.[78]

It is wrong to conflate artwork NFTs with cryptocurrency and reduce them both to nothing more than "crypto asset securities." Artwork NFTs are embodiments of the creative expression of artists, whose expression is protected by the First Amendment.

B. Requiring Securities Registration Before Artwork NFTs May Be Publicly Sold Results in an Unlawful Prior Restraint

The SEC's position in requiring artwork NFTs to be registered with and approved by the SEC *before* artists can sell them to the public constitutes an unlawful prior restraint.[79] As explained below, to prohibit artists from distributing their artwork NFTs to the public until they receive the SEC's approval in the securities registration process — which is expensive and takes months — is an impermissible, pre-

[75] *Museums Are Learning to Love NFTs*, ECONOMIST (Nov. 30, 2023), https://www.economist.com/culture/2023/11/30/museums-are-learning-to-love-nfts [https://perma.cc/VQE2-SEQP].

[76] Shanti Escalante-De Mattei, *Christie's, Still Betting Big on Crypto, Launches NFT Platform*, ARTNEWS (Sept. 28, 2022, 12:31 PM), https://www.artnews.com/art-news/news/christies-nft-platform-artnews-1234640979/ [https://perma.cc/EZJ4-8EVA]; Rosie Perper, *Sotheby's Launches On-Chain Secondary NFT Marketplace*, COINDESK, https://www.coindesk.com/web3/2023/05/01/sothebys-launches-on-chain-secondary-nft-marketplace/ (last updated Jan. 23, 2024, 4:30 PM) [https://perma.cc/7A35-BCJP].

[77] *See* Arun Kakar, *Two Years Since the Historic Beeple Sale, What's Happened to the NFT Market?*, ARTSY (Mar. 10, 2023, 9:12 AM), https://www.artsy.net/article/artsy-editorial-two-years-historic-beeple-sale-happened-nft-market [https://perma.cc/LPZ3-A7NZ].

[78] Kyle Chayka, *How Beeple Crashed the Art World*, THE NEW YORKER (Mar. 22, 2021), https://www.newyorker.com/tech/annals-of-technology/how-beeple-crashed-the-art-world [https://perma.cc/7L2J-HPAK].

[79] The precise scope of the SEC's position on NFTs is unclear. It has announced settlements against only two NFT projects. Because the SEC has not provided public guidance on its view of NFTs generally, it is impossible to tell how it will treat other NFT projects. But the vagueness in the SEC's position only compounds the First Amendment problem and may create a chilling effect on other NFT projects.

publication government restraint on artistic expression. That prior restraint is doubly pernicious as applied to artists because securities law also includes a prohibition of the registrant from making public statements about its offering outside of its prospectus approved by the SEC during the "quiet period."[80] And the SEC enforces this rule "quite broad[ly]" to all sorts of communications by the registrant.[81] The Securities Act was never intended to restrict artworks.[82]

1. Prior Restraints Violate the First Amendment

A prior restraint is a government prohibition that forbids a person from speaking or publishing speech, including when the prohibition is merely temporary and can be removed upon the government's approval.[83] As the Supreme Court explained, "[T]he main purpose of [the First Amendment] is 'to prevent all such *previous restraints* upon publications as had been practiced by other governments.'"[84]

The Framers of the U.S. Constitution abhorred the British monarchy's control over the printing press, another technology that greatly facilitated creative expression.[85] As the Court explained the origin of the prior restraint doctrine:

[80] *See* Susan B. Heyman, *The Quiet Period in a Noisy World: Rethinking Securities Regulation and Corporate Free Speech*, 74 OHIO ST. L.J. 189, 196-202 (2013) (explaining securities law's "restrictions on speech" related to "offers" of registered securities during quiet period).

[81] *Quiet Period*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/glossary/quiet-period (last visited Aug. 21, 2024) [https://perma.cc/U6TG-V4UK].

[82] *See* Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 78-79 (2006) (discussing enactment of Securities Act of 1933 following the stock market crash and Great Depression, and need for regulation of securities market).

[83] *See* Thomas I. Emerson, *The Doctrine of Prior Restraint*, 20 LAW & CONTEMP. PROBS. 648, 648 (1955) ("[T]he doctrine of prior restraint holds that the First Amendment forbids the Federal Government to impose any system of prior restraint, with certain limited exceptions, in any area of expression that is within the boundaries of that Amendment.").

[84] Neb. Press Ass'n v. Stuart, 427 U.S. 539, 557 (1976) (emphasis in original) (alterations in original) (quoting Patterson v. Colorado *ex rel.* Attorney General of Colorado, 205 U.S. 454, 462 (1907)).

[85] *See* Emerson, *supra* note 83, at 650.

> The First Amendment's guarantee of "the freedom of speech, or of the press" prohibits a wide assortment of government restraints upon expression, but the core abuse against which it was directed was the scheme of licensing laws implemented by the monarch and Parliament to contain the "evils" of the printing press in 16th- and 17-century England. The Printing Act of 1662 had "prescribed what could be printed, who could print, and who could sell." Mayton, Toward a Theory of First Amendment Process: Injunctions of Speech, Subsequent Punishment, and the Costs of the Prior Restraint Doctrine, 67 Cornell L. Rev. 245, 248 (1982). It punished the publication of any book or pamphlet without a license and required that all works be submitted for approval to a government official, who wielded broad authority to suppress works that he found to be "'heretical, seditious, schismatical, or offensive.'" F. Siebert, Freedom of the Press in England, 1476-1776, p. 240 (1952). The English licensing system expired at the end of the 17th century, but the memory of its abuses was still vivid enough in colonial times that Blackstone warned against the "restrictive power" of such a "licenser" — an administrative official who enjoyed unconfined authority to pass judgment on the content of speech. 4 W. Blackstone, Commentaries on the Laws of England 152 (1769).[86]

In the First Amendment, the Framers rejected "any system of prior restraint."[87] As the Supreme Court admonished, "[P]rior restraints on speech and publication are the most serious and the least tolerable infringement on First Amendment rights."[88] Accordingly, "Any prior restraint on expression comes . . . with a 'heavy presumption' against its constitutional validity."[89] The government bears the burden of proving that the speech involved is unprotected expression.[90] And "the

[86] Thomas v. Chi. Park Dist., 534 U.S. 316, 320 (2002).

[87] Emerson, *supra* note 83, at 652.

[88] *Neb. Press Ass'n*, 427 U.S. at 559.

[89] Org. for a Better Austin v. Keefe, 402 U.S. 415, 419 (1971) (quoting Bantam Books, Inc. v. Sullivan, 372 U.S. 58, 70 (1963)).

[90] Freedman v. Maryland, 380 U.S. 51, 58 (1965).

procedure must also assure a prompt final judicial decision, to minimize the deterrent effect of an interim and possibly erroneous denial of a license."[91] The government has a tall order to satisfy the First Amendment strictures on prior restraints:

> An order issued in the area of First Amendment rights must be couched in the narrowest terms that will accomplish the pin-pointed objective permitted by constitutional mandate and the essential needs of the public order. In this sensitive field, the State may not employ "means that broadly stifle fundamental personal liberties when the end can be more narrowly achieved."[92]

Under prior restraint doctrine, requiring people to perform an administrative act — such as filing an application with a government agency for a license, permit, or registration — before they can distribute expressive works to the public is a paradigmatic example of a prior restraint.[93] As the Supreme Court explained in *Lovell v. City of Griffin*, a case involving a city ordinance requiring people to obtain a government permit *before* one could distribute materials of any kind to the public, "[w]hatever the motive which induced [the ordinance's] adoption, its character is such that it strikes at the very foundation of the freedom of the press by subjecting it to license and censorship."[94] A major concern under the First Amendment is giving discretion to government employees to decide what speech is approved before its dissemination.[95] As the Court elaborated, "[T]he peaceful enjoyment of freedoms which the Constitution guarantees contingent upon the uncontrolled will of an official — as by requiring a permit or license which may be granted

[91] *Id.* at 59.

[92] Carroll v. President & Comm'rs of Princess of Anne, 393 U.S. 175, 183-84 (1968) (quoting Shelton v. Tucker, 364 U.S. 479, 488 (1960)).

[93] *See* Lovell v. City of Griffin, 303 U.S. 444, 451-52 (1938) (internal citations omitted); *see also Org. for a Better Austin*, 402 U.S. at 419 ("No prior decisions support the claim that the interest of an individual in being free from public criticism of his business practices in pamphlets or leaflets warrants use of the injunctive power of a court.").

[94] *Lovell*, 303 U.S. at 451.

[95] *See* FW/PBS, Inc. v. City of Dallas, 493 U.S. 215, 225-26 (1990) (plurality opinion).

or withheld in the discretion of such official — is an unconstitutional censorship or prior restraint upon the enjoyment of those freedoms."[96]

Prior restraints can even arise from laws that do not require pre-publication approval, but instead, simply impose "onerous restrictions [that] function as the equivalent of prior restraint by giving the [government agency] power analogous to licensing laws implemented in 16th- and 17th-century England . . . ."[97] People are left with a Hobson's choice simply to speak: either comply with expensive and time-consuming administrative burdens or risk being subject to an agency enforcement action requiring potentially more expenses. This unconstitutional Catch-22 squelches speech by discouraging people from engaging in expressive activities that might subject them to an agency investigation. As Justice Kennedy explained, "Many persons, rather than undertake the considerable burden (and sometimes risk) of vindicating their rights through case-by-case litigation, will choose simply to *abstain from protected speech* — harming not only themselves but society as a whole, which is deprived of an uninhibited marketplace of ideas."[98]

2. Requiring Securities Registration of Artwork NFTs Is a Prior Restraint

If the SEC classifies artwork NFTs as securities and requires them to be registered *before* their creators can distribute the artwork NFTs to the public, that restriction constitutes a prior restraint. When applied to artwork NFTs, securities registration operates as a system of pre-publication licensing and a prior restraint on the artist's distribution of artwork NFTs to the public, in violation of the First Amendment.

To understand how SEC registration operates as a prior restraint when applied to artwork NFTs, we must examine the basic features of securities registration. The system of securities regulation is complex and highly technical: it imposes an elaborate set of requirements that an

[96] Shuttlesworth v. City of Birmingham, 394 U.S. 147, 151 (1969) (quoting Staub v. City of Baxley, 355 U.S. 313, 322 (1958)).

[97] Citizens United v. FEC, 558 U.S. 310, 335 (2010).

[98] *Id.* at 335-36 (emphasis added) (quoting Virginia v. Hicks, 539 U.S. 113, 119 (2003) (citation omitted)).

offeror of securities must satisfy before it may sell them to the public. First, before any sale of securities to the public, the offeror must register a statement with the SEC describing at length, in a prospectus and audited financial statements, the "business operations, financial condition, results of operations, risk factors, and management."[99] Second, the offeror must refrain from making public comments about its offer or its business during the so-called quiet period.[100]

In a case where the offering involves a stock offering, the First Amendment is likely not implicated in the underlying security because a share in a company is arguably not speech or artistic expression.[101] Thus, for stock offerings, securities registration may be required without raising First Amendment concerns, although some scholars disagree over the extent to which First Amendment scrutiny should apply to securities requirements.[102] By contrast, when artwork NFTs are involved, they are protected expression of their creators. That

[99] *What is a Registration Statement?*, SEC (June 24, 2024), https://www.sec.gov/education/smallbusiness/goingpublic/registrationstatement [https://perma.cc/4UE3-9KAQ].

[100] *See* Heyman, *supra* note 80, at 196-97.

[101] *See generally What Are Shares? How They Compare to Stocks*, INVESTOPEDIA (June 28, 2024), https://www.investopedia.com/terms/s/shares.asp [https://perma.cc/NN28-KE9D] (defining shares as "units of ownership in a company").

[102] *See* Lucian A. Bebchuk & Robert J. Jackson, Jr., *Shining Light on Corporate Political Spending*, 101 GEO. L.J. 923, 955 (2013) ("The Court's First Amendment analysis has long given the SEC considerable deference in the development of rules that provide investors with information necessary to facilitate the functioning of securities markets."); Frederick Schauer, *The Boundaries of the First Amendment: A Preliminary Exploration of Constitutional Salience*, 117 HARV. L. REV. 1765, 1778-80 (2004) (discussing the anomalous treatment of content-based restrictions of securities regulation under the First Amendment). *But see* Allen D. Boyer, *Free Speech, Free Markets, and Foolish Consistency*, 92 COLUM. L. REV. 474, 475 (1992) (reviewing Nicholson Wolfson's book that argues securities law should be subject to full First Amendment scrutiny, instead of the current minimal review); Wendy Gerwick Couture, *The Collision Between the First Amendment and Securities Fraud*, 65 ALA. L. REV. 903, 950-69 (2014) (arguing that securities regulation raises First Amendment concerns). Kyle Langvardt and James Tierney have recommended that the SEC stay clear from regulation of "the aesthetic design of brokerage apps" — which they call "confetti regulation" — because they fear it might lead to greater First Amendment scrutiny of securities regulations. Kyle Langvardt & James Fallows Tierney, *On "Confetti Regulation": The Wrong Way to Regulate Gamified Investing*, 131 YALE L.J. F. 717, 720-21 (2022).

distinguishes artwork NFTs from stocks and other securities that contain no art at all. If the proposed sale involves artworks, the First Amendment protects the artists' right to freedom of expression in the artworks, including in their public distribution. The SEC's requirement of securities registration as applied to artwork NFTs before they can be sold to the public effectuates a pre-distribution permit system for artworks that strikes at the very core of the First Amendment.

Some critics may contend that securities registration is a mere formality that does not involve any content-based review by the SEC of the underlying artwork NFTs and therefore securities registration cannot constitute a prior restraint. But that argument is fundamentally flawed. First, a prior restraint doesn't hinge on proving that content-based review occurred or that a government official discriminated against the party based on content; instead, if speech is restrained by the government before it is disseminated, it operates as a prior restraint.[103] Moreover, nothing in the public record supports the contention that the SEC did not review any of the artworks of the NFT projects involved. The SEC order against the Stoner Cats indicates the exact opposite,[104] and the SEC's order against Impact Theory includes images of the artworks of the NFTs and indicates that the SEC reviewed Impact Theory's website, which contains other artworks of the project.[105] The SEC's press releases for both actions indicate its own skepticism about each project's "*purported* non-fungible tokens (NFTs)," which presumably was based on the SEC's review of the NFTs including their artistic content.[106]

The public record provides no information on why the SEC obtained settlement orders against only these two NFT projects — both of which involved well-known public figures and celebrities — out of the many

[103] *See* Riley v. Nat'l Fed'n of the Blind of N.C., Inc., 487 U.S. 781, 802 (1988) (state law requiring professional fundraisers to obtain a license before fundraising was prior restraint in violation of First Amendment because it "permits a delay without limit").

[104] *See* Stoner Cats Order, *supra* note 10, at ¶ 3 ("Each Stoner Cats NFT was associated with a unique still image of one of the characters in the Stoner Cats web series, with different expressions, apparel, accessories, and backgrounds, resulting in a multitude of NFTs.").

[105] *See* Impact Theory Order, *supra* note 10, at ¶ 4.

[106] *See* SEC Charges Stoner Cats, *supra* note 9; SEC Charges Impact Theory, *supra* note 9.

thousands of artwork NFT projects. Although the SEC may have had perfectly legitimate reasons, the reasons remain unclear. From a First Amendment perspective, the problem is that the SEC has not promulgated *any* guidance on when it views NFTs as securities — or not.[107]

This lack of guidance creates precisely the kind of scenario — a government entity having standardless discretion over investigating artwork NFT projects — that the prior restraint doctrine is meant to avoid.[108] As Commissioners Peirce and Uyeda lamented in their dissent:

> The application of the *Howey* investment contract analysis in this matter lacks any meaningful limiting principle. It carries implications for creators of all kinds. Were we to apply the securities laws to physical collectibles in the same way we apply them to NFTs, artists' creativity would wither in the shadow of legal ambiguity. *Rather than arbitrarily bringing enforcement actions against NFT projects*, we ought to lay out some clear guidelines for artists and other creators who want to experiment with NFTs as a way to support their creative efforts and build their fan communities.
>
> Whether an artist is selling numbered versions of physical prints for fans to display on their walls or NFTs for fans to display on social media, she deserves *clear guidance* about whether and how the securities laws apply.[109]

The SEC's lack of guidance discourages artists of all kinds from creating NFT projects, lest they become the target of an SEC investigation. This is precisely what the First Amendment prohibits.[110]

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[107] *See supra* notes 4–15 and accompanying text.

[108] *See* Van Wagner Bos., LLC v. Davey, 770 F.3d 33, 38 (1st Cir. 2014) ("It is being subject to a prior restraint on protected expression through requirements embodying standardless discretion, not being harmed by the unfavorable exercise of such discretion, that causes the initial injury.").

[109] Peirce & Uyeda, *Dissent in Stoner Cats*, *supra* note 29 (emphasis added).

[110] *See* Citizens United v. FEC, 558 U.S. 310, 336 (2010) ("Yet, the FEC has created a regime that allows it to select what political speech is safe for public consumption by applying ambiguous tests. If parties want to avoid litigation and the possibility of civil and criminal penalties, they must either refrain from speaking or ask the FEC to issue an advisory opinion approving of the political speech in question.").

The prior restraint doctrine is also meant to avoid mere *delays* to a person's dissemination of speech.[111] To adapt Martin Luther King Jr.'s famous statement, speech too long delayed is speech denied.[112]

But preparing the securities registration statement, including the prospectus and the required audited financial statements of the company,[113] plus hiring the attorneys and accountants to prepare the materials, will likely take months. And then, the SEC's review may take an additional three to five months.[114] Practically speaking, NFT projects might have to delay the sale and distribution of their artwork NFTs for nearly one year if they are required to register them as securities. That "[r]isk of delay" creates an unconstitutional prior restraint on artwork NFTs and the artists' expression.[115]

In an analogous situation involving a state law requiring professional fundraisers to obtain a license before fundraising, without any guarantee of a prompt administrative review, the Supreme Court held that the licensing requirement imposed on professional fundraisers an unlawful prior restraint because the "delay compels the speaker's silence" during the pendency of the application.[116] That principle applies here: the delay caused by securities registration compels the artist's silence — and it does so even more broadly under the SEC's required "quiet period" for registrants.

Securities regulation does not receive a free pass from the First Amendment. The Supreme Court has considered one case involving an alleged prior restraint in securities law enforcement — and whether an

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[111] *See* FW/PBS, Inc. v. City of Dallas, 493 U.S. 215, 226 (1990) (plurality opinion).

[112] *See* Martin Luther King, Jr., *Letter from a Birmingham Jail* (Apr. 16, 1963), https://www.africa.upenn.edu/Articles_Gen/Letter_Birmingham.html [https://perma.cc/DA5C-ENWY].

[113] *See* Michele M. Anderson, Alexander F. Cohen, Paul M. Dudek, Joel H. Trotter, Timothy D. Brown & Erin L. McCloskey, *Financial Statement Requirements in US Securities Offerings: What You Need to Know*, LATHAM & WATKINS LLP & KPMG LLP (2024), https://www.lw.com/admin/upload/SiteAttachments/us-financial-statements-guide.pdf [https://perma.cc/VDM3-EWEN].

[114] *See IPO Insights: Tips for Successful SEC Staff Review of Your IPO*, ORRICK, https://www.orrick.com/en/Insights/2018/06/Tips-for-Successful-SEC-Staff-Review-of-Your-IPO (last updated Oct. 2, 2023) [https://perma.cc/A4R3-JHMH].

[115] *FW/PBS*, 493 U.S. at 223-24.

[116] Riley v. Nat'l Fed'n of the Blind of N.C., Inc., 487 U.S. 781, 802 (1988).

injunction can be imposed on publishers of "nonpersonalized investment advice and commentary in securities newsletters" to paid subscribers, which the SEC contended was in violation of the requirement of registration as an investment adviser under the Investment Advisers Act of 1940.[117] The question presented was whether the injunction from publishing the investment newsletters without registration as an investment adviser violated the First Amendment.[118] The Supreme Court decided, instead, to apply the canon of constitutional doubt and avoid the constitutional question by interpreting the statute in a narrow way that eliminated the question.[119]

Ultimately, the Court interpreted the statutory exception for "the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation" as applying to publications of investment advisers for their nonpersonalized advice.[120] In giving the statutory exception a broad reading, the Supreme Court quoted at length its First Amendment precedents on unlawful prior restraints.[121] Thus, the Court's ruling applied not only to the injunction, but also to the SEC's attempt to require registration as an investment adviser before publishing this kind of expression. In a concurrence in the result, joined by Chief Justice Burger and Justice Rehnquist, Justice White expressed his view that the Court should have decided the First Amendment question and should have held that prohibiting the investment adviser from publishing his newsletters before registering with the SEC violated the First Amendment.[122]

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[117] Lowe v. SEC, 472 U.S. 181, 183 (1985); *see* 15 U.S.C. § 80b-3(c).

[118] *Lowe*, 472 U.S. at 188-89.

[119] *See id.* at 190 ("[W]e should 'not decide a constitutional question if there is some other ground upon which to dispose of the case,' and the further fact that the District Court and the dissenting judge in the Court of Appeals both believed that the case should be decided on statutory grounds, a careful study of the statute may either eliminate, or narrowly limit, the constitutional question that we must confront." (internal citations omitted)).

[120] *See id.* at 204 (internal citations omitted).

[121] *Id.* at 204-05.

[122] *Id.* at 228 (White, J., concurring in the result); *id.* at 233 ("The application of the Act's enforcement provisions to prevent unregistered persons from engaging in the business of publishing investment advice for the benefit of any who would purchase

Although the *Lowe* Court did not reach the First Amendment question, its decision signals that the SEC's enforcement action to require registration before the dissemination of expression may raise a serious First Amendment problem. It does so here. Prohibiting artists from selling artwork NFTs unless they first register them as securities and comply with all the requirements of securities law operates as a prior restraint and violates their freedom of expression.

3. The Courts Recognize That Sales of Artworks Do Not Create a Security

Courts have consistently rejected attempts to expand "investment contract" and securities registration to the sales of artworks.[123] That is so even where the defendant art galleries allegedly engaged in a fraudulent scheme to induce a collector to purchase artworks. For example, in *Stenger v. R.H. Love Galleries*, the plaintiff bought twelve paintings for $1.5 million based on the defendant gallery's statement "that investing in art through defendant Galleries would produce *a safe profit*," along with the Galleries' "*promise*[] *to create a market of plaintiff's paintings* and . . . resell the paintings," various certificates establishing the authentication, provenance, and appraisal of the paintings' value, as well as a guarantee by the Galleries to repurchase the paintings for credit given to the plaintiff to "the purchase price . . . of one or two

their publications, however, is a direct restraint on freedom of speech and of the press subject to the searching scrutiny called for by the First Amendment.").

[123] *See, e.g.*, Stenger v. R.H. Love Galleries, Inc., 741 F.2d 144, 147 (7th Cir. 1984) ("Plaintiff's plea that we establish a regulatory framework for the sale of art cannot be answered through the securities laws."); Faircloth v. Jackie Fine Arts, Inc., 682 F. Supp. 837, 844-45 (D.S.C. 1988) (rejecting claim that sale of art master for Picasso's *Portrait Au Cou Bleu* was investment contract), *aff'd in part and rev'd in part sub nom.* Faircloth v. Finesod, 938 F.2d 513 (4th Cir. 1991); Mechigian v. Art Cap. Corp., 612 F. Supp. 1421, 1428 (S.D.N.Y. 1985) ("The expansion of the scope of the securities laws sought by the plaintiff herein seems to me to be unwarranted and even perhaps detrimental to the common good. In our mercantile economy, we should not try to turn every 'thing' [here, an artwork] which might be purchased and sold into a 'security.'"); *see also* Brian D. Tobin, *The Virtues of Common Law Theories and Disclosure Requirements in the Market for Fine Art*, 21 SETON HALL J. SPORTS & ENT. L. 333, 362-70 (2011) (analyzing why art sales are not investment contracts).

works of art having equal or greater value."[124] In sum, "the plaintiff alleges [these documents] transform an otherwise ordinary retail sale of paintings into a sale of securities."[125]

The Seventh Circuit rejected the plaintiff's argument: "Plaintiff's plea that we establish a regulatory framework for the sale of art cannot be answered through the securities laws."[126] The court examined the documents related to the art sale and found nothing that either created a common enterprise or showed that "the appreciation or depreciation of plaintiff's collection [of paintings purchased from the defendants] would benefit anyone other than himself."[127] Indeed, under the instruments, the "fortunes of plaintiff and defendant are unrelated": "Plaintiff's paintings may appreciate and he is free to sell them through any means he wishes; defendant would not share in any profit. Conversely, defendants would receive a sales commission if plaintiff sells his paintings through defendant Galleries, even if he sells them at a loss."[128] As the Seventh Circuit concluded, "[t]his relationship is no different than that found in a typical commodities brokerage account, in which the broker profits from commissions while the investor profits from appreciation."[129] Other cases are in accord.[130]

Although these cases did not discuss the First Amendment problem that would arise had the courts treated the sales of artworks as securities, the decisions can be justified on that ground. Imposing the costly and lengthy process of securities registration on the sale of

[124] *Stenger*, 741 F.2d at 145-46 (emphasis added).

[125] *Id.* at 146.

[126] *Id.* at 147.

[127] *Id.*

[128] *Id.*

[129] *Id.*

[130] *See, e.g.*, Faircloth v. Finesod, 938 F.2d 513 (1991) (sale of art master was not investment contract); Faircloth v. Jackie Fine Arts, Inc., 682 F. Supp. 837, 844-45 (D.S.C. 1988), *aff'd in part and rev'd in part sub nom*; Mechigian v. Art Cap. Corp., 612 F. Supp. 1421, 1424 (S.D.N.Y. 1985) (no investment contract in the sale of artwork, coupled with defendant's art appraisal, non-recourse note (loan), and statement to "the plaintiff that prints could be made from the original and could be sold for a profit"). The SEC's position on different arrangements with the sale of artworks has been more varied. *See* Maureen Holm, *The Art Investment Contract: Application of Securities Law to Art Purchases*, 9 FORDHAM URB. L.J. 385, 425-27 (1980) (summarizing no-action letters).

artworks, whether in the form of paintings, prints, or artwork NFTs, would result in an unlawful prior restraint.

C. The Wire Fraud Statute and Tort Law Already Provide Less Restrictive Alternatives to Securities Registration

Another reason why requiring securities registration of artwork NFTs violates the First Amendment is that a less restrictive alternative already exists. The U.S. government has prosecuted NFT projects for fraud related to sales of NFTs — commonly called "rug pulls" — under the federal wire fraud statute.[131] In addition, the government has brought enforcement actions against celebrities for undisclosed paid endorsements of cryptocurrencies.[132] Likewise, tort law provides collectors with a whole panoply of claims against fraudulent and deceptive activities of an art seller.[133]

These less restrictive alternatives can regulate and deter fraudulent and deceptive practices by NFT projects. Securities registration would not add much, if anything. While securities registration requires mandatory, pre-offering information be available to prospective investors, such information has limited, if any, benefit for investors of NFT. In its action against the Stoner Cats project, Carolyn Welshhans, Associate Director of the SEC's Home Office, stated in an SEC press release: "Registration of securities, including crypto asset securities,

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[131] *See, e.g.*, Sander Lutz, *An NFT Rug Pull Scammer Has Finally Been Convicted, Faces Federal Prison*, DECRYPT (Nov. 14, 2023), https://decrypt.co/206059/nft-rug-pull-mutant-ape-planet-federal-conviction-faces-jail-term [https://perma.cc/9ZLP-SE6U] (discussing federal prosecutions of rug pulls related to Mutant Ape Planet, Frosties NFT, and Baller Ape Club projects).

[132] *See* Paul Guirguis & Susan Ross, *Celebrity Crypto Fines Flag Lessons for Lawyers*, BLOOMBERG LAW (Oct. 13, 2022, 1:01 AM), https://news.bloomberglaw.com/us-law-week/celebrity-crypto-fines-flag-lessons-for-lawyers [https://perma.cc/3JGR-2KTT]; Press Release, SEC, SEC Charges Kim Kardashian for Unlawfully Touting Crypto Security (Oct. 3, 2022), https://www.sec.gov/news/press-release/2022-183 [https://perma.cc/WM7H-R973]; Press Release, SEC, Two Celebrities Charged With Unlawfully Touting Coin Offerings (Nov. 29, 2018), https://www.sec.gov/newsroom/press-releases/2018-268.

[133] *See*, *e.g.*, Martin Hilti Fam. Tr. v. Knoedler Gallery, LLC, 137 F. Supp. 3d 430, 483 (S.D.N.Y. 2015) (recognizing state law causes of action for fraud, fraudulent concealment, aiding and abetting fraud against art galleries in the sale of artworks).

protects investors by providing them with disclosures so they can make informed investing decisions."[134] It is unclear, however, what sort of information required by securities registration would have better informed the public. Both Impact Theory and Stoner Cats involved well-known public figures and celebrities. A prospectus for a securities offering is unlikely to be read and, even if read, is unlikely to be understood by lay people.[135] As a 2012 article by the SEC staff recognized based on a Library of Congress Report: "[I]nvestors do not understand the most elementary financial concepts."[136] Moreover, newly formed startups or individual artists are unlikely to have any financial statements of past business. No doubt a large segment of the American public understands that NFTs are highly speculative, based on the media's coverage.[137] And, if people don't, NFT projects often include such warnings to their consumers in their terms of use, as both Impact Theory and Stoner Cats did.[138]

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[134] SEC Charges Stoner Cats, *supra* note 9.

[135] LEE, *supra* note 8, at 241-42.

[136] SEC STAFF, STUDY REGARDING FINANCIAL LITERACY AMONG INVESTORS vii-viii (2012) https://www.sec.gov/files/917-financial-literacy-study-part1.pdf [https://perma.cc/T4AY-UGJZ].

[137] *See* Sabrina Toppa, *Are More Than 95% of NFTs Worthless?*, THESTREET (Sept. 26, 2023, 7:19 AM), https://www.thestreet.com/crypto/innovation/are-more-than-95-of-nfts-worthless [https://perma.cc/AE55-XFX2].

[138] *See Impact Theory Site Terms and Terms of Sale*, FOUNDERSKEY.IO, https://web.archive.org/web/20240526114905/https://founderskey.io/termsofuse (last updated Oct. 12, 2021) [https://perma.cc/K8R7-KNB7] ("The value of KeyNFTs may be derived from the continued willingness of market participants to exchange fiat currency or digital assets for KeyNFTs, which may result in the potential for permanent and total loss of value of a particular KeyNFT should the market for that KeyNFT disappear. You acknowledge that the NFT ecosystem is in its infancy and as such, there could be risks that are unknown to us at this time. You agree and understand that you are solely responsible for determining the nature, potential value, suitability, and appropriateness of these risks for yourself, and that we do not give advice or recommendations regarding KeyNFTs, including the suitability and appropriateness of, and investment strategies for, KeyNFTs."); *Terms of Service*, STONER CATS, https://www.stonercats.com/terms (last updated July 30, 2021) [https://perma.cc/Y6YD-Q2U8] ("Each Stoner Cats NFT has no inherent or intrinsic value. We cannot guarantee that any purchasers of Stoner Cats NFTs will retain their original value, as their value is inherently subjective and factors occurring outside of the Platform may materially impact the value and desirability of any particular Stoner Cats NFT.").

D. Response to Criticisms

1. Commercial Speech Doctrine Does Not Shield Prior Restraints

Some critics may contend that the SEC's classification of artworks NFTs as securities is permissible as a form of regulation of commercial speech, subject to a lower level of protection under the *Central Hudson* test.[139] That argument ignores, however, that artistic expression, including artwork NFTs, is not commercial speech and is entitled to full First Amendment protection.[140] Thus, even if an artist makes a statement that is purely commercial speech — that is, it does "no more than propose a commercial transaction"[141] — that statement does not turn the artist's *artwork* into commercial speech. Unlike offerings of stocks,[142] artwork NFTs involve creative expression entitled to full First Amendment protection.[143] Even assuming for argument's sake that there is a "commercial speech" exception to the doctrine of prior restraints,[144] imposing a prior restraint on artwork NFTs restricts far more speech than the purely commercial.

Consider this example. For many years, Picasso's works drew little, if any, interest among art collectors and the art establishment in the

[139] *See* Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n, 447 U.S. 557, 564 (1980).

[140] *See supra* notes 48–64 and accompanying text.

[141] Pittsburgh Press Co. v. Pittsburgh Comm'n on Hum. Rel., 413 U.S. 376, 385 (1973).

[142] Several scholars contend that securities regulation should be subject to greater First Amendment scrutiny than the low to no scrutiny often assumed. *See, e.g.*, Couture, *supra* note 102, at 954-69 (arguing for First Amendment scrutiny of securities regulation); Lloyd L. Drury, *Disclosure is Speech: Imposing Meaningful First Amendment Constraints on SEC Regulatory Authority*, 58 S.C. L. REV. 757, 779-88 (2007) (same); Heyman, *supra* note 80, at 211-30 (same); Karl M. F. Lockhart, *A 'Corporate Democracy'? Freedom of Speech and the SEC*, 104 VA. L. REV. 1593, 1598-99 (2018) (same); Antony Page, *Taking Stock of the First Amendment's Application to Securities Regulation*, 58 S.C. L. REV. 789, 806-30 (2007) (same).

[143] *See supra* notes 48–64 and accompanying text.

[144] In dicta in a 1976 decision, the Supreme Court suggested that commercial speech "may also make inapplicable the prohibition against prior restraints." Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, Inc., 425 U.S. 748, 772 n.24 (1976); *see* Cent. Hudson Gas & Elec. Corp., 447 U.S. at 571 n.13. However, the Court has never so held, and its later decision casts doubt on that suggestion. *See infra* notes 148–155 and accompanying text.

United States, given how radical — and even "degenerate" — they seemed at the time.[145] Imagine his representatives tried to sell his works to the public by touting him as a promising new artist whose works will be "great investments" and "will return great value" one day, urging them to become "patrons" of Picasso and a part of his "artistic enterprise" by investing in his paintings. Even if this promotion were treated as commercial speech under an overly broad understanding of that term, it would not turn Picasso's paintings into commercial speech under the First Amendment. And even if the SEC took the view that the promotional statements created an investment contract under the *Howey* test (contrary to the approach of the federal courts[146]) and required Picasso to register his offering of paintings and other artworks as securities before he could sell them to the public, that SEC ruling would constitute an impermissible prior restraint.[147]

The Court's approach to commercial speech does not create exceptions to other fundamental First Amendment protections, such as the doctrine of prior restraints. The Supreme Court's analysis in *Sorrell v. IMS Health, Inc.*[148] is instructive. The case involved a permanent restraint on pharmacies from disseminating certain information for marketing purposes.[149] Even though the Court did not analyze the prior restraint doctrine, its analysis of the intersection between commercial speech and other First Amendment doctrines is relevant.[150] In the case, a state law prohibited "pharmacies, health insurers, and similar entities

[145] *See* HUGH EAKIN, PICASSO'S WAR: HOW MODERN ART CAME TO AMERICA 44-55, 145 (2022); *see also id.* at 44-55 (discussing backlash and hostile reception to Armory Show in 1913 and modern art).

[146] *See* Stenger v. R.H. Love Galleries, Inc., 741 F.2d 144, 147 (7th Cir. 1984) ("Plaintiff's plea that we establish a regulatory framework for the sale of art cannot be answered through the securities laws.").

[147] Some scholars have suggested that artworks should be subject to securities regulation to protect art investors. Surprisingly, the law review articles devote little or no attention to the First Amendment implications of such proposal. *See, e.g.*, Holm, *supra* note 130, at 386 (arguing "[a]rt transactions are in substance investment contracts" that should be subject to securities law, but ignoring the First Amendment issue such a proposal raises).

[148] 564 U.S. 552 (2011).

[149] *Id.* at 558-59.

[150] *Id.* at 571-72.

from selling prescriber-identifying information, absent the prescriber's consent."[151] The pharmacies were allowed to share prescriber-identifying information "for any reason save one: [t]hey must not allow the information to be used for *marketing*."[152] Because the law restrained the speech of particular speakers (e.g., pharmacies), the Court held it was unconstitutional under heightened scrutiny.[153] And the Court held there was "no exception" for commercial speech to the strict scrutiny of content-based laws, even if the laws appear content-neutral on their face, but were enacted for content-based reasons.[154] Thus, where a law violates fundamental First Amendment protections, invoking "commercial speech" is unavailing. In all events, "the outcome is the same whether a special commercial speech inquiry or a stricter form of judicial scrutiny is applied."[155]

2. Artists' Business Development Does Not Disqualify Their First Amendment Rights

Some critics may defend the SEC's enforcement orders against the two NFT projects of Impact Theory and Stoner Cats because both projects were using NFTs as a part of building a new media business for online gaming and an animated series, respectively.[156] Under this defense, it is perfectly fine for the SEC to target a business — the "next Disney" — that attracts investors into a "common enterprise" under the *Howey* test.[157] The SEC may have been proceeding under this view because it repeatedly emphasized the business aspirations of both NFT projects in the enforcement orders:

> Impact Theory emphasized that the company was "trying to build the next Disney," and, if successful, it would deliver "tremendous value" to KeyNFT purchasers, and that the future

[151] *Id.* at 559.

[152] *Id.* at 572 (emphasis added).

[153] *Id.* at 557.

[154] *Id.* at 566.

[155] *Id.* at 571.

[156] *See* Impact Theory Order, *supra* note 10, at ¶ 2; Stoner Cats Order, *supra* note 10, at ¶ 2.

[157] *See* SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1946).

> value of the KeyNFTs would be significantly greater than their purchase price.[158]
>
> On its website, SC2 [the Stoner Cats' project] promised that if 100% of the NFTs were sold (which happened), it would facilitate the creation of a decentralized autonomous organization ("DAO") comprised of Stoner Cats NFT holders and that it would commit to working with the DAO to "develop at least one new animation project a year for the next three years." The website promised that NFT holders would have access to this additional content.[159]

The SEC's orders apparently treated the NFT projects' collection of resale royalties, often called creator royalties, as *inculpatory* activity of the two projects.[160] This is puzzling. Visual artists of all kinds seek creator royalties in their resale of the artworks to better capture the value of their artworks over time based on their success and to sustain their artistic pursuits.[161] Indeed, resale royalties have a venerable history originating from French copyright law and the *droit de suite* for physical works of visual art; now eighty countries recognize such a right under copyright law.[162] Although U.S. copyright law does not, the U.S. Copyright Office favored such an approach either as a matter of copyright law or as a matter of contract.[163] It is a mystery why the SEC viewed the collection of resale royalties as problematic under securities law. Resale royalties go back to the artist or project and *decrease* the amount of any profit an NFT holder makes from a resale.[164] In other words, resale royalties are income to artists, but they are a loss to the NFT purchaser. Indeed, when the NFT holder sells the NFT for a loss, the resale royalty that goes as income to the NFT project *increases* the

[158] Impact Theory Order, *supra* note 10, at ¶ 6.

[159] Stoner Cats Order, *supra* note 10, at ¶ 11.

[160] *See* Impact Theory Order, *supra* note 10, at ¶ 11; Stoner Cats Order, *supra* note 10, at ¶ 10.

[161] *See* LEE, *supra* note 8, at 142-43.

[162] *Id.* at 140-41.

[163] *Id.*

[164] *See generally id.* at 140-44 (discussing the history of resale royalties for artists under French copyright law and their adoption for NFTs).

loss, not profit, to the holder who sold it.[165] Even when an NFT is sold for a profit, the resale royalty *decreases* the profit of the seller. That is why many NFT holders have simply avoided paying royalties by selling NFTs on marketplaces that don't collect them, relegating resale royalties almost to a nullity on these marketplaces.[166]

However, the SEC speculated that future resale royalties could have helped Stoner Cats create its show, and "[i]f the Stoner Cats show was successful, the price of the NFTs could rise and so could the amount of royalties."[167] To borrow the Supreme Court's words, "this income — if indeed there is any — is far too speculative and insubstantial to bring the entire transaction within the Securities Acts."[168]

Far from avoiding the First Amendment problem, the SEC's targeting of efforts to develop a media or entertainment business that creates artistic expression only compounds the problem. The targeting of such efforts for content creation only makes clear that the SEC's order restricts not only the existing artworks in the NFTs offered, but also the *future expression* of the NFT projects in developing an online game by

[165] *Cf.* Stenger v. R.H. Love Galleries, Inc., 741 F.2d 144, 147 (7th Cir. 1984) (discussing adverse interests of art seller and dealer).

[166] *Cf.* Leeor Shimron, *NFT Creators Are Suddenly Losing a Major Source of Income*, FORBES (Oct. 24, 2022, 9:29 AM), https://www.forbes.com/sites/leeorshimron/2022/10/24/nft-creators-are-suddenly-losing-a-major-source-of-income/?sh=7765f65b3063 ("A growing trend in the NFT space is the elimination of creator royalties among major NFT collections, marketplaces, and platforms."). For an innovative proposal to help creators enforce royalties, see Katelyn Holcomb, Note, *The Paradoxical Solution to Enforce Resale Royalties and Keep the NFT Market Decentralized*, 20 WASH. J.L. TECH. & ARTS (forthcoming 2025) (manuscript on file with author).

[167] Stoner Cats Order, *supra* note 10, at ¶ 10.

[168] United Hous. Found. Inc. v. Forman, 421 U.S. 837, 856 (1975).

Impact Theory[169] or a web animated series by Stoner Cats.[170] But the Supreme Court has long recognized that entertainment, films, and video games are entitled to full First Amendment protection.[171] And the Court has also recognized that government restrictions imposed on the *funding* of creative expression raise First Amendment problems as well.[172] As Justice Kennedy explained in *Citizens United v. FEC*, a case involving corporate funding of an election-related film, "[a]ll speakers, including individuals and the media, use money amassed from the economic marketplace to fund their speech," which is protected by the First Amendment.[173]

However one interprets the *Howey* test, it does not immunize the SEC from First Amendment scrutiny. Securities law can permissibly impose

[169] *See* Jon Stojan, *Tom Bilyeu and Impact Theory's Quest to Revolutionize the Entertainment Industry Through Gaming: Exploring Project Kyzen*, LA WEEKLY (July 17, 2023), https://www.laweekly.com/tom-bilyeu-and-impact-theorys-quest-to-revolutionize-the-entertainment-industry-through-gaming-exploring-project-kyzen/; *see also* Impact Theory, *We Are the New House of Ideas*, FOUNDERSKEY.IO, https://web.archive.org/web/20240224103856/https://founderskey.io/ [https://perma.cc/9H8G-AU82] ("Our mission is to introduce people to empowering ideas at scale through story. In addition to Project Kyzen and Merry Modz, we currently have an entire slate of stories in development. There are several different ways that our projects will take to come to life, but the most common path will be starting as a comic book.").

[170] *See About*, STONER CATS, https://www.stonercats.com/ (last visited Oct. 7, 2024) [https://perma.cc/33CX-R4LT] ("In the before-times (aka pre-pandemic), three seasoned creators, Ash Brannon, Chris Cartagena, and Sarah Cole developed a little show called Stoner Cats. Based on Sarah's personal experience with her mother, Stoner Cats is a story of a woman who uses medical marijuana to alleviate her early Alzheimer's symptoms and her beautiful family of cats who will do literally anything to save her. Once Mila Kunis and her Orchard Farm Productions partners heard this story, they knew that a hilarious and intimate story like this needed to have deep direct engagement with its audience. So they formed a formidable collective of voice talent, animators, and creatives of all kinds to come together with technology and NFT experts (including the brilliant minds behind CryptoKitties) to bring this story to life using NFTs.").

[171] *See* Brown v. Ent. Merchs. Ass'n, 564 U.S. 786, 790 (2011) (video games are protected speech); Schad v. Borough of Mount Ephraim, 452 U.S. 61, 65 (1981) ("Entertainment, as well as political and ideological speech, is protected; motion pictures, programs broadcast by radio and television, and live entertainment, such as musical and dramatic works fall within the First Amendment guarantee.").

[172] *See* Citizens United v. FEC, 588 U.S. 310, 355-56 (2010).

[173] *Id.* at 351.

restrictions on the *shares of stock* in Disney or another company.[174] But what securities law cannot do is impose restrictions on the *artworks* of Disney. From a First Amendment perspective, the SEC's approach has the perverse effect of chilling the efforts of artists and creators to develop new ways to sustain themselves as artists, which is daunting to do in the United States.[175] If artists must hire high-priced securities lawyers to even consider whether they can offer artwork NFTs, many artists are unlikely to have the resources to do so. Instead, to borrow Justice Kennedy's words, artists "will choose simply to *abstain from protected speech* — harming not only themselves but society as a whole."[176]

II. THE ORIGINAL PUBLIC MEANING OF "INVESTMENT CONTRACT" IN THE SECURITIES ACT OF 1933 REQUIRES AN *INVESTMENT* OF MONEY IN EXCHANGE FOR A *CONTRACTUAL* RIGHT TO RECEIVE INCOME SOLELY FROM THE OFFEROR'S EFFORTS

Drawing on the analysis of Amici Securities Law Professors,[177] Part II explains why NFTs do not constitute investment contracts absent a contractual right for the NFT owner to receive profits or income derived from the NFT venture. To determine if an investment contract exists, one must, as a threshold matter, examine the financial instruments offered by the business venture to see if they create an "investment contract" under the Securities Act, as interpreted by *Howey*, including if they offered a contractual right of the investor to receive income made solely from the offeror's efforts.[178] This interpretation of "investment contract" aligns with both the text of the Securities Act,[179] as understood contemporaneously with its passage in 1933, and the Supreme Court's

[174] *See* 15 U.S.C. § 77b(a)(1) ("stock" is an example of a security). *See generally* Michael R. Siebecker, *Corporate Speech, Securities Regulation, and an Institutional Approach to the First Amendment*, 48 WM. & MARY L. REV. 613, 642-45 (2006) (summarizing the Supreme Court's discussion of securities regulation and the First Amendment).

[175] *See* LEE, *supra* note 8, at 21-28.

[176] *Citizens United*, 588 U.S. at 335 (emphasis added).

[177] *See* Brief of Securities Law Scholars as Amici Curiae in Support of Coinbase's Motion for Judgment on the Pleadings, *supra* note 41, at 3-12.

[178] *See infra* notes 281–289 and accompanying text.

[179] *See* § 77b(a)(1).

cases interpreting the text.[180] An investment contract cannot exist without a contract of a particular kind: a quid (a person's investment of money) pro quo (in exchange for a right of the investor to receive profits or income generated solely by the offeror's efforts). This reading of "investment contract" is clear from the Act's text, which adopts a term derived from state "blue sky" laws that conveyed this distinct meaning to the public.[181] To the extent there is any ambiguity in the Securities Act, the canon of constitutional doubt favors, if not compels, this interpretation to avoid the potential First Amendment problem of imposing a prior restraint on the sale of artworks, including artwork NFTs, through securities registration.[182] Courts in pending lawsuits involving this issue should carefully examine the First Amendment problem created by an overbroad application of "investment contract" to NFTs and, instead, adhere to its original public meaning.[183]

[180] *See infra* notes 261–276 and accompanying text (discussing ordinary meaning of "investment contract" at time of passage of Securities Act of 1933); *infra* notes 296–305 (analyzing all Supreme Court decisions on "investment contract").

[181] *Id*.

[182] *Cf.* Lowe v. SEC, 472 U.S. 181, 190 (1985) (applying canon of constitutional doubt to securities law).

[183] Courts have not identified this First Amendment problem in the cases in which plaintiffs have alleged that NFTs were securities, although the defendants apparently did not raise the issue. *See, e.g.*, Harper v. O'Neal, No. 23-21912-CIV, 2024 WL 3845444, at *8-11 (S.D. Fla. Aug. 16, 2024) (denying motion to dismiss and finding sufficient allegations that Astrals digital avatar NFTs promoted by Shaquille O'Neal were investment contracts and unregistered securities); Dufoe v. DraftKings Inc., No. 23-cv-10524, 2024 WL 3278637, at *10 (D. Mass. July 2, 2024) (denying motion to dismiss and finding sufficient allegations that DraftKings NFTs of images of NFL players were investment contracts); Friel v. Dapper Labs, Inc., 657 F. Supp. 3d 422, 450 (S.D.N.Y. 2023) (rejecting motion to dismiss and finding that NBA's NFTs called "Moments" for video highlights could be an investment contract based on allegations including "that Dapper Labs maintains private control over the Flow Blockchain, which significantly, if not entirely, dictates Moments' use and value"). Dapper Labs settled the case against it. *See* Cheyenne Ligon, *Dapper Labs Agrees to $4M Settlement in Class Action Securities Suit*, CoinDesk, https://www.coindesk.com/policy/2024/06/04/dapper-labs-agrees-to-4m-settlement-in-class-action-securities-suit/ (last updated June 4, 2024, 1:11 PM) [https://perma.cc/AJR5-QSHQ]. In July 2024, the artists Jonathan Mann and Brian L. Frye filed a declaratory judgment action against the SEC seeking a declaration that their respective NFTs were not securities, but the complaint does not mention the First Amendment. *See* Complaint at 7-9, Mann v. SEC, No. 24-cv-01881 (E.D. La. July 29, 2024) (describing NFTs as works of digital art yet failing to recognize that the First

A. The Original Public Meaning of "Investment Contract" in 1933

The history of "investment contract" shows that its origin was derived from popular use. It was *not* a technical term, legal term of art, or neologism created by Congress or state legislatures. Instead, it was a term whose origin dates back as early as the 1800s and was based on the ordinary, lay meaning of "investment" and "contract." People sold investments in contracts — meaning the contract itself was the vehicle for a person's investment. Typically, the offering stipulated how much profit or income an investor would receive by investing in the contract.[184]

1. People Offered "Investment Contracts" as Early as the 1800s

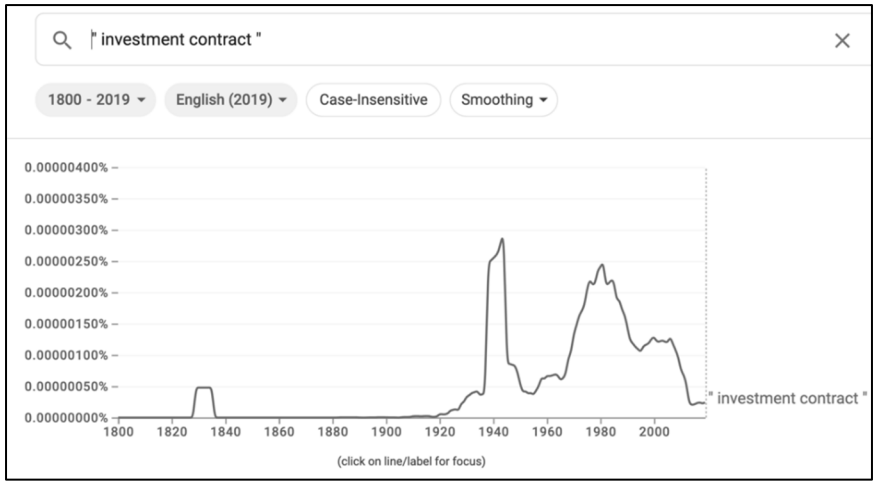
A Google Books Ngram analysis of the use of the term "investment contract" in the corpus of books in Google Books shows that its origin dates to as early as the 1800s, as shown in Figure 1 below.[185]

Amendment protects artistic expression). Whether "Bored Ape" NFTs are investment contracts is an issue before Judge Olguin in the Central District of California. *See* Pl.'s' Suppl. Mem. in Further Supp. of Opp'n. to Def.s' Mot. to Dismiss Second Am. Class Action Compl., Johnson v. Yuga Labs, Inc., No. 2:22-cv-08909-FMO-PLA (filed Nov. 4, 2024); *see also* Winston Cho, *Celebrity Promoters Sued Over Bored Ape NFT Endorsements*, HOLLYWOOD REP. (Dec. 9, 2022, 3:45 PM), https://www.hollywoodreporter.com/business/business-news/celebrity-promoters-sued-over-bored-ape-nft-endorsements-1235279115/ [https://perma.cc/3VT4-LH33] (lawsuit alleging Bored Ape NFTs were unregistered securities). A lawsuit against Cristiano Ronaldo alleging the sale of his NFTs involved unregistered securities has been stayed pending a determination of whether the case is subject to mandatory arbitration. *See* Billie Schwab Dunn, *Cristiano Ronaldo Suffers Legal Blow*, NEWSWEEK (May 7, 2024, 10:45 AM), https://www.newsweek.com/cristiano-ronaldo-legal-blow-binance-lawsuit-sizemore-1897875 [https://perma.cc/NA6A-FSNZ]. In one trademark lawsuit, the defendant asserted a First Amendment interest in his NFTs depicting images of "MetaBirkins" bags, which were similar to Hermès iconic Birkin bags; the district court ruled that the defendant's use of "MetaBirkins" as a source identifier fell outside the First Amendment protection set forth in *Rogers v. Grimaldi*, 875 F.2d 994, 998 (2d Cir. 1989). *See* Hermès Int'l v. Rothschild, 603 F. Supp. 3d 98, 104-06 (S.D.N.Y. 2022), *appeal filed*, No. 23-1081 (2d Cir. Jul. 24, 2023).

[184] *See infra* notes 187–188 and accompanying text (investment contract offering "6 per cent. interest and a share of the profits"); *see also infra* notes 189, 197–199, 201–203, 208–209 and accompanying text (providing other examples of investment contracts guaranteeing profits or dividends).

[185] Frequency of Use of "Investment Contract" in Books from 1800–2019, GOOGLE BOOKS NGRAM VIEWER, https://books.google.com/ngrams/graph?content=%22investment

FIGURE 1. GOOGLE BOOKS NGRAM FOR "INVESTMENT CONTRACT" AS USED IN CORPUS OF BOOKS



Even before any state legislature enacted a "blue sky" law to regulate securities, the first being enacted in 1911,[186] the term "investment contract" was used in popular discourse, as shown in Figure 1 and below with historical examples. In other words, the state legislatures did not coin the term "investment contract." People did.

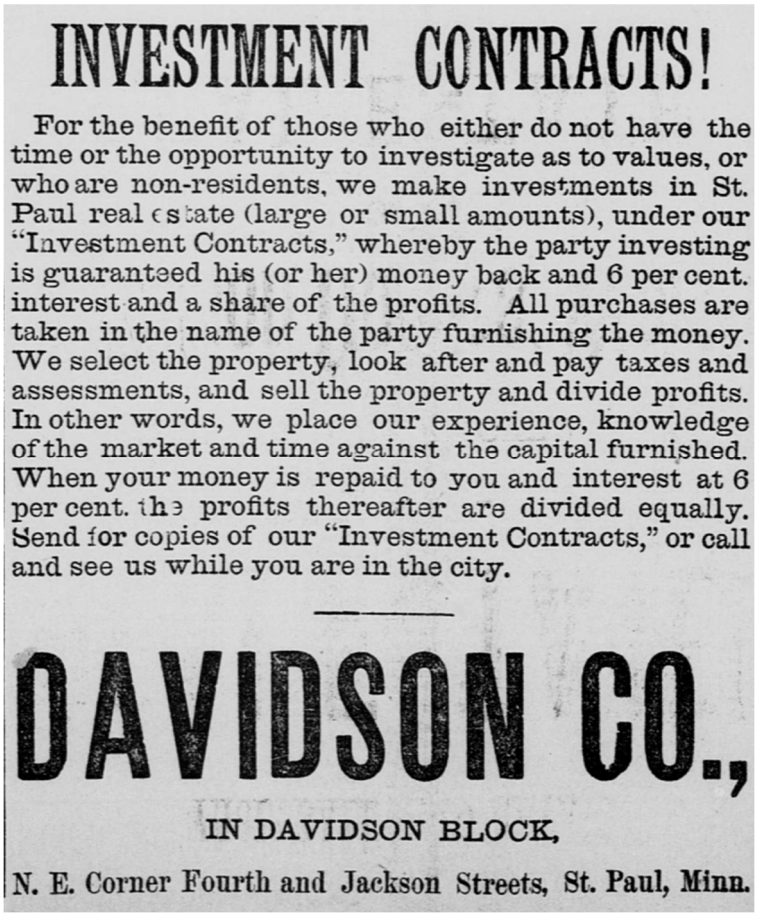
For example, on January 17, 1887, the real estate business the Davidson Company offered the sale of "investment contracts" in an ad published in the *St. Paul Daily Globe*, as depicted in relevant part in Figure 2.[187]

+contract%22&year_start=1800&year_end=2019&corpus=en-2019&smoothing=3 (last visited Aug. 24, 2024) [https://perma.cc/6VPR-UA8J].

[186] Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L. REV. 347, 361-63 (1991).

[187] Davidson Co., *Wholesale and Retail Real Estate!*, ST. PAUL DAILY GLOBE, Jan. 17, 1887, at 8, https://chroniclingamerica.loc.gov/lccn/sn90059522/1887-01-17/ed-1/seq-10/ [https://perma.cc/G8FS-AJF2].

FIGURE 2. DAVIDSON CO. AD OFFERING INVESTMENT CONTRACTS ON JAN. 17, 1887



INVESTMENT CONTRACTS!

For the benefit of those who either do not have the time or the opportunity to investigate as to values, or who are non-residents, we make investments in St. Paul real estate (large or small amounts), under our "Investment Contracts," whereby the party investing is guaranteed his (or her) money back and 6 per cent. interest and a share of the profits. All purchases are taken in the name of the party furnishing the money. We select the property, look after and pay taxes and assessments, and sell the property and divide profits. In other words, we place our experience, knowledge of the market and time against the capital furnished. When your money is repaid to you and interest at 6 per cent. the profits thereafter are divided equally. Send for copies of our "Investment Contracts," or call and see us while you are in the city.

DAVIDSON CO.,

IN DAVIDSON BLOCK,

N. E. Corner Fourth and Jackson Streets, St. Paul, Minn.

As the ad indicates, the investment contract offered by the real estate company "guarantee[s]" to the investor "his (or her) money back and 6 per cent. interest and a share of the profits." Several months later, Davidson ran another ad for its investment contracts, with the same guarantee of profits from their investment contracts, as shown in Figure 3.[188]

[188] Davidson Co., *Investment Contracts!*, ST. PAUL DAILY GLOBE, May 1, 1887, at 25, https://chroniclingamerica.loc.gov/lccn/sn90059522/1887-05-01/ed-2/seq-25/ [https://perma.cc/5APY-UJWH].

FIGURE 3. DAVIDSON CO. AD OFFERING INVESTMENT CONTRACTS ON MAY 1, 1887


THE · DAVIDSON · COMPANY

OFFER ONE MILLION DOLLARS WORTH of REAL ESTATE

FOR SALE!

OUR INVESTMENT CONTRACTS:

We have improved business blocks for sale, bearing rentals from $10,000 to $30,000 per year; business locations in the very heart of the city suitable to improve, ranging in cost from $600 to $1,500 per front foot; residence lots, blocks, additions, acres in almost every part of the city, and from the highest to the lowest prices. We control several additions between St. Paul and Minneapolis in the popular Midway District. We buy and sell for all who desire to make money in real estate in St. Paul or Minneapolis or in the Midway District between these cities, or in farms or wild lands in the Northwest on the following terms: We take the money to be invested and give one of our "Investment Contracts" therefor, by which we agree to use our best judgment, buy on the lowest and best terms possible, look after the property, pay taxes and assessments out of money to be furnished by the investor, take all titles in the name of the investor, sell to best advantage at highest price and on best terms obtainable, and when the deal is closed, (time therefor being limited in the Investment Contract), the investor shall first receive all of his or her money back, with interest thereon at 6 per cent., and ONE-HALF (½) THE PROFITS. We take the other one-half (½) the profits instead of commissions or other compensations. This fully identifies our interest with that of the investor, and insures carefulness and discretion in buying LOW and diligence and energy in selling HIGH. Interviews furnished to all who desire. Send for copies of our Investment Contracts.

We have recently REMOVED from the "Davidson Block" to "Union Block," another of the business blocks owned by members of our firm, a cut of which appears above. Address hereafter as follows:

Other real estate investment ventures offered similar investment contracts.[189] Sisley & Bell, brokers of real estate, loans, and investments, published an ad in *The Morning Leader* on October 4, 1889, that boasted: "We have the Best List of all kinds of Acreage, Business and Residence

[189] *See, e.g.*, Duluth Invs., *Duluth Investments*, NEW HAVEN DAILY MORNING J. & COURIER, Dec. 23, 1887, at 3, https://chroniclingamerica.loc.gov/lccn/sn82015483/1887-12-23/ed-1/seq-3/ [https://perma.cc/F445-SNA2] (newspaper ad stating "[w]e give special attention to investing money for non residents in Real Estate in Duluth, Minn., . . . where investors are constantly realizing 15 to 70 per cent net on their investments. Send for a copy of our investment contracts"); *Legal Notices*, ALBUQUERQUE MORNING J., Oct. 22, 1917, at 7, https://chroniclingamerica.loc.gov/lccn/sn84031081/1917-10-22/ed-1/seq-7/ [https://perma.cc/X2UM-UQ2J] (articles of incorporation for real estate business planning to offer "investment contracts"); Welshans & Low, *Welshans & Low*, OMAHA DAILY BEE, Jan. 5, 1888, at 7, https://chroniclingamerica.loc.gov/lccn/sn99021999/1888-01-05/ed-1/seq-7/ [https://perma.cc/542V-EX8G] (newspaper ad stating "invest for non-residents, perfect titles, attend to all business, take title in investors name for share of profits when deal is closed. Send stamp for our Investment Contract").

Property. Send for our *Investment Contract Guaranteeing Profits*."[190] Through the investment contracts, people, including nonresidents,[191] could invest in the offeror's real estate business, instead of buying land for their own personal use.

The term "investment contract" was not limited to real estate ventures. As explained below, the term was used broadly to apply to an array of investments, including contractual offerings in bonds, insurance,[192] mining businesses,[193] and general, unspecified investments. As the real estate developer and entrepreneur Percy M. Pond explained in a speech in 1903, "Investment contracts such as are offered by building and loan societies, real estate concerns, and life insurance companies are often of great value in stimulating . . . the saving of

[190] Sisley & Bell, *Real Estate, Loan and Investment Brokers*, MORNING LEADER (Washington), Oct. 4, 1889, at 4, https://books.google.com/books?id=KSlmAAAAIBAJ&q=%22investment+contract%22#v=snippet&q=%22investment%20contract%22&f=false [https://perma.cc/QJ2W-TNRK] (emphasis added) (ad); *see also Articles of Incorporation of The Home Builders Company*, SANTA FE NEW MEXICAN, Jan. 2, 1903, at 4, https://chroniclingamerica.loc.gov/lccn/sn84020630/1903-01-02/ed-1/seq-4/ [https://perma.cc/SS7H-PRQF] (articles of incorporation of home building and real estate company authorizing it to sell "investment contracts for the purpose of raising money").

[191] *See, e.g.*, Davidson Co., *One Million Dollars' Worth of Improved Business Blocks for Sale*, ST. PAUL DAILY GLOBE, Dec. 25, 1886, at 26, https://chroniclingamerica.loc.gov/lccn/sn90059522/1886-12-25/ed-1/seq-29/ [https://perma.cc/P77F-HE8J] (ad for "[i]nvestments made for non-residents under a special investment contract").

[192] *See, e.g.*, Aetna Life Ins. Co., *Life Insurance Which IS an Investment*, BIRMINGHAM AGE-HERALD, Apr. 25, 1920, at 64, https://chroniclingamerica.loc.gov/lccn/sn85038485/1920-04-25/ed-1/seq-64/ [https://perma.cc/3CKZ-DWTG] (ad describing life insurance policy as an "investment contract").

[193] Speculative, if not fraudulent, companies were called "wildcat" companies; many were in the mining and oil businesses. *See* Gilbert E. Brach, Note, *The Blue Sky Law*, 3 MARQ. L. REV. 142, 143 (1919); Richard G. Himelrick, *A Historical Introduction to Arizona's Securities Laws*, 7 ARIZ. SUMMIT L. REV. 679, 687-88 (2014); N. AM. SEC. ADMIN. ASS'N, A CENTURY OF INVESTOR PROTECTION 1911–2011, https://www.nasaa.org/wp-content/uploads/2011/07/100_Years_Commemorative_FINAL.pdf [https://perma.cc/A9PL-N67D] (citing an estimate that 75% of 1,500 companies that applied for business permits in Kansas following passage of its blue-sky law "were mining, oil, gas and stock selling schemes of a fraudulent nature in which there could be no possible return for the money invested").

money."[194] But, Pond warned, "The greatest care . . . should be exercised to enter upon no contract that does not provide an equitable settlement in case the investor is unable to carry it through to maturity."[195] As Pond's remarks indicate, business ventures offered contracts as the vehicle for investments.

For example, the New York Life Insurance ran an ad in *The Morning Herald* (*Baltimore*) on January 11, 1889 that offered an "unequaled Insurance *Investment Contract*," an "Insurance Bond, with Guaranteed Interest."[196] The ad included three examples, with figures, of the actual amount of dividends and returns paid to the beneficiaries under the contract.[197] Similarly, in 1920, Aetna Life Insurance touted, in a full-page ad, its life insurance policy as a "WONDERFUL Investment Contract."[198] The American Mining Investment Company advertised the

[194] *Percy Pond on Investments That Are Safe for Young Men*, PAC. COM. ADVERTISER (HONOLULU), Dec. 12, 1903, at 5, https://chroniclingamerica.loc.gov/lccn/sn85047084/1903-12-12/ed-1/seq-5/ [https://perma.cc/B4CH-42M2].

[195] Id.

[196] N.Y. Life Ins. Co., *Will It Pay? That's the Question!*, MORNING HERALD (Baltimore), Jan. 11, 1889, at 4, https://books.google.com/books?id=n_5BAAAAIBAJ&q=%22investment+contract%22#v=snippet&q=%22investment%20contract%22&f=false [https://perma.cc/K7Z9-2NXM] (emphasis added) (ad).

[197] *Id.*; *see also An Insurance Conundrum*, FREE LANCE (Fredericksburg), Apr. 17, 1902, at 2, https://chroniclingamerica.loc.gov/lccn/sn87060165/1902-04-17/ed-1/seq-2/ [https://perma.cc/HK8S-B2Y7] (ad touting "New York Life under Investment Contracts pays Larger Dividends"); Cont'l Fin. Co., ST. LOUIS REPUBLIC, Nov. 30, 1902, at 2, https://chroniclingamerica.loc.gov/lccn/sn84020274/1902-11-30/ed-1/seq-38/ [https://perma.cc/J3TC-6M5G] (ad for "mutual loan and investment contracts"); Mut. Life Ins. Co. of N.Y., GRANT CNTY. HERALD (Lancaster), Jan. 23, 1902, at 6, https://chroniclingamerica.loc.gov/lccn/sn85033133/1902-01-23/ed-1/seq-6/ [https://perma.cc/G7WK-AMAD] (ad for "most attractive INVESTMENT CONTRACTS which the science of Life Insurance and the progress of the age can produce"); Pac. Mut. Life Ins. Co., *The Mutual Investment Contract*, OTTUMWA SEMI-WEEKLY COURIER, May 1, 1902, at 6, https://chroniclingamerica.loc.gov/lccn/sn86061214/1902-05-01/ed-1/seq-6/ [https://perma.cc/V4VA-Q7X6] (ad for "Mutual Investment Contract of The Pacific Mutual Life Insurance Co. of California"); Pac. Mut. Life Ins. Co. of Cal., *The Mutual Investment Contract*, MAUI NEWS, Dec. 29, 1906, at 6, https://chroniclingamerica.loc.gov/lccn/sn82014689/1906-12-29/ed-1/seq-6/ [https://perma.cc/3HNG-ZS6N] (ad for "The Mutual Investment Contract").

[198] Aetna Life Ins. Co., *supra* note 192; *see also* Mut. Life Ins. Co., MAUI NEWS, Jan. 9, 1904, at 4, https://chroniclingamerica.loc.gov/lccn/sn82014689/1904-01-09/ed-1/seq-4/ [https://perma.cc/4HTE-RG7Y] (ad for mutual "investment contract").

sale of its mining investment contracts for shares in gold mining business "with the certainty of several dividends this year."[199] The Port Pearlas Banana Co. even sold a "novel, short term banana investment contract."[200]

One company's ad offering the sale of investment contracts didn't explain how the company would make money for investors. [201] Instead, the company simply offered the "diamond investment contracts" with a schedule of stipulated amounts for income each investor would supposedly receive, as shown in Figure 4.[202]

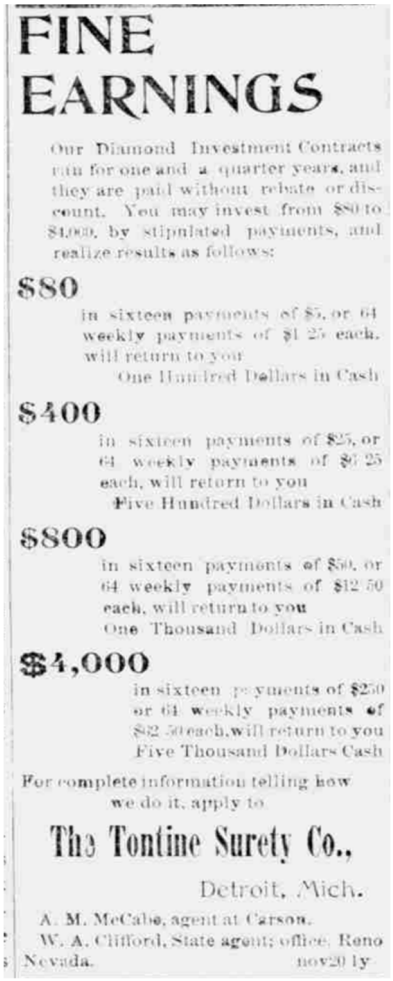
[199] Am. Mining Inv. Co., *Kettle-Curlew Drummer's Mines and Townsite and the Susquehanna Placer Gold Mines*, ST. PAUL GLOBE, Feb. 3, 1900, at 7, https://chroniclingamerica.loc.gov/lccn/sn90059523/1900-02-03/ed-1/seq-7/ [https://perma.cc/B6DQ-YJRD] (ad); *see also* Homestake Gold Mining Co., *Mines and Miners*, ST. PAUL GLOBE, Feb. 11, 1900, at 18, https://chroniclingamerica.loc.gov/lccn/sn90059523/1900-02-11/ed-1/seq-18/ [https://perma.cc/W2JK-ZFW9] (discussing mining investment contracts).

[200] Port Pearlas Banana Co., *Solicitors*, OMAHA DAILY BEE, June 14, 1908, at 27, https://chroniclingamerica.loc.gov/lccn/sn99021999/1908-06-14/ed-1/seq-27/ [https://perma.cc/225J-3E2X].

[201] Tontine Surety Co., *Fine Earnings*, MORNING APPEAL (Carson City), Nov. 22, 1899, at 2, https://chroniclingamerica.loc.gov/lccn/sn86076999/1899-11-22/ed-1/seq-2/ [https://perma.cc/BBU2-J7CG] (ad).

[202] *Id.*

FIGURE 4. TONTINE SURETY CO. OFFERING OF INVESTMENT CONTRACTS ON NOV. 22, 1899



FINE EARNINGS

Our Diamond Investment Contracts run for one and a quarter years, and they are paid without rebate or discount. You may invest from $80 to $4,000, by stipulated payments, and realize results as follows:

$80

in sixteen payments of $5, or 64 weekly payments of $1 25 each, will return to you
One Hundred Dollars in Cash

$400

in sixteen payments of $25, or 64 weekly payments of $6 25 each, will return to you
Five Hundred Dollars in Cash

$800

in sixteen payments of $50, or 64 weekly payments of $12 50 each, will return to you
One Thousand Dollars in Cash

$4,000

in sixteen payments of $250 or 64 weekly payments of $62 50 each, will return to you
Five Thousand Dollars Cash

For complete information telling how we do it, apply to

The Tontine Surety Co.,

Detroit, Mich.

A. M. McCabe, agent at Carson.
W. A. Clifford, State agent; office, Reno Nevada. nov20 1y

This example shows how the contract itself was the vehicle for the investment, and the offerors typically promoted their investment contracts by stipulating the profits or income the contracts would (putatively) yield for investors.[203]

[203] *See also, e.g.*, *Financial Statement of the North Dakota Improvement Company*, DEVILS LAKE INTER-OCEAN, Jan. 28, 2010, at 2, https://chroniclingamerica.loc.gov/lccn/sn88076516/1910-01-28/ed-1/seq-2/ [https://perma.cc/RWN2-NH2M] (setting forth "Ten

One business even called itself the American Contract Company, whose product was nothing more than selling "investment contracts payable in installments"[204] as shown in Figure 5. According to the company, it was "an absolutely safe system of investment."[205]

FIGURE 5. THE AMERICAN CONTRACT CO. AD FOR INVESTMENT CONTRACTS ON JULY 21, 1894

The Jefferson Guaranty & Surety Co. ran a similar ad on March 6, 1901, which touted its offer of "the best INVESTMENT CONTRACT on the Market," as shown in Figure 6.[206]

Good Reasons Why You Should Buy Our Ten-Year Profit Sharing Investment Contract," including profit-sharing and annual cash dividends); Tontine Loan and Sec. Co., *The Tontine Loan and Security Co.*, ST. LOUIS REPUBLIC, Oct. 8, 1902, at 4, https://chroniclingamerica.loc.gov/lccn/sn84020274/1902-10-08/ed-1/seq-18/ [https://perma.cc/ZV5Q-WG6W] (ad for "Six-Year Investment Contract[s]" with a listing of revenues yielded based on payments).

[204] Am. Cont. Co, *The American Contract Co.*, CHI. EAGLE, July 21, 1894, at 5, https://chroniclingamerica.loc.gov/lccn/sn84025828/1894-07-21/ed-1/seq-5/ [https://perma.cc/ZG6B-AHUV] (alteration in original).

[205] *Id.*

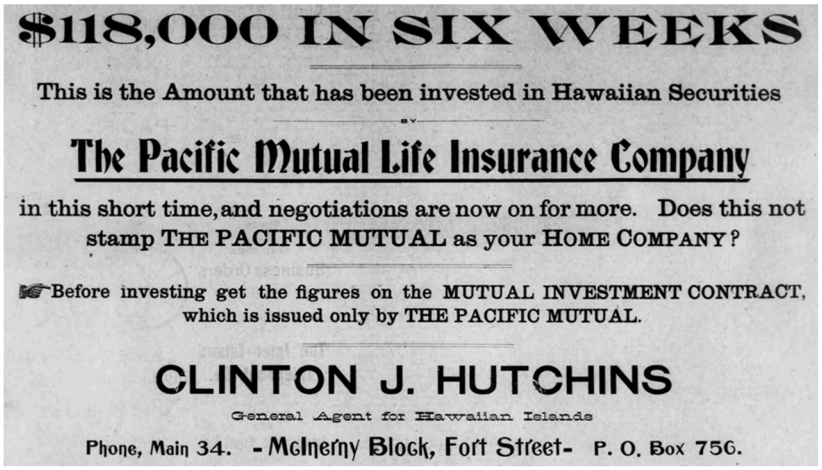
[206] Jefferson Guar. & Sur. Co., *The Jefferson Guaranty & Surety Co.*, RICHMOND CLIMAX, Mar. 6, 1901, at 3, https://chroniclingamerica.loc.gov/lccn/sn86069162/1901-03-06/ed-1/seq-3 [https://perma.cc/X57G-3JYE].

FIGURE 6. THE JEFFERSON GUARANTY & SURETY CO. AD ON MAR. 6, 1901

Likewise, the Pacific Mutual Life Insurance Company offered its "MUTUAL INVESTMENT CONTRACT," under the (misleading) title: "$118,00 IN SIX WEEKS," without any explanation of the offering, as shown in Figure 7.[207]

[207] Pac. Mut. Life Ins. Co., *$118,000 in Six Weeks*, HONOLULU REPUBLICAN, May 19, 1901, at 6, https://chroniclingamerica.loc.gov/lccn/sn85047165/1901-05-19/ed-1/seq-6/ [https://perma.cc/7HZL-RZKR] (ad); *cf. Every Figure Guaranteed in Policy*, HERALD & NEWS (Newberry), Apr. 7, 1905, at 2, https://chroniclingamerica.loc.gov/lccn/sn86063758/1905-04-07/ed-1/seq-2/ [https://perma.cc/S26F-ZK3E] (ad for "Mutual investment Contract"); *Pacific Mutual Life: The Mutual Investment Contract*, HERALD & NEWS (Newberry), Mar. 31, 1905, at 2, https://chroniclingamerica.loc.gov/lccn/sn86063758/1905-03-31/ed-1/seq-2/ [https://perma.cc/R3BC-TGGE] (ad for "Mutual Investment Contract" with forms including whole life, fifteen-payment life, and twenty-year endowment); *Pleased With the Mutual*, MIDLAND J (Rising Sun), Sept. 11, 1903, at 2, https://chroniclingamerica.loc.gov/lccn/sn89060136/1903-09-11/ed-1/seq-2/ [https://perma.cc/9F3P-X57G] (putative letter of customer of Mutual Life Insurance Co. endorsing insurance policy plus "investment contract" for an "endowment plan" purchased).

FIGURE 7. PACIFIC MUTUAL LIFE INSURANCE COMPANY AD ON MAY 19, 1901



Or consider The North Dakota Improvement Company's explanation of its investment contract in 1909, as shown in Figure 8:

FIGURE 8. THE NORTH DAKOTA IMPROVEMENT COMPANY'S INVESTMENT CONTRACT IN 1909

According to the ad, people consider two things in an investment: "[A] sufficient guarantee of a return, when due, of the amount invested" and "a rate of interest consistent with the guarantee."[208] The company's own investment contracts offered to investors a "rate of interest paid to the contract holder . . . based upon a pro rata share of the net profits" of the company.[209] This company later ran into financial trouble and was accused of engaging in fraud.[210]

These examples show that the contract itself was what was offered as the investment.[211] Entities sold *investment contracts*. The precise details

[208] N.D. Improvement Co., *Investment and Income*, FARGO F. & DAILY REPUBLICAN, Aug. 14, 1909, at 2, https://chroniclingamerica.loc.gov/lccn/sn85042224/1909-08-14/ed-1/seq-2/ [https://perma.cc/4QUL-LM6K].

[209] *Id.*; *see also Be a Partner in a Money Making Business*, FARGO F. & DAILY REPUBLICAN, Apr. 2, 1910, at 2, https://chroniclingamerica.loc.gov/lccn/sn85042224/1910-04-02/ed-1/seq-2/ [https://perma.cc/694N-25N8] (similar ad by same company); *The Real Tests of the Attractive Investment*, DEVILS LAKE INTER-OCEAN, Mar. 18, 1910, at 2, https://chroniclingamerica.loc.gov/lccn/sn88076516/1910-03-18/ed-1/seq-2/ [https://perma.cc/X7AJ-3CEY] (North Dakota Improvement Co.'s ad explaining how its investment contract is a "profit-sharing" contract that pays dividends).

[210] By 1913, the North Dakota Improvement Co. stopped taking payments on its existing contracts and was subject to a court-appointed receiver to readjust the disbursement of claims in an "equitable manner." *See Baldwin Named as Receiver*, FARGO F. & DAILY REPUBLICAN, Oct. 20, 1913, at 7, https://chroniclingamerica.loc.gov/lccn/sn85042224/1913-10-20/ed-1/seq-7/ [https://perma.cc/Q5TV-ZZD7]; *see also Amidon Sustains Demurer in Improvement Co. Case*, FARGO F. & DAILY REPUBLICAN, July 14, 1915, at 1, 10, https://chroniclingamerica.loc.gov/lccn/sn85042224/1915-07-14/ed-1/seq-10/ [https://perma.cc/72A6-5TW3] (court grants demurrer of federal indictment of four individuals who were not charged as being employees or agents of the North Dakota Improvement Company, which had allegedly fraudulently sold investment contracts); *Declared Unearned Dividends*, FARGO F. & DAILY REPUBLICAN, Oct. 28, 1916, at 1, 7, https://chroniclingamerica.loc.gov/lccn/sn85042224/1916-10-28/ed-1/seq-1/ [https://perma.cc/VRL6-RES9] (discussing trial of two individuals, E. A. Wilson and R. M. Farmer, in which evidence indicated fraudulent accounting of North Dakota Improvement Company inflating value of profits); *E.A. Wilson Found Guilty*, JAMESTOWN WKLY. ALERT, Nov. 16, 1916, at 6, https://chroniclingamerica.loc.gov/lccn/sn85042405/1916-11-16/ed-1/seq-6/ [https://perma.cc/K57S-82QF] (jury found E. A. Wilson guilty, but acquitted R. M. Farmer).

[211] *See also, e.g.*, *New Trust Co. in New Quarters*, FARGO F. & DAILY REPUBLICAN, Sept. 28, 1910, at 7, https://chroniclingamerica.loc.gov/lccn/sn85042224/1910-09-28/ed-1/seq-7/ [https://perma.cc/8537-CEB6] (article describing related Fargo Bond & Trust Co. offering savings accounts and investment contract of North Dakota Improvement Co.); *Surety Company Chartered*, RICHMOND DISPATCH, Nov. 11, 1902, at 8,

of the investment were almost secondary, at least in terms of how the contracts were often offered to the public. But, as many of the above examples show, a key ingredient of the public offerings of investment contracts was an entitlement of the investor to receive a share of the profits made from the venture.[212] That's what the investors were buying.

As the North Dakota Improvement Company's ad recognized, investors want a "sufficient guarantee of a return," such as "a pro rata share of the net profits" offered by its contract.[213] The company boasted about "The Power of Contract" as a popular "form of investment."[214] It "*entitles* you to share . . . all the net earnings of [the] business."[215] Moreover, after Kansas passed the first blue-sky law that regulated companies offering securities in 1911, such investment companies had a legal incentive to include a right to profits in their contracts because Kansas's law prohibited companies from doing business in Kansas if they did "not *promise a fair return* on the stocks, bonds or other securities . . . offered for sale."[216] Ten other states adopted this approach by 1913.[217]

Ads to hire people to serve as sellers of investment contracts provide further evidence that what was being sold was the contract itself. On

https://chroniclingamerica.loc.gov/lccn/sn85038614/1902-11-11/ed-1/seq-8/ [https://perma.cc/X833-MYVX] ("The company is formed to *deal in investment contracts* to be paid for on the weekly or monthly plan . . . ." (emphasis added)).

[212] *See supra* notes 189–192, 198–199, 201, 203–205, 210-211; *infra* note 215-217.

[213] N.D. Improvement Co., *supra* note 208; *see also Ask Receiver for Prudential Investment Co.*, SAN ANTONIO LIGHT & GAZETTE, Dec. 4, 1909, at 1, https://chroniclingamerica.loc.gov/lccn/sn86090238/1909-12-04/ed-1/seq-1/ [https://perma.cc/H7SD-V6QD] (civil lawsuit alleging that "plaintiffs took out *investment contracts* in the defendant firm on recommendations that they would obtain a loan and that if they did not desire a loan they would *share in the profits of the concern*," but defendant engaged in fraud (emphasis added)).

[214] *The Power of Contract*, FARGO F. & DAILY REPUBLICAN, Oct. 12, 1910, at 3, https://chroniclingamerica.loc.gov/lccn/sn85042224/1910-10-12/ed-1/seq-3/ [https://perma.cc/37F2-4RDY].

[215] *Are You An Investor for Profit?*, FARGO F. & DAILY REPUBLICAN, Oct. 19, 1910, at 12, https://chroniclingamerica.loc.gov/lccn/sn85042224/1910-10-19/ed-1/seq-12/ [https://perma.cc/WXX6-KN6Q] (emphasis added).

[216] Macey & Miller, *supra* note 186, at 361 (emphasis added) (citing Act of March 10, 1911, ch. 133, § 5, 1911 Kan. Sess. Laws 210).

[217] *See id.* at 377.

September 18, 1899, American Guaranty Co. advertised in *The Post Express* for a job opening: "PROFITABLE EMPLOYMENT — Men and women, selling our guaranteed, secured, six per cent. Compound interest *investment contract*."[218] Likewise, ads sought to hire agents to

[218] Am. Guar. Co., *Profitable Employment*, POST EXPRESS (Rochester), Sept. 18, 1899, at 11, https://books.google.com/books?id=WUNGAAAAIBAJ&printsec=frontcover&source=gbs_ge_summary_r&cad=0#v=onepage&q=%22american%20guaranty%22&f=false [https://perma.cc/R65M-NH55] (emphasis added) (ad); *see also Agents Wanted*, ST. LOUIS REPUBLIC, July 5, 1903, at 3, https://chroniclingamerica.loc.gov/lccn/sn84020274/1903-07-05/ed-1/seq-33/ [https://perma.cc/FYC9-RHDR] ("AGENTS WANTED — To Insurance Men — You know the advantages of short term *investment contracts*; we are the originators of this form of policy; we wrote more ten-year investment endowment policies last year than all other companies combined . . . ." (emphasis added)); *FIRST CLASS Salesmen Wanted*, MONTGOMERY ADVERTISER, Oct. 21, 1906, at 22, https://chroniclingamerica.loc.gov/lccn/sn84020645/1906-10-21/ed-1/seq-30/ [https://perma.cc/CK8S-URA2] (ad for agents to sell "best monthly installment investment contract ever offered in the South"); *Insurance Men*, MINNEAPOLIS J, Dec. 12, 1902, at 19, https://chroniclingamerica.loc.gov/lccn/sn83045366/1902-12-12/ed-1/seq-19/ [https://perma.cc/LH3S-Q2KW] (ad to hire salesmen for "savings investment contract"); *Investment Contracts that Sell Like Hot Cakes*, BILLINGS GAZETTE, Sept. 7, 1904, at 8, https://chroniclingamerica.loc.gov/lccn/sn84036008/1904-09-07/ed-1/seq-8/ [https://perma.cc/7GU6-L5BD] (ad for agent to sell investment contract); *Managers Wanted*, ST. LOUIS REPUBLIC, Dec. 22, 1901, at 4, https://chroniclingamerica.loc.gov/lccn/sn84020274/1901-12-22/ed-1/seq-18/ [https://perma.cc/L4DL-GJ77] (ad for "[w]ell-known, old-line insurance company, issuing best *investment contracts* on the market" (emphasis added)); *Men to Sell*, OMAHA DAILY BEE, Aug. 13, 1905, at 4, https://chroniclingamerica.loc.gov/lccn/sn99021999/1905-08-13/ed-1/seq-12/ [https://perma.cc/N3GH-Y6ES] (ad for agent to sell "investment contract easily sold"); *National Life Insurance Company*, MINNEAPOLIS J., Aug. 7, 1903, at 11, https://chroniclingamerica.loc.gov/lccn/sn83045366/1903-08-07/ed-1/seq-11/ [https://perma.cc/9W6C-CW9M] (ad to hire agents to sell insurance policies and "several attractive and distinct forms of *Investment Contracts*" (emphasis added)); *Solicitors Wanted*, ST. LOUIS REPUBLIC, Dec. 22, 1901, at 4, https://chroniclingamerica.loc.gov/lccn/sn84020274/1901-12-22/ed-1/seq-18/ [https://perma.cc/CD9S-RWSS] (ad for "[t]en i*nvestment* solicitors for best-selling *contracts* issued" by First National Bank (emphasis added)); *Solicitors Wanted*, ST. LOUIS REPUBLIC, July 21, 1903, at 10, https://chroniclingamerica.loc.gov/lccn/sn84020274/1903-07-21/ed-1/seq-10/ [https://perma.cc/8LY5-J3RC] (ad for "solicitors for *investment contract:* something novel in the insurance and investment world" (emphasis added)); *Solicitors Wanted*, ST. LOUIS REPUBLIC, July 31, 1903, at 10, https://chroniclingamerica.loc.gov/lccn/sn84020274/1903-07-31/ed-1/seq-10/ [https://perma.cc/38LZ-QX42] (ad for "German-speaking solicitors for *investment contract*; good proposition with good chance of promotion" (emphasis added)); *Solicitors Who Can Sell Investment Contracts*, MINNEAPOLIS J., Apr. 29, 1903, at 14, https://chroniclingamerica.loc.gov/lccn/sn83045366/1903-04-29/ed-1/seq-15/ [https://perma.

write "investment contracts."[219] Ads proposed to purchase existing investment contracts: "WANTED — I PAY CASH FOR Diamond Investment Contracts of The Mutual Fidelity Co."[220]

As many of the above examples show, the offering of investment contracts around the start of the twentieth century often stipulated the precise rate or amount of anticipated profit for the investor. Investors understandably would want to know how much money they would or

cc/MDU4-FED8]; Standard Guar. & Tr. Co., S.F. CALL, Feb. 15, 1903, at 36, https://chroniclingamerica.loc.gov/lccn/sn85066387/1903-02-15/ed-1/seq-36/ [https://perma.cc/TMQ9-7FN2] (ad to hire salesmen for "investment contracts" described as "no 'get rich quick' proposition"); Int'l Credit Co., *Wanted*, WICHITA DAILY EAGLE, Apr. 19, 1903, at 15, https://chroniclingamerica.loc.gov/lccn/sn82014635/1903-04-19/ed-1/seq-15/ [https://perma.cc/QZ4W-ZJ93] (ad to hire agent "to write investment contracts, with guarantee bond attached"); *Wanted*, OMAHA DAILY BEE, May 4, 1902, at 20, https://chroniclingamerica.loc.gov/lccn/sn99021999/1902-05-04/ed-1/seq-20/ [https://perma.cc/AY54-3TUA] (ad for salesman "to represent an eastern company in Nebraska in the sale of high grade *investment contracts* as issued in connection with fraternal insurance" (emphasis added)); *Wanted*, S.F. CALL, Aug. 2, 1903, at 42, https://chroniclingamerica.loc.gov/lccn/sn85066387/1903-08-02/ed-1/seq-42/ [https://perma.cc/P49E-4TZ3] (ad for "[m]an of ability, energy and push as general agent ... writing *investment contracts*" (emphasis added)); *Wanted*, S.F. CALL, Aug. 9, 1903, at 42, https://chroniclingamerica.loc.gov/lccn/sn85066387/1903-08-09/ed-1/seq-42/ [https://perma.cc/PK8K-CFJE] (ad for "[s]olicitors, men or women employed preferred, write *investment contracts* for us" (emphasis added)); *Wanted*, ARIZ. REPUBLICAN, Jan. 10, 1904, at 7, https://chroniclingamerica.loc.gov/lccn/sn84020558/1904-01-10/ed-1/seq-7/ [https://perma.cc/PBW9-7H9J] (ad to hire solicitors to sell "Gold Investment Contracts" for the Gold Bond Mercantile Co.); *Wanted, At Once, Manager*, TIMES DISPATCH (Richmond), Dec. 8, 1907, at 10, https://chroniclingamerica.loc.gov/lccn/sn85038615/1907-12-08/ed-1/seq-30/ [https://perma.cc/VW6K-UYDD] (ad for "manager for investment contract company"); *Wanted. Pushing Manager*, RICHMOND DISPATCH, Dec. 9, 1900, at 14, https://chroniclingamerica.loc.gov/lccn/sn85038614/1900-12-09/ed-1/seq-14/ [https://perma.cc/4PLV-C5KP] (ad for "PUSHING MANAGER; ENTIRE charge; stock company for selling Gold Watches; investment contract; weekly payments; $10,000 to $20,000 profit . . . .").

[219] G. R. Barkley, *Wanted*, ARIZ. REPUBLICAN, Apr. 29, 1912, at 8, https://chroniclingamerica.loc.gov/lccn/sn84020558/1912-04-29/ed-1/seq-8/ [https://perma.cc/3SVC-48P3] (ad to hire agents "to write loan and investment contracts").

[220] *WANTED — I Pay Cash for Diamond Investment Contracts*, VIRGINIAN PILOT, Nov. 1, 1900, at 2, https://chroniclingamerica.loc.gov/lccn/sn86071779/1900-11-01/ed-1/seq-2/ [https://perma.cc/CTT5-DGK6] (alteration in original) (ad); *see also* S. C. Jones, *For Sale*, EVENING TIMES (Grand Forks), May 6, 1912, at 7, https://chroniclingamerica.loc.gov/lccn/sn85042373/1912-05-06/ed-1/seq-7/ [https://perma.cc/2WCD-VSK4] (offer to sell "[i]nvestment contracts in the North Dakota Improvement company").

could potentially make under the investment contract. Otherwise, the investors would have no way of knowing whether they could make a profit from their investment. Indeed, the Savings and Loan Association of Topeka touted its investment contract based on its clear, stipulated terms for profits: "All interested will agree that certainty as to time of maturity, coupled with profitable investment and unquestioned security, is a most desirable feature in an investment contract. Profits as promised have been earned and paid in and credited to each member in proportion to shares held."[221]

In short, businesses offered the public the chance to invest in contracts with a right to profits from the businesses. As one home-building enterprise touted in 1908, their "investment contracts places within the reach of small investors an opportunity to save a portion of their earnings and *share in the profits* equally with the large investors."[222] Or, as another real-estate venture explained in 1909: "Our Contract issue is PROFIT-SHARING, having paid 11 per cent annum for three consecutive years."[223]

[221] Sav. & Loan Assn. of Topeka, *Report of the Condition of the Savings and Loan Association of Topeka, Kansas*, TOPEKA STATE J., Feb. 4, 1899, at 5, https://chroniclingamerica.loc.gov/lccn/sn82016014/1899-02-04/ed-1/seq-5/ [https://perma.cc/86MB-WKB3].

[222] *South Florida Loan & Trust Co.*, PUNTA GORDA HERALD, Jan. 16, 1908, at 3, https://chroniclingamerica.loc.gov/lccn/sn95047324/1908-01-16/ed-1/seq-3/ [https://perma.cc/73TS-J8PT] (emphasis added).

[223] *The North Dakota Improvement Company*, FARGO F. & DAILY REPUBLICAN, Mar. 13, 1909, at 3, https://chroniclingamerica.loc.gov/lccn/sn85042224/1909-03-13/ed-1/seq-3/ [https://perma.cc/DW57-BPNR]; *see also Declare Big Profits: N. D. Improvement Co. Shows Handsome Dividends for Their Investment Contract Holders*, FARGO F. & DAILY REPUBLICAN, Dec. 9, 1909, at 12, https://chroniclingamerica.loc.gov/lccn/sn85042224/1909-12-09/ed-1/seq-12/ [https://perma.cc/PYV8-BUSQ] (announcing that North Dakota Improvement Company reportedly paid 11 percent dividend to its investors); *Safe and Profitable*, FARGO F. & DAILY REPUBLICAN, May 15, 1912, at 3, https://chroniclingamerica.loc.gov/lccn/sn85042224/1912-05-15/ed-1/seq-3/ [https://perma.cc/6VRS-VX45] (likening its investment contract to a mortgage that entitles investors to "net profits of the business"); *Within Safe Limits*, FARGO F. & DAILY REPUBLICAN, Apr. 17, 1909, at 4, https://chroniclingamerica.loc.gov/lccn/sn85042224/1909-04-17/ed-1/seq-4/ [https://perma.cc/HVT5-89BX] (ad for The North Dakota Improvement Company touting "[a] large army of contract-holders" who were satisfied with results of the "[c]ontracts . . . issued in any denomination" with a "share in the net profits").

"Investment contract" is a term that newspaper articles used in the same manner. For example, on May 17, 1900, the *St. Paul Globe* reported the court's grant of a preliminary injunction, at the request of the attorney general, against the Equitable Building and Loan Association, "restrain[ing] [it] from making out any more of the 'ready-money, get-rich-while-you-wait' diamond investment contracts."[224]

Likewise, the *Evening Star* in D.C. reported the decision of the assistant attorney for the Post Office "concerning the use of the mails in the promotion of certain so-called bond investment schemes":

> The opinion holds that, while the basic principles upon which these bond investment scheme are founded are not unlawful, yet the scheme as at present operated are inimical to the postal laws. The general style of *bond investment contracts* provides that upon the payment of monthly dues for a certain period, a certain amount will be paid at maturity. A portion of the income is placed in a redemption fund and the balance in the reserve and expense funds. The redemption fund is used for the payment of bonds prior to maturity, in a certain order set out in the contract, and the amount returned on the redemption of such bonds is the amount paid thereon and a certain profit. These profits are generally unequal at different periods of redemption, and are, therefore, considered as prizes. The award of such prizes being dependent upon chance, it is held that the schemes

[224] *State Steps into It*, ST. PAUL GLOBE, May 17, 1900, at 3, https://chroniclingamerica.loc.gov/lccn/sn90059523/1900-05-17/ed-1/seq-3/ [https://perma.cc/2V7U-WYST] (alteration in original); *see also Ask Receiver for International Securities Company; Charge Fraud Conspiracy Exists*, EVENING TIMES (Grand Forks), Mar. 11, 1913, at 1, https://chroniclingamerica.loc.gov/lccn/sn85042373/1913-03-11/ed-1/seq-1/ [https://perma.cc/FQ86-27TJ] (state prosecution of company selling stocks and investment contracts "somewhat in the nature of an endowment insurance policy"); *State Banking Department Ordered Two Arrests*, PRESCOTT DAILY NEWS, Feb. 10, 1915, at 1, https://chroniclingamerica.loc.gov/lccn/sn90050307/1915-02-10/ed-1/seq-1/ [https://perma.cc/898F-TRJB] (state prosecution for selling "investment contracts" issued by Empire Realty and Mortgage Co.); *Walker to Drive Out "Get Rich Quick"*, S.F. CALL, Nov. 3, 1913, at 1, https://chroniclingamerica.loc.gov/lccn/sn85066387/1913-11-03/ed-1/seq-1/ [https://perma.cc/GB5A-QLYJ] (reporting state and building loan commissioner attempting prosecution of National Mercantile company for its "investment contracts").

> are in the nature of lotteries. *Most of the promise in these contracts being impossible of fulfillment under the known and recognized rules of investment unless many lapses occur and unexpected earnings accrue*, it is further held that, inasmuch as some of the contract holders will lose on their investments, the schemes are fraudulent under the provisions of the statute, which forbid the use of the mails in the promotion of such enterprises.[225]

The United States prosecuted a similar case against a company selling "diamond investment contracts," under which an investor was putatively entitled to receive "what he had paid in with interest at the rate of 8 per cent, and all surplus earnings."[226] Likewise, the *St. Paul Globe* reported the state's prosecution of the "notorious Tontine Savings Association of Minneapolis" for its illegal tontine scheme consisting of "200 merchandise investment contract[s]" by which the offeror profited through deceitful accounting.[227] These illegal investment

[225] *Bond Investment Schemes*, EVENING STAR (Wash. D.C.), Dec. 13, 1900, at 14, https://chroniclingamerica.loc.gov/lccn/sn83045462/1900-12-13/ed-1/seq-14/ [https://perma.cc/N8V8-5Z2K] (emphasis added); *see also Sandlie Case Is Begun*, GRAND FORKS DAILY HERALD, June 18, 1915, at 10, https://chroniclingamerica.loc.gov/lccn/sn89074405/1915-06-18/ed-1/seq-10/ [https://perma.cc/HMC2-YJD9] (federal prosecution of officers of International Securities company for "misusing the mails" to sell "investment contracts and stock").

[226] *Argument in Fidelity Case*, EVENING J., Apr. 17, 1902, at 1, https://chroniclingamerica.loc.gov/lccn/sn85042354/1902-04-17/ed-1/seq-1/ [https://perma.cc/68PK-JRDE]; *see also General Tyner Willing to Be Cross-Examined*, WASH. TIMES, May 19, 1904, at 1-2, https://chroniclingamerica.loc.gov/lccn/sn84026749/1904-05-19/ed-1/seq-1/ [https://perma.cc/AQ9C-WP5P] (use the Library of Congress website interface to scroll to page 2 to view the entire source referenced here) (discussing trial of Postmaster General James Tyner and Harrison Barrett, former acting assistant attorney general for Post Office, for alleged fraud; Barrett testified about "several investment contracts" that he amended); *Investment Co Agents Accused*, EVENING TIMES, Jan. 2, 1914, at 2, https://chroniclingamerica.loc.gov/lccn/sn85042373/1914-01-02/ed-1/seq-2/ [https://perma.cc/G6M2-NS64] (prosecution of officers of Capitol Security Co. for selling investment contracts through the mails that allegedly violated lottery laws).

[227] *Tontine Must Quit*, ST. PAUL GLOBE, Mar. 21, 1902, at 2, https://chroniclingamerica.loc.gov/lccn/sn90059523/1902-03-21/ed-1/seq-2/ [https://perma.cc/MP3B-L9UH]; *see also Allison Concludes Hearing*, MONTGOMERY ADVERTISER, Aug. 2, 1903, at 16, https://chroniclingamerica.loc.gov/lccn/sn84020645/1903-08-02/ed-1/seq-16/ [https://perma.cc/X66J-GZAG] (discussing claim for distribution of funds of bankrupt Continental Security Redemption Company that included transaction swapping bonds

for "certain contracts called Diamond *Investment contracts*" (emphasis added)); *Details Made Public: Letters Sent to Certificate Holders of National Life and Trust Company*, EVENING TIMES-REPUBLICAN, June 10, 1903, at 2, https://chroniclingamerica.loc.gov/lccn/sn85049554/1903-06-10/ed-1/seq-2/ [https://perma.cc/EJ85-RW8M] (quoting Iowa State Auditor letter to certificate holders stating regulation of insurance company that "had on deposit with the auditor of state, approved securities in an amount equal to the cash value of all of its insurance and *investment contracts*, bonds and policies" (emphasis added)); *Files a Demurrer*, OMAHA DAILY BEE, May 27, 1902, at 3, https://chroniclingamerica.loc.gov/lccn/sn99021999/1902-05-27/ed-1/seq-3/ [https://perma.cc/A9YG-6CA5] (discussing state attorney general's action against company for "issuing *investment contracts* which provide for the promotion of an impracticable scheme" (emphasis added)); *Firm Barred Out*, OMAHA DAILY BEE, May 8, 1902, at 3, https://chroniclingamerica.loc.gov/lccn/sn99021999/1902-05-08/ed-1/seq-3/ [https://perma.cc/X8Y2-FA8T] (state banking board notified company that its "investment contracts," combining tontine and numeral contract features, were illegal); *Five Suits: Against a Kentucky Investment Company at Lexington — Important Questions at Issue*, EVENING BULL., July 18, 1901, at 2, https://chroniclingamerica.loc.gov/lccn/sn87060190/1901-07-18/ed-1/seq-2/ [https://perma.cc/U9E7-NBSG] (lawsuits against allegedly fraudulent "investment contracts"); *Home Building Scheme*, PAC. COM. ADVERT., June 29, 1904, at 3, https://chroniclingamerica.loc.gov/lccn/sn85047084/1904-06-29/ed-1/seq-3/ [https://perma.cc/V87Q-QKCL] (describing investigation of "Co-Operative Home Purchasing Society" and its "investment contract"); *In Hands of Receiver: Mutual Fidelity Company Goes Up*, MONTGOMERY ADVERTISER, Oct. 17, 1901, at 3, https://chroniclingamerica.loc.gov/lccn/sn84020645/1901-10-17/ed-1/seq-3/ [https://perma.cc/3YPD-658Y] ("The concern wrote what it termed as *diamond investment contracts* on the plan of debenture or investment companies." (emphasis added)); *In the Southern Mutual Investment Company Case*, DAILY PUB. LEDGER, Mar. 28, 1906, at 3, https://chroniclingamerica.loc.gov/lccn/sn86069117/1906-03-28/ed-1/seq-3/ [https://perma.cc/6WH7-M29J] (discussing court's ruling that "forfeitures of investment contracts for nonpayment of dues is illegal"); *Says They Are Lotteries*, RICHMOND CLIMAX, Dec. 4, 1901, at 4, https://chroniclingamerica.loc.gov/lccn/sn86069162/1901-12-04/ed-1/seq-4/ [https://perma.cc/5T8N-VW5K] ("The question before the court was whether the contract of [the United States Investment Company] was a legal contract or a lottery . . . ."); *This Finance "Frenzied?": At Least No Authority to Work in Oklahoma*, GUTHRIE DAILY LEADER, Apr. 19, 1905, at 1, https://chroniclingamerica.loc.gov/lccn/sn86063952/1905-04-19/ed-1/seq-1/ [https://perma.cc/3FMB-MM8E] (discussing investigation of out-of-state business Continental Finance Co. that offered "investment contracts"); *Trust Company Enjoined*, BIRMINGHAM AGE-HERALD, Oct. 26 1910, at 9, https://chroniclingamerica.loc.gov/lccn/sn85038485/1910-10-26/ed-1/seq-9/ [https://perma.cc/8CTV-NBQF] (explaining that the state judge enjoined Jackson Loan and Trust Company from issuing further investment contracts due to alleged fraudulent misrepresentation); *Will Comply with Auditor's Demands*, MO. VALLEY TIMES, June 11, 1903, at 6, https://chroniclingamerica.loc.gov/lccn/sn84038335/1903-06-11/ed-1/seq-6/ [https://perma.cc/FLN7-KX2L] (discussing merger requirement that post-merger company "furnish the auditor with such information . . .

contracts purported to give the investors a contractual right to profits but were structured in some fraudulent or deceptive way, typically rendering the contracts bad deals for investors.[228] Newspapers reported bills and efforts in states to regulate businesses that offered investment contracts.[229]

By contrast, some newspaper articles supported the sale of investment contracts, such as the *Topeka State Journal*'s positive review: "[A] new form of investment policy, known as their 10-year endowment bond, a policy that is the *ideal of investment contracts*, both for profit and security, in fact the best investment policy ever offered to the insuring public."[230]

In sum, starting in the 1800s, "investment contract" was a term widely used by people to describe the sale of investment opportunities through contracts. People secured the investment by buying the contract.

2. Starting in the 1920s, Courts Applied the Original Public Meaning of Investment Contract

As the Amici Securities Law Professors' brief explains, state "blue sky" laws, which predated the Securities Act of 1933, started to include the term "investment contract" in the first securities laws, starting in

to ascertain the net cash value of every insurance and every *investment contract*" (emphasis added)).

[228] *See supra* notes 222–225 and accompanying text.

[229] *See, e.g.*, *Base Insult Is Offered*, ARIZ. REPUBLICAN, May 18, 1912, at 3, https://chroniclingamerica.loc.gov/lccn/sn84020558/1912-05-18/ed-1/seq-3/ [https://perma.cc/UNS4-BD9S] (discussing bill, passed by Arizona legislature and approved by Governor Hunt, "regulating companies issuing investment contracts"); *Measure Introduced Permitting Normal School to Buy More Land*, L.A. HERALD, Jan. 21, 1905, at 4, https://chroniclingamerica.loc.gov/lccn/sn85042462/1905-01-21/ed-1/seq-4/ [https://perma.cc/Y9HG-MKCW] (discussing California bill to regulate all corporations offering "investment certificates or *investment contracts* in the state of California" (emphasis added)); *Reform for Insurance*, ROCK ISLAND ARGUS, Jan. 3, 1906, at 1, https://chroniclingamerica.loc.gov/lccn/sn92053934/1906-01-03/ed-1/seq-1/ [https://perma.cc/RTK7-M5PB] (quoting N.Y. Governor Higgins' speech asking legislature to pass law regulating insurance industry, including "other corporations dealing in indemnity and investment contracts").

[230] *A Sound Financial Institution*, TOPEKA STATE J., July 6, 1901, pt 1., at 4, https://chroniclingamerica.loc.gov/lccn/sn82016014/1901-07-06/ed-1/seq-4/ [https://perma.cc/8ABR-EVNA] (emphasis added).

1919.[231] In that year, Minnesota's blue-sky statute regulated "stocks, bonds, *investment contracts*, or other securities."[232] The undefined term "investment contract" was left for the courts to interpret. As explained in this section, they did so by adopting the ordinary public meaning of the words as commonly understood.

In 1920, in the seminal case of *State v. Gopher Tire & Rubber Co.*, the Supreme Court of Minnesota held that, under the state's "blue sky" law, an investment contract existed in a local tire dealer's "certificate," a financial instrument that contained the following contractual right for investors:

> [The certificate] provides that, in consideration of the certificate holder's promise to render such assistance and in further consideration of $50 paid by him, *defendant will divide pro rata among all the holders of like certificates who reside at a specified place 20 per cent. of the net price of such tires and tubes as may be sold by defendant's representative at such place*, such division to be made quarterly for the period of 20 years, that the holder is entitled to a discount of 10 per cent. on all its goods which he may purchase from defendant for his personal use, and that *defendant will annually set aside as a bonus to certificate holders all of its excess earnings* after paying operating expenses, fixed charges and dividends to stockholders, the same to be distributed at its option in the form of perferred [sic] stock.[233]

The investment contract in *Gopher Tire* was created by a financial instrument (i.e., the certificate) that constituted a particular type of contract, or quid pro quo: a person's investment of money, the *quid*, in

[231] *See* Brief of Securities Law Scholars as Amici Curiae in Support of Coinbase's Motion for Judgment on the Pleadings, *supra* note 41, at 3-12.

[232] *Id.* at 6 (quoting Minn. Laws 1917, ch. 429 § 3, as amended by Minn. Laws 1919, ch. 105, 257); *see Af Vigtighed*, FERGUS FALLS UGEBLAD 4 (May 7, 1919), https://chroniclingamerica.loc.gov/lccn/sn83025227/1919-05-07/ed-1/seq-4/ [https://perma.cc/8AX4-ELAK] (quoting Minn. law upon its enactment).

[233] *State v. Gopher Tire & Rubber Co.*, 177 N.W. 937, 937-38 (Minn. 1920) (emphasis added).

exchange for a contractual right to receive a share in the income generated solely by the offeror's efforts, the *quo*.[234]

As the Minnesota Supreme Court explained, "[t]he placing of capital or laying out of money in a way intended to secure income or profit from its employment is an investment as *that word is commonly used and understood*."[235] Although the Court did not define "contract," there is no indication that the word meant anything other than the ordinary meaning of contract. Indeed, the Court described the certificates at issue in contractual terms: the offeror's "certificates are like stock in that they give their holders the *right to share* in the profits of the corporation."[236] The Minnesota Supreme Court thus interpreted "investment contract" in the state's blue-sky law based on its original public meaning — that is, how the word "investment" and "contract" are "*commonly used and understood*."[237] As the Court recognized in a subsequent case, the state's blue-sky law regulated "offers to the public

[234] *See also* State v. Bushard, 205 N.W. 370, 370 (Minn. 1925) (investment contract based on bus "operator's agreement" that entitled the bus operator, in exchange for his payments to buy and drive the bus, a "ratable share in one-fourth of the net profits on all the buses"); Union Land Assocs. v. Ussher, 149 P.2d 568, 570 (Ore. 1944) ("The act fails, however, to define 'investment contract' but in other jurisdictions the term 'investment contract,' as used in a 'blue sky law,' has been defined as a contract providing for the investment of capital in a way intending to secure income or profit from its employment." (citing 47 Am. Jur. 475, Securities Acts § 16)).

[235] *Gopher Tire*, 177 N.W. at 938 (emphasis added).

[236] *Id.* (emphasis added); *see also* State v. Ogden, 191 N.W. 916, 917 (Minn. 1923) (oil leases from which "the unit holders were to participate in profits in proportion to their holdings and were to be interested in the same proportion in the corporation holding the title and operating"); State v. Evans, 191 N.W. 425, 426 (Minn. 1922) (option for land sale that stipulated buyer "surrender his contract and receive the amount paid in with a bonus of $70 for each $1,000, from the profits obtained on sale of contracts on which the company is prepared to purchase other real estate"); State v. Summerland, 185 N.W. 255, 267 (Minn. 1921) (oil "units entitles the owner . . . to the profits resulting from the operation"); Montreville J. Brown, *A Review of the Cases on "Blue Sky" Legislation*, 7 MINN. L. REV. 431, 438-42 (1923) (discussing cases involving investment contracts).

[237] *See generally* Kevin P. Tobia, *Testing Ordinary Meaning*, 134 HARV. L. REV. 726, 738-39 (2020) ("Public Meaning Originalism seeks to determine the meaning the words and phrases of the Constitution would have had, in context, to ordinary readers, speakers, and writers of the English language, reading a document of this type, at the time adopted." (internal quotations and citation omitted)).

of *investment contracts evidencing a right to participate in the proceed of a venture*."[238]

Other state supreme courts were in accord. In *State v. Heath*, the Supreme Court of North Carolina explained the original public meaning of "investment contract":

> The term is not defined in the act, *but it implies the apprehension of an investment as well as of a contract. The word "investment" has no technical definition* and its meaning in particular cases is often determined by its relation to the context. It has been variously defined as *the conversion of money into property from which a profit is to be derived in the ordinary course of trade or business*; an expenditure for profits; *the placing of capital to secure an income from its use*.[239]

The Court even quoted favorably the *Gopher Tire* definition of the term.[240]

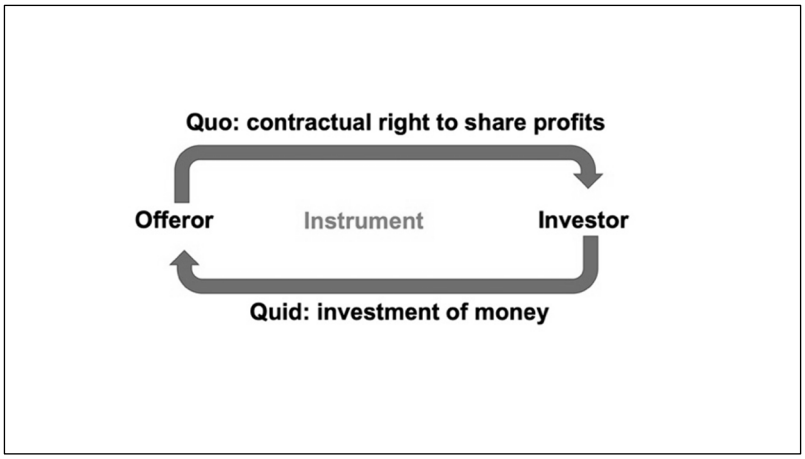
Figure 9 depicts this quid pro quo, which includes a contractual right to share in the profits generated solely by the offeror.

[238] *See* Kerst v. Nelson, 213 N.W. 904, 905 (Minn. 1927) (emphasis added).

[239] State v. Heath, 153 S.E. 855, 857 (N.C. 1930) (emphasis added).

[240] *See id.* (quoting State v. Gopher Tire & Rubber Co., 177 N.W. 937, 938 (Minn. 1920)).

FIGURE 9. THE QUID PRO QUO OF AN "INVESTMENT CONTRACT" IN SECURITIES LAW



An investment contract involves an instrument effectuating a quid (what *Gopher Tire* described as the investor's "placing of capital or laying out of money"[241]) in exchange for a quo (a right "to secure income or profit from [the money's] employment" by the offeror[242]). Or, put simply, "[a]s an inducement to invest, he is *promised a share in defendant's profits*."[243] In sum, in an investment contract, a person's *investment* of money goes to the offeror to make money from that investment and, in exchange, the investor receives a *contractual* right to share in any profit.[244] If either is lacking, there is simply no "investment contract."

Gopher Tire's adoption of the original public meaning of investment contract was later followed by the U.S. Supreme Court. The U.S. Supreme Court adopted *Gopher Tire*'s definition of the original public meaning of "investment contract" in the seminal case of *SEC v. W.J. Howey Co*.[245] In 1946, in interpreting "investment contract" in the Securities Act of 1933,[246] the U.S. Supreme Court adopted and quoted

[241] *Gopher Tire*, 177 N.W. at 938.

[242] *Id.*

[243] *Id.* (emphasis added).

[244] *See supra* notes 211–212 and accompanying text.

[245] 328 U.S. 293, 298 (1946).

[246] *See* Securities Act of 1933, 15 U.S.C. § 77b(a)(1); Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10).

the Minnesota Supreme Court's definition: "An investment contract thus came to mean a contract or scheme for 'the placing of capital or laying out of money in a way intended to secure income or profit from its employment.'"[247] The Court viewed this definition of investment contract as uniform among the states: "This definition was uniformly applied by state courts to a variety of situations where individuals were led to invest money in a common enterprise with the expectation that they would earn a profit solely through the efforts of the promoter or of some one other than themselves."[248]

Adhering to the original public meaning of the Securities Act accords with the Supreme Court's general approach to statutory interpretation. As the U.S. Supreme Court recently explained, "This Court normally interprets a statute in accord with the ordinary public meaning of its terms at the time of its enactment."[249] Otherwise, courts "would deny

[247] *W.J. Howey Co.*, 328 U.S. at 298 (quoting State v. Gopher Tire & Rubber Co., 177 N.W. 937, 938 (Minn. 1920)).

[248] *Id*. Although Justice Frankfurter, in dissent, suggested that the majority's definition of "investment contract" had wrongly converted it into a term of art, I think that mischaracterizes the majority's interpretation, which ultimately borrowed from *Gopher Tire*'s definition of the term as "commonly used and understood." *See id.* at 301 (Frankfurter, J., dissenting) ("'Investment contract' is not a term of art."). Overlooking the history of popular usage of "investment contract" and *Gopher Tire*'s recognition of it, some legal scholars have also mischaracterized *W.J. Howey*'s definition as viewing "investment contract" as a term of art. *See, e.g.*, Cecile C. Edwards, *A New Literalism? Rejection of the Sale of Business Doctrine*, 30 ST. LOUIS U. L.J. 427, 435 n.41 (1986) ("The *Howey* court noted that, although the term 'investment contract' was not defined by Congress, it was a term of art that had acquired a meaning in state blue sky laws and judicial opinions prior to the enactment of the 1933 and 1934 Acts."); J. Christopher Kojima, *Product-Based Solutions to Financial Innovation: The Promise and Danger of Applying the Federal Securities Laws to OTC Derivatives*, 33 AM. BUS. L.J. 259, 292-93 (1995) ("Other listed devices, including 'investment contracts,' are terms of art with elusive characteristics, and have served as catch-all categories for transactions that cannot be easily pigeon-holed into classifications familiar to the layperson."). This assertion is refuted by the history of investment contracts. As explained above, the term "investment contract" derived from popular usage and the practice of selling investment contracts as investment vehicles. Dictionary definitions of "investment" and "contract" denoted that public meaning. *Gopher Tire* adopted the common usage.

[249] Bostock v. Clayton Cnty., 590 U.S. 644, 654 (2020); *see also* Niz-Chavez v. Garland, 593 U.S. 155, 160 (2021) ("When called on to resolve a dispute over a statute's meaning, this Court normally seeks to afford the law's terms their ordinary meaning at the time Congress adopted them."); Wis. Cent. Ltd. v. United States, 585 U.S. 274, 277 (2018)

the people the right to continue relying on the original meaning of the law they have counted on to settle their rights and obligations."[250] Accordingly, "[a] fundamental canon of statutory construction is that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning."[251]

The Supreme Court's recent decision in *Garland v. Cargill* is instructive.[252] The Court examined whether the National Firearms Act of 1934's definition of "machinegun" — specifically, "any weapon which shoots, is designed to shoot, or can be readily restored to shoot, automatically more than one shot, without manual reloading, *by a single function of the trigger*" — applied to today's semiautomatic rifles equipped with a device known as a bump stock, as the Bureau of Alcohol, Tobacco, Firearms and Explosives ("ATF") had concluded in a new rule in 2018.[253] In reversing the ATF's decision, the Supreme Court examined dictionary definitions of "function" and "trigger" contemporaneous with the Act's passage in 1934.[254] (These are the same dictionaries I use below for the definitions of "investment" and "contract" in the Securities Act of 1933.[255]) Under the original public meaning of "by a single function of the trigger," the term meant "the physical trigger

(same); Perrin v. United States, 444 U.S. 37, 42 (1979) (same). *See generally* ANTONIN SCALIA & BRYAN A. GARNER, READING LAW: THE INTERPRETATION OF LEGAL TEXTS 82-83 (2012) (explaining how interpretation based on original meaning serves democracy, and respects the roles of the legislature and executive in the enactment of statutes); Steven Semeraro, *We're All Originalists Now . . . or Are We?:* Bostock*'s Misperceived Quest to Distinguish Title VII's Meaning from the Public's Expectations*, 49 HOFSTRA L. REV. 377, 383 (2021) ("A court interpreting a statute must look to the public meaning, i.e., a reasonable reader's intersubjective understanding of the relevant clause in the context of the entire statute and American law more generally.").

[250] *Bostock*, 590 U.S. at 654; *see also* Landreth Timber Co. v. Landreth, 471 U.S. 681, 685 (1985) ("It is axiomatic that '[t]he starting point in every case involving construction of a statute is the language itself.'" (internal citation omitted)).

[251] *Perrin*, 444 U.S. at 42; *see also* Cent. Bank, N.A. v. First Interstate Bank, N.A., 511 U.S. 164, 174 (1994) ("Adherence to the text in defining the conduct covered by § 10(b) is consistent with our decisions interpreting other provisions of the securities Acts.").

[252] Garland v. Cargill, 602 U.S. 406, 410 (2024).

[253] *Id.* at 410-11.

[254] *Id.* at 415-16 (citing Oxford English Dictionary (1933); Webster's New International Dictionary (2d ed. 1934)).

[255] *See infra* notes 261–262, 268.

movement required to shoot the firearm."[256] However, today's semiautomatic rifles equipped with a bump stock did not fall within that textual requirement because the rifles still require the trigger to be pulled for each shot.[257] A single function of the trigger of a semiautomatic rifle with a bump stock didn't automatically shoot more than one shot.[258]

To interpret "investment contract" more broadly in situations completely lacking any offering of a contractual right would impermissibly read the word "contract" right out of the statute.[259] And it would violate "the core administrative-law principle that an agency may not rewrite clear statutory terms to suit its own sense of how the statute should operate."[260] Just as the ATF cannot eliminate a statutory requirement of the National Firearms Act of 1934 inherent in its original public meaning, so too the SEC cannot eliminate a statutory requirement of the Securities Act of 1933 for an investment contract. It is for Congress alone to decide.

Because *Gopher Tire* correctly identified the original public meaning of "investment contract," the U.S. Supreme Court had no reason to consult with dictionaries. Had it, it would have found the same meaning. In 1933, the Oxford English Dictionary defined "investment" in relevant part:

> The conversion of money or circulating capital into some species of property from which an income or profit is expected to be derived in the ordinary course of trade or business.
>
> Distinguished from *speculation*, in which the object is the chance of reaping a rapid advantage by a sudden rise in the market price

[256] *Garland*, 602 U.S. at 415-16.

[257] Id.

[258] *Id.* at 416, 421.

[259] *See* Lamar, Archer & Cofrin, LLP v. Appling, 584 U.S. 709, 719 (2018) (holding that an interpretation of federal statute that "must be rejected, for it reads [the word] 'respecting' out of the statute").

[260] Util. Air Regul. Grp. v. EPA, 573 U.S. 302, 328 (2014).

> of something is bought merely in order to be held till it can be thus advantageously sold again.[261]

In 1923, Webster's New International Dictionary had a similar definition of investment: "The investing of money or capital; the laying out of money in the purchase of some species of property, esp. a source of income or profit . . . ."[262] In 1828, Webster's had a similar definition: "The laying out of money in the purchase of some species of property[.]"[263]

Gopher Tire's definition uses some of the same words as these dictionary definitions, as indicated in italics: "The placing of *capital* or *laying out of money* in a way intended to secure *income or profit* from its employment."[264] Notably, what *Gopher Tire* left out from the dictionary definitions is the language of investing in "some species of property."[265] That omission was understandable given the use of "investment" with "contract."[266] For an investment contract, a key element was not property, but a contract. An investor was not buying property but an investment contract.[267] The ordinary public meaning of "contract" meant an agreement between two or more parties "for something [to] be done,"[268] namely, for the offeror to make profits (or try to) for the investor.

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[261] *Investment*, 5 OXFORD ENGLISH DICTIONARY 458 (1st ed. 1933), https://archive.org/details/the-oxford-english-dictionary-1933-all-volumes/ [https://perma.cc/85ZM-54YP] (italics in original).

[262] *Investment*, WEBSTER'S NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE 1137 (1923), https://archive.org/details/webstersnewinter00unse_0 [https://perma.cc/M5GF-F5G7].

[263] *Investment*, NOAH WEBSTER'S 1828 DICTIONARY 7063 (1828), https://archive.org/details/noah-websters-1828-dictionary-ellen-g-white-estate [https://perma.cc/EJ25-YS74].

[264] State v. Gopher Tire & Rubber Co., 177 N.W. 937, 938 (Minn. 1920).

[265] *See supra* notes 231–233 and accompanying text.

[266] Inclusion of "some species of property" likely would have caused confusion in the context of "investment contract." *Gopher Tire*'s definition conveyed the ordinary meaning of the term.

[267] Indeed, this distinction explains why the nominal land sale in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) was really a part of an investment contract: investors weren't buying the land; instead, they were buying into an orange-growing venture. *See infra* notes 323–324 and accompanying text.

[268] The Oxford English Dictionary defined contract as "[a] mutual agreement between two or more parties that something shall be done or forborne by one or both."

Thus, combining the definitions of "contract" and "investment" from the Oxford dictionary published in 1933,[269] an investment contract means *a contract or agreement* "from which an income or profit is expected to be derived in the ordinary course of trade or business" of the offeror. Or, in the words of *Gopher Tire*'s definition, an investment contract is an agreement involving "[t]he placing of *capital* or *laying out of money* in a way intended to secure *income or profit* from its employment" by the offeror.[270] This agreement, or contract, constitutes the investment. Investment contracts were understood as offering the purchasers a share in the profits.[271]

Nothing in *Howey* suggests that the Supreme Court rejected the ordinary meaning of "investment contract" or was adopting a different meaning than *Gopher Tire*. Instead, the Supreme Court adopted the original public meaning of "investment contract" by expressly adopting its contemporaneous meaning "as used by Congress," a term "the meaning of which had been crystalized by [*Gopher Tire*]" by the time Congress enacted the Securities Act of 1933.[272] Indeed, as analyzed above, newspaper articles and advertisements before the passage of the 1933 Act show that "investment contract" was a term commonly used in public discourse to refer to a contract offered as an investment.[273] In

Contract, 5 OXFORD ENGLISH DICTIONARY, *supra* note 261, at 912. Similarly, Webster's New International Dictionary defined contract: "An agreement between two or more persons to do or forbear something, esp. such an agreement that is legally enforceable." *Contract*, WEBSTER'S NEW INTERNATIONAL DICTIONARY, *supra* note 262, at 488.

[269] *See supra* notes 252, 259.

[270] State v. Gopher Tire & Rubber Co., 177 N.W. 937, 938 (Minn. 1920) (emphasis added).

[271] *See* Recent Case Note, *License — Blue Sky Law — Application to Contracts for Sale of Land*, 37 YALE L.J. 112, 123-24 (1927) (summarizing *Gopher Tire* and other cases recognizing "investment contracts" under state blue sky laws based on their "entitling the buyer to a share in the profits").

[272] SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1946).

[273] *See supra* notes 186–220 and accompanying text (collecting numerous examples of investment contracts advertised or discussed in newspapers); *see also, e.g.*, *Business Opportunities*, EVENING STAR (Wash. D.C.), July 12, 1920, https://chroniclingamerica.loc.gov/lccn/sn83045462/1920-05-24/ed-1/seq-22/ [https://perma.cc/75ZE-KU8C] ("OUR INVESTMENT CONTRACTS earn from 12 to 200 per cent. Not stocks, bonds or real estate. This is a safe, conservative investment."); Protective Association of North Dakota, Inc., *Warning!*, GRAND FORKS HERALD, Aug. 13, 1920, https://chroniclingamerica.

regulating securities in the 1930s, Congress used the "*ordinary* concept of a security."[274]

The *Howey* Court held that the *Gopher Tire* definition of investment contract "was uniformly applied by state courts to a variety of situations where individuals were led to invest money in a common enterprise with the expectation that they would earn a profit solely through the efforts of the promoter or of some one other than themselves."[275] "It is . . . reasonable to attach that meaning to the term [investment contract] as used by Congress,"[276] the Supreme Court concluded.

Thus, an investment contract "means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party."[277] The Supreme Court's definition clarified that the investor's expectation of income or profit from the contract must arise "solely from the efforts of the promoter or a third party,"[278] a point the Court

loc.gov/lccn/sn85042414/1920-08-13/ed-1/seq-3/ [https://perma.cc/H7AF-7UAH] ("We are informed that stock or *investment contracts* of the following companies are being offered for sale to residents of North Dakota . . . ." (emphasis added)); *Salesmen*, EVENING STAR (Wash. D.C.), July 12, 1920, https://chroniclingamerica.loc.gov/lccn/sn83045462/1920-07-12/ed-1/seq-19/ [https://perma.cc/5A57-ZE7U] (ad by Union Home Builders to hire salesmen for "[b]est loan and *investment contract*" (emphasis added)); *Thrift Company Ruling is Upheld*, EVENING STAR (Wash. D.C.), Sept. 13, 1930, https://chroniclingamerica.loc.gov/lccn/sn83045462/1930-09-13/ed-1/seq-18/ [https://perma.cc/EU33-38B8] (The California Attorney General's "decision that California thrift contract or *investment contract* companies conduct a class of business . . . identical with some of the business transacted by building and loan companies and thus under the civil code are properly subject to the jurisdiction of the building and loan commissioner is a good thing for the building and loan business." (emphasis added) (quoting H. Morton Bodfish, executive manager of the U.S. Building and Loan League)).

[274] H.R. REP. NO. 73-85, at 11 (1933) (emphasis added); *see* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 847-48 (1975) (recognizing Congress's broad definition of "the many types of instruments that in our commercial world fall within the ordinary concept of security" (quoting H.R. REP. NO. 73-85., at 11 (1933))).

[275] *W.J. Howey Co.*, 328 U.S. at 298.

[276] *Id.*

[277] *Id.* at 299.

[278] *Id.* This requirement was implicit in *Gopher Tire*'s recognition of the investor's "laying out of money in a way intended to secure income or profit *from its employment*," meaning *by the offeror*. State v. Gopher Tire & Rubber Co., 177 N.W. 937, 938 (Minn. 1920) (emphasis added).

repeated three times.[279] This requirement was developed by the Ninth Circuit in two prior cases — both cited by the *Howey* Court[280] — involving contracts (one for bottling whiskey and one for land leases for oil prospecting) that were both structured to give the contract holders a right to the profits made entirely from the offeror's efforts.[281] As the Ninth Circuit explained, "the phrase 'investment contract' . . . include[s] *agreements* where 'the purchasers [look] entirely to the efforts of the promoters to make their investment a profitable one.'"[282] The *Howey* Court's specification of the "sole efforts of the promoter" and the "promise of profits" from the promoter distinguished a mere investment (e.g., in collectibles, commodities, or real estate) from an investment *contract*.[283] The latter involves a contract or agreement involving a bargain in which the investor paid money in exchange for the potential profits generated by the offeror.[284]

Thus, the contemporaneous public meaning of "investment contract" at the passage of the Securities Act of 1933 referred to a particular type

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[279] *See W.J. Howey Co.*, 328 U.S. at 298, 299-300.

[280] *See id.* at 299 n.5.

[281] *See* Penfield Co. of Cal. v. SEC, 143 F.2d 746, 750 (9th Cir. 1944) (using investment contract in contracts for bottling whiskey, which required the offeror "to sell the bottled whiskey *and to pay to the contract-holders the proceeds less all expenses and a commission of 10 percent of the gross sales price per case*" (emphasis added)); Atherton v. U.S., 128 F.2d 463, 465 (9th Cir. 1942) (noting that investment contract in sale of land leases "upon the promise and representation that the proceeds of the sale would be used for bringing a well into production," after which land "would be sold . . . and that *each purchaser of an assignment would receive a proportionate share of the purchase price*" (emphasis added)).

[282] *Penfield Co. of Cal.*, 143 F.2d at 750 (emphasis added) (alteration in original) (quoting *Atherton*, 128 F.2d at 465); *see* SEC v. Wickham, 12 F. Supp. 245, 247-48 (D. Minn. 1935) (discussing *Gopher Tire* and "[o]ther cases involving various types and forms of contracts from which the buyer anticipates a return through efforts other than his own" (internal citations omitted)).

[283] *W.J. Howey Co.*, 328 U.S. at 299 (distinguishing purchase of fee simple interests in land); *see* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 858 (1975) ("What distinguishes a security transaction — and what is absent here — is an investment where one parts with his money in the hope of receiving profits from the efforts of others, and not where he purchases a commodity for personal consumption or living quarters for personal use").

[284] *See W.J. Howey Co.*, 328 U.S. at 301 ("The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others.").

of investment — one that involved a certain type of quid pro quo. A person "invests . . . money in a common enterprise" (the quid, or the investment) in exchange for a right to share "a profit solely through the efforts of the promoter" (the quo, or the contractual share in the profits).[285]

To determine if an investment contract exists, one must examine the instruments involved in the offering.[286] That conclusion is supported by the *noscitur a sociis* canon,[287] given that the Securities Act's definition provision includes "investment contract" with many other examples of securities commonly embodied in financial instruments of some kind.[288] Indeed, *certificates* of various kinds are mentioned eight times as examples of securities.[289] As the Court explained, the *noscitur a sociis* canon "avoid[s] ascribing to one word a meaning so broad that it is inconsistent with its accompanying words, thus giving unintended breadth to the Acts of Congress."[290] Even the Supreme Court's dicta stating that the term investment contract "embodies a flexible rather than a static principle" focuses on the "the issuance of 'the many types

[285] *Id.* at 299-301.

[286] *See* SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943) ("In the Securities Act the term 'security' was defined to include by name or description many documents in which there is common trading for speculation or investment.").

[287] *See* Yates v. United States, 574 U.S. 528, 543-44 (2015) (applying *noscitur a sociis* canon to interpret "tangible object" in relation to and limited in meaning by the other terms "any record or document").

[288] 15 U.S.C. § 77b(a)(1) ("[A]ny 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." (emphasis added)).

[289] *Id.*

[290] *Yates*, 574 U.S. at 543 (citation omitted) (quoting Gustafson v. Alloyd Co., 513 U.S. 561, 575 (1995)).

of instruments' " to determine if they are schemes involving this quid pro quo: "the use of the money of others on the *promise of profits*."[291]

It is important to recognize that simply investing money or even expecting to make profits from an investment does not satisfy the original public meaning of investment contract. For example, investing in futures of commodities (such as agricultural products or gold) is not an investment contract because there is no contractual right of the investor to share in the profits derived solely from the broker's efforts.[292] Instead, the investors simply get a financial interest in the commodities, whose values are determined by the market. Likewise, a simple purchase of real estate from a land developer, even one with ambitious plans to build a new residential community that would presumably increase the property values, is not an investment contract.[293] As the Tenth Circuit recognized, such a real estate investment involves "*no contractual obligation* to the plaintiffs other than to deliver title once purchase terms were met."[294] The investor is entitled to the real estate, but nothing more. Or return to Pokémon. Even if investors have a reasonable expectation that The Pokémon Company will continue to cultivate the overall brand, thereby increasing the value of the cards, an investor's purchase of Pokémon cards does not create an investment contract. Why? The sale doesn't constitute a contract entitling the purchaser to any profits generated by the company. Instead, all one gets is the collectible, not a contract.

By contrast, in *Howey,* the instruments consisted of a land sales contract, a warranty deed, and a service contract that expressly stipulated the contractual right of the investors to "an allocation of the net profits based upon a check made at the time of picking."[295] As the Court described the question presented: "[*W*]*hether, under the circumstances, the land sales contract, the warranty deed and the service*

[291] SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946) (emphasis added).

[292] *See* Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 622 F.2d 216, 219, 223-24 (6th Cir. 1980), *aff'd*, 456 U.S. 353 (1982); Milnarik v. M-S Commodities, Inc., 457 F.2d 274, 279 (7th Cir. 1972).

[293] *See* Woodward v. Terracor, 574 F.2d 1023, 1026 (10th Cir. 1978).

[294] *Id.* at 1025 (emphasis added).

[295] *W.J. Howey Co.*, 328 U.S. at 296.

contract together constitute an 'investment contract' within the meaning of § 2(1)."[296]

The contracts did. As the Court found, the money people invested in the orange-growing arrangement entitled them to a contractual share in the money generated from the defendant's use of their money.[297] Indeed, this is clear from the very first sentence of *Howey*: "This case involves the application of § 2(1) of the Securities Act of 1933 to an offering of units of a citrus grove development, *coupled with a contract for . . . remitting the net proceeds to the investor*."[298]

The arrangement in *Howey* was similar to the one in *State v. Agey*, decided under North Carolina blue-sky law, that found an investment based on two contracts for the sale of tracts of land and for the offeror's cultivation of fig trees on the land, the latter of which contract stipulated: "The company *guarantees the purchaser hereof 3 cents per pound for all fruit grown* on said trees delivered at the preserving plant in good condition."[299] Notably, the Supreme Court of North Carolina held the contracts themselves constituted an "offering to sell our people 'investments.'"[300]

Howey is in accord. As the Supreme Court explained, the Securities Act regulates offerings of "the essential ingredients of an investment contract."[301] How many people accepted the offer (or whether it was enforceable under state law) is not crucial for this inquiry.[302] But what is crucial is an offering of an "opportunity to contribute money and to

[296] *Id.* at 297 (emphasis added).

[297] *See id.* at 299.

[298] *Id.* at 294 (emphasis added).

[299] State v. Agey, 88 S.E. 726, 729 (1916) (emphasis added).

[300] *Id.* at 730; *see also* R. F. C., Note, *Pension Plans as Securities*, 96 U. PA. L. REV. 549, 553 (1948) [hereinafter R.F.C., *Pension Plans*] ("The equivalency of a 'contract which is an investment' and an 'investment contract' is apparent, and several subsequent cases have treated it as a valid transposition.").

[301] SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946).

[302] *See id.* ("it is enough that the respondents merely offer the essential ingredients of an investment contract"); SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344, 349 (1943) ("Whether, as the dissenting Judge below suggests, the assignee acquired a legal right to compel the drilling of the test well is a question of state law which we find it unnecessary to determine.").

share in the profits" made by the offeror.[303] The offering must offer to investors "shares of the profits,"[304] or "the promise of profits."[305] As the *Howey* Court emphasized in the final paragraph, "[t]he test is whether the scheme involves an investment of money in a common enterprise," the quo, "with profits to come solely from the efforts of others," the quid.[306]

Every Supreme Court decision that found an investment contract involved a situation in which the offering entitled investors, by contract (effectuated by instruments), to share in the profits generated by the offeror.[307] Table 1 below summarizes all Supreme Court cases involving alleged investment contracts, and identifies (i) the instruments involved and (ii) the contractual right to share in the profits in the cases in which the Court found an investment contract. As Table 1 shows, every investment contract was evidenced by a *contractual* right to receive income derived solely from the offeror's efforts. Conversely, every case in which the Supreme Court found no such investment contract *lacked* such a contractual right of the investor to share in the profits.

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[303] *W.J. Howey, Co.*, 328 U.S. at 299.

[304] *Id.* at 300. The *W.J. Howey Co.* Court used "share" or "shares" in the profits or enterprise five times in analyzing the investment contract. *See id.* at 299-300.

[305] *Id.* at 299.

[306] *Id.* at 301.

[307] *See* SEC v. Edwards, 540 U.S. 389, 391 (2004) ("Under the leaseback and management agreement [for payphones], purchasers received $82 per month, a 14% annual return."); SEC v. United Benefit Life Ins. Co., 387 U.S. 202, 205 (1967) ("The purchaser[s], at all times before maturity, is entitled to his proportionate share of the total fund and may withdraw all or part of this interest. The purchaser is also entitled to an alternative cash value measured by a percentage of his net premiums which gradually increases from 50% of that sum in the first year to 100% after 10 years."); Tcherepnin v. Knight, 389 U.S. 332, 337 (1967) (investors in capital shares in a savings and loan association were entitled to "receive dividends declared by an association's board of directors and based on the association's profits"); SEC v. Variable Annuity Life Ins. Co. of Am., 359 U.S. 65, 71 (1959) (variable annuity plan entitling the holder to "a pro rata share of what the portfolio of equity interests reflects"); SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344, 348 (1943) ("[Defendants'] proposition was to sell documents which offered the purchaser a chance, without undue delay or additional cost, of sharing in discovery values which might follow a current exploration enterprise."); *see also* Brief of Securities Law Scholars as Amici Curiae in Support of Coinbase's Motion for Judgment on the Pleadings, *supra* note 41, at 14-16 (collecting cases).

TABLE 1. SUPREME COURT'S ANALYSIS OF INVESTMENT CONTRACTS AND UNDERLYING INSTRUMENTS

Case	Instruments involved	Contractual right to receive profit solely from offeror's efforts?	Investment contract?
S.E.C. v. C. M. Joiner Leasing Corp (1943)	Oil leases plus offeror's agreement to drill for oil. Offer letter stated: "[I]f you send in an order for 20 acres . . . , you will get 10 acres Free in the next block of acreage *we drill* . . . . You will really be in the oil business. Remember, if you do not make money on your investment, it will be impossible for us to make money . . . ."	Yes. "[T]he acceptance of the offer quoted made a contract in which payments were timed and contingent upon completion of the well, and therefore a form of investment contract in which *the purchaser was paying both for a lease and for a development project*." "Their proposition was to sell *documents which offered the purchaser a chance*, without undue delay or additional cost, of *sharing in discovery values which might follow a current exploration enterprise*."	Yes
SEC v. W.J. Howey Co. (1946)	Land sale and warranty deed, coupled with offer of service contract to grow and sell oranges for landowners.	Yes. Service contract entitled owners to "*an allocation of the net profits* based upon a check made at the time of picking."	Yes
S.E.C. v. Variable Annuity Life Ins. Co. of Am. (1959)	Variable annuity contracts offered by life insurance co.	Yes. Variable annuity contracts in which "holder gets only a *pro rata share of what the portfolio of equity interests reflects* . . . ."	Yes
S.E.C. v. United Benefit Life Insurance Company (1967)	"Flexible fund" contract offered by life insurance co.	Yes. "The purchaser, at all times before maturity, is *entitled to his proportionate share*	Yes

		of the total fund, and may withdraw all or part of this interest. The purchaser is also *entitled to an alternative cash value measured by a percentage of his net premiums which gradually increases from 50% of that sum in the first year to 100% after 10 years . . . .*"	
Tcherepnin v. Knight (1967)	Withdrawable capital shares offered by savings and loan under Illinois Savings and Loan Act.	Yes. Holders of withdrawable capital share were entitled to "*receive dividends* declared by an association's board of directors and based on the association's profits."	Yes
S.E.C. v. Edwards (2004)	Payphones "offered with an agreement under which ETS leased back the payphone from the purchaser for a fixed monthly payment, thereby giving purchasers a fixed 14% annual return on their investment."	Yes. "[A]greement under which [offeror] ETS leased back the payphone from the purchaser for a fixed monthly payment, thereby giving purchasers *a fixed 14% annual return on their investment*."	Yes
United Hous. Found., Inc. v. Forman (1975)	"Shares of stock entitling a purchaser to lease an apartment in Co-op City, a state subsidized and supervised nonprofit housing cooperative."	No. Lease shares only entitled purchaser to room in co-op. The net income that theoretically the co-op could make from income generated from renting common commercial spaces, and thereby reduce the rent of tenants, "is far too speculative and	No

		insubstantial to bring the entire transaction within the Securities Acts."	
International Brotherhood of Teamsters v. Daniel (1979)	Noncontributory employee pension plan	No. A noncontributory, compulsory pension plan did not involve employee's investment, was only available to employees with 20% years of service, and "the possibility of participating in a plan's asset earnings 'is far too speculative and insubstantial to bring the entire transaction within the Securities Acts.'"	No

For example, in *SEC v. Edwards*, the investment contract involved a scheme effectuated through the following instruments: "[A] site lease, a 5-year leaseback and management agreement, and a buyback agreement" for the public to lease payphones and then lease them back to the business venture.[308] As the Court noted, "*Under the leaseback and management agreement*, purchasers received $82 per month, a 14% annual return."[309] Given that contractual right to a return on their investment, the Court held that the scheme was an investment contract.[310] The Court explained:

> The Eleventh Circuit's perfunctory alternative holding, that respondent's scheme falls outside the definition because purchasers had a contractual entitlement to a return, is incorrect and inconsistent with our precedent. We are considering investment *contracts*. The fact that investors have bargained for a return on their investment does not mean that

[308] *Edwards*, 540 U.S. at 391.

[309] *Id.* at 391 (emphasis added).

[310] *Id.* at 397.

> the return is not also expected to come solely from the efforts of others. Any other conclusion would conflict with our holding that an investment contract was offered in *Howey* itself. 328 U.S., at 295–296, 66 S. Ct. 1100 (service contract entitled investors to allocation of net profits).[311]

As indicated above, the Court emphasized the word *contracts* as a focal point of the *Howey* test. Indeed, in *Edwards*, the Court quoted its prior decision in *Reves v. Ernst & Young* and its recognition that the concept of "security" broadly "encompass[es] virtually any *instrument* that might be sold as an investment,"[312] as the Securities Act's definition of security indicates.[313] Accordingly, the Court recognized that "Congress did not . . . 'intend to provide a broad federal remedy for all fraud.'"[314] These Supreme Court cases show the need to examine the financial instruments involved to determine if the instruments create a contractual right of the investor to receive profits. If they do not, there is no investment contract.

The cases where the Court found no investment contract involved situations in which the individuals were not entitled by any instrument to profits derived solely from the efforts of the offeror. In *United Housing Foundation, Inc. v. Forman*, the shares sold by a non-profit housing co-op entitled purchasers to a room in the co-op.[315] The Supreme Court held

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[311] *Id.* at 397 (emphasis in original).

[312] *Id.* at 393 (emphasis added) (quoting Reves v. Ernst & Young, 494 U.S. 56, 61 (1990)).

[313] *See* 15 U.S.C. § 77b(a)(1); 15 U.S.C. § 78c(a)(10) ("[O]r, in general, any instrument commonly known as a 'security' . . . ."); *C. M. Joiner Leasing Corp.*, 320 U.S. at 351 ("In the Securities Act, the term 'security' was defined to include by name or description many documents in which there is common trading for speculation or investment."); *see also* Loftus C. Carson II, *Application of the Federal Securities Acts to the Sale of a Closely Held Corporation by Stock Transfer*, 36 ME. L. REV. 1, 5 (1984) ("Also included within the definitions are a number of more general terms such as 'instruments commonly known as a "security,"' and 'investment contracts.' These more general terms were included to give a broad scope to the definition of 'security,' to satisfy Congress' intent that the definition encompass 'the many types of instruments that in our commercial world fall within the ordinary concept of a security.'" (footnote omitted) (citing H.R. REP. NO. 85, 73d Cong., 1st Sess. 11 (1933))).

[314] Reves v. Ernst & Young, 494 U.S. 56, 61 (1990) (quoting Marine Bank v. Weaver, 455 U.S. 551, 556 (1982)).

[315] United Hous. Found., Inc. v. Forman, 421 U.S. 837, 842 (1975).

that the net income that the co-op could theoretically make from income generated from renting common commercial spaces, which could later reduce the rent of the purchaser-tenants, "is far too speculative and insubstantial to bring the entire transaction within the Securities Acts."[316] The co-op shares, in other words, created no contractual right to receive any income generated solely by the co-op. Put simply, money paid to the co-op entitled one to a room, but nothing else.

Likewise, in *International Brotherhood of Teamsters v. Daniel*, the Supreme Court held that a noncontributory, compulsory pension plan offered by an employer did not constitute an investment contract.[317] First, there was no quid, or an investment of money: "An employee who participates in a noncontributory, compulsory pension plan, by definition, makes no payment into the pension fund."[318] Second, there was no quo, or contractual right to share in the profits of the pension plan: employees were only eligible for a pension after twenty years of employment, and any "profit" from the appreciation in value of the pension plan's investments were "far too speculative and insubstantial."[319]

These Supreme Court cases all uniformly applied and adhered to the original public meaning[320] of "investment contract" in the Securities Act of 1933, as first elaborated for state "blue sky" laws in 1920. Although the SEC may scrutinize various investment schemes to identify their "economic reality,"[321] the SEC may not rewrite the Securities Act or ignore its original public meaning of investment contract. The Act requires the offering of a financial instrument that effectuates a certain type of quid pro quo: an investment of money in the offeror's venture in exchange for a contractual right of the investor to share the income or

[316] *Id.* at 856.

[317] Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551, 559 (1979).

[318] *Id.* at 559.

[319] *Id.* at 553-54, 562 (quoting *Forman*, 421 U.S. at 856).

[320] *See generally* Wis. Cent. Ltd. v. United States, 585 U.S. 274, 284 (2018) (examining a statute's "original public meaning" of "money remuneration").

[321] SEC v. W.J. Howey Co. 328 U.S. 293, 298 (1946).

profits generated by the offeror's efforts.[322] *Howey*'s test encapsulates this definition.[323] Notably, every state court decision[324] and lower federal court decision[325] the *Howey* Supreme Court cited for its analysis of

[322] *See* 15 U.S.C. § 77b(a)(1) (including "investment contract" as one type of "security").

[323] *See supra* notes 252–267 and accompanying text (explaining the derivation of definition of "investment contract").

[324] *See* People v. White, 12 P.2d 1078, 1081 (Cal. Ct. App. 1932) (investment contract that "plainly provides that a certain sum of money has been paid to the party of the second part, that this money is to be used only for the purpose of investment and *the second party agrees to pay a specified sum on a specified date as principal and earnings for the stated period of time upon the investment*" (emphasis added)); Stevens v. Liberty Packing Corp., 161 A. 193, 193-94 (N.J. Ch. 1932) (investment contracts based on scheme of company consisting of agreement called a "lease" offering putative sale of rabbits to be leased back to company for breeding based on the company's efforts and pamphlet "guarantees to pay you One Dollar for each offspring when 8 weeks old," which yields "$56 . . . net profit-32 per cent on investment"); Prohaska v. Hemmer-Miller Dev. Co., 256 Ill. App. 331, 338 (Ill. App. Ct. 1930) (investment contract based on contract for real estate sale, with a rider entitling purchaser to net profits derived from offeror's harvesting of crops); State v. Evans, 191 N.W. 425, 426 (Minn. 1922) (investment contract created by the sale of realty options for land purchase for $25, with option that "he may surrender his contract and receive the amount paid in *with a bonus of $70 for each $1,000, from the profits obtained on sale of contracts on which the company is prepared to purchase other real estate*" (emphasis added)); *see also* State v. Heath, 153 S.E. 855, 855, 858 (N.C. 1930) (finding no investment contract where Freeman paid $3,500 for exclusive use of defendants' copyrighted system and, under the terms of the contract, was entitled to keep eighty percent of gross receipts derived from his own efforts).

[325] *See* Penfield Co. of Cal. v. SEC, 143 F.2d 746, 750-51 (9th Cir. 1944) (investment contract in contracts for bottling whiskey, which required the offeror "to sell the bottled whiskey *and to pay to the contract-holders the proceeds less all expenses and a commission of 10 percent of the gross sales price per case*" (emphasis added)); Atherton v. United States, 128 F.2d 463, 465 (9th Cir. 1942) (investment contract in sale of land leases "upon the promise and representation that the proceeds of the sale would be used for bringing a well into production," after which land "would be sold . . . and that *each purchaser of an assignment would receive a proportionate share of the purchase price*" (emphasis added)); SEC v. Universal Serv. Ass'n, 106 F.2d 232, 236-37 (7th Cir. 1939) (investment contract where "[p]aragraph three of the instrument directs that *each twelve months 30% of this endowment be set aside and distributed among plenocrats* [*contributors*]" and defendants assured contributors "that by placing money with the defendants *a 'contributor' would receive 30% profit per annum* from agricultural operations in which he takes no part other than making his contribution" (emphasis added)); SEC v. Crude Oil Corp., 93 F.2d 844, 847-48 (7th Cir. 1937) (investment contract based on a scheme for investing in oil sales by corporation by which "buyer is not to receive the oil, but is to *accept the proceeds of the*

"investment contract" involved such a an offering of a contractual right to profits, typically with the precise amount or formula for profit distribution to investors.

3. Economic Reality Is Not a License to Rewrite "Investment Contract" to Simply "Investment"

If the SEC has interpreted "investment contract" in the Securities Act more broadly than the Act's original public meaning, as recognized in *Howey*, the SEC should clearly explain its reasoning in a public guidance instead of resorting to regulation by selective, nonprecedential enforcement actions.[326] As Justice Gorsuch and Janie Nitze cogently explain in their book *Over Ruled*, the rule of law "requires laws that are

sales [by corporation], *which proceeds are to be paid monthly and distributed over a maximum period of twenty-five years*" (emphasis added)); SEC v. Bourbon Sales Corp., 47 F. Supp. 70, 71 (W.D. Ky. 1942) (investment contract based on company offering of "Sales and Bottling Contract" to owners of warehouse receipts of whiskey stored in bonded warehouses by which owners would receive, as stipulated in the contract, "*such amount which the* [*company*] *receives from the sales of said bottled goods*" (emphasis added)); SEC v. Bailey, 41 F. Supp. 647, 649 (S.D. Fla. 1941) (investment contract based on a scheme involving putative sale of land and development contract for offeror to grow and cultivate tung trees on purchaser's land, with "*purchaser receiving either a stated rental or a share of the proceeds of the crop*" (emphasis added)); SEC v. Payne, 35 F. Supp. 873, 875, 878 (S.D.N.Y. 1940) (investment contracts based on scheme to sell silver foxes and "*the proceeds from the sale of such offspring be divided pro rata among the respective purchasers*" (emphasis added)); SEC v. Pyne, 33 F. Supp. 988, 988 (D. Mass. 1940) ("The ship shares which the defendants offered and are offering for sale which carried with them *the right to the receipt of profits by the prospective purchasers* through efforts other than their own." (emphasis added)); SEC v. Timetrust, Inc., 28 F. Supp. 34, 38 (N.D. Cal. 1939) (investment contract based on offering of bank certificate "whereby through the device of what is called a 'trust' and the issuance of a 'trust' certificate *the purchaser acquires the certificate and the interest it represents, i.e., Bank of America stock*" (emphasis added)); SEC v. Wickham, 12 F. Supp. 245, 248 (D. Minn. 1935) (investment contract offered by investment business that stipulated "[t]he purchaser of the contract puts up the money for the venture. The defendant contributes his skill, experience, and time. The earnings, if any, are divided 60 per cent. to the purchaser and 40 per cent. to the defendant trader").

[326] *See* Todd Phillips, What's Left but Enforcement Actions? 19-21 (July 17, 2024) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4892950 [https://perma.cc/9TZF-KWD4].

publicly declared, knowable to ordinary people, and stable."[327] And, whatever its reasoning, the SEC's interpretation is entitled to no deference by courts, as the Supreme Court recently ruled[328] — and should be rejected. "Courts must exercise their independent judgment in deciding whether an agency has acted within its statutory authority, as the APA requires."[329]

Thus far, in the few cases considering whether cryptocurrencies are investment contracts, the Southern District of New York has rejected the argument that an investment contract requires a contractual right of the investor to receive profits derived solely from the offeror's efforts.[330] These decisions, however, overread *Howey*'s recognition of examining the "economic reality" and the substance, not form, of "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts

[327] NEIL GORSUCH & JANIE NITZE, OVER RULED 27-28 (2024); *see* Jorge deNeve, Andrew J. Geist, Jamie Quinn, Bill Martin & Britta A. Nordstrom, *SEC's Impact on NFTs Is More Than Theory: First Enforcement Action Against an NFT Creator*, O'MELVENY (Sept. 5, 2023), https://www.omm.com/insights/alerts-publications/sec-s-impact-on-nfts-is-more-than-theory-first-enforcement-action-against-an-nft-creator/ [https://perma.cc/77EH-VRJV] ("[T]he Impact Theory Order will not satisfy NFT creators who want greater clarity about how to comply with federal securities laws when offering and selling NFTs.").

[328] *See* Loper Bright Enters. v. Raimondo, 144 S. Ct. 2244, 2273 (2024); SEC v. Sloan, 436 U.S. 103, 111-12 (1978) (noting that no deference is given to SEC's interpretation of Securities Exchange Act of 1934's grant of power to issue serial 10-day suspension orders because statute did not authorize serial suspension orders).

[329] *Loper Bright Enters.*, 144 S. Ct. at 2273.

[330] *See, e.g.*, SEC v. Coinbase, Inc., No. 23 Civ. 4738 (KPF), 2024 WL 1304037, at *25 (S.D.N.Y Mar. 27, 2024); Order Denying Motion to Dismiss and Setting Case Management Schedule at 15, SEC v. Payward, Inc. (Aug. 23, 2024) (No. 23-cv-06002-WHO), https://storage.courtlistener.com/recap/gov.uscourts.cand.421113/gov.uscourts.cand.421113.90.0.pdf [https://perma.cc/AD6R-8D9K] ("In short, the blue sky laws from which *Howey* drew inspiration may have involved more formal contracts, but the Court in *Howey*, the Ninth Circuit in *Hocking*, and numerous courts since have made clear that contractual formalities are not required for something to qualify as an investment contract, and therefore a security."); SEC v. Terraform Labs Pte. Ltd., 684 F. Supp. 3d 170, 193 (S.D.N.Y. 2023) ("By stating that 'transaction[s]' and 'scheme[s]' — and not just 'contract[s]' — qualify as investment contracts, the Supreme Court made clear in *Howey* that Congress did not intend the term to apply only where transacting parties had drawn up a technically valid written or oral contract under state law."); *see also* SEC v. Kik Interactive Inc., 492 F. Supp. 3d 169, 178 (S.D.N.Y. 2020) ("[A]n ongoing contractual obligation is not a necessary requirement for a finding of a common enterprise.").

of the promoter or a third party."[331] Examining the economic reality and substance of a scheme, such as the land sale plus service agreement in *Howey*, does allow courts to look at what the offered scheme, in fact, does in operation.[332] The form of an instrument is not dispositive.

Of course, it does not have to be titled "investment contract" to be an investment contract.[333] The *substance* of the financial arrangement is key. For example, in *Howey*, the land sale was in name only;[334] the economic reality was that the scheme was an investment in the defendant's orange-growing business that entitled the purchaser to a contractual share in the profits.[335] Businesses cannot immunize their offerings from securities law simply through disclaimers or artful legal instruments that purport not to constitute investment contracts.[336] *Howey*'s recognition of the economic reality and focus on the substance of financial arrangements allow courts to look beyond the form of any documents, including such disclaimers.[337] The economic reality or substance of an offering of an investment contract may be implied based on the facts, including the conduct and representations of the parties.[338]

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[331] SEC v. W. J. Howey Co., 328 U.S. 293, 298-99 (1946).

[332] *See id.* at 298-99, 301.

[333] *See* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 849 (1975) ("Congress intended the application of [the securities laws] to turn on the economic realities underlying a transaction, and not on the name appended thereto.").

[334] *See generally* R.F.C., *Pension Plans*, *supra* note 300, at 553 ("Purported sales of land outside of the state was one of the principal abuses which brought about the early Blue Sky laws, and the early statutes and cases indicate that the term 'investment contract' related specifically to this abuse.").

[335] *W.J. Howey Co.*, 328 U.S. at 299.

[336] *See, e.g.*, SEC v. Merch. Cap., LLC, 483 F.3d 747, 760 (11th Cir. 2007) (rejecting "[a] focus on the bare terms of the legal agreement" because it would "would be an invitation to artful manipulation of business forms to avoid investment contract status"); SEC v. Crude Oil Corp., 93 F.3d 844, 848 (7th Cir. 1937) ("The title of the contract, to-wit, 'Bill of Sale and Delivery Contract,' was a misnomer and a deceptive one. It was obviously conceived for the purpose of avoiding any regulatory control by state or Federal governments of a 'security' speculative in nature.").

[337] *See, e.g.*, SEC v. MacElvain, 417 F.2d 1134, 1137 (5th Cir. 1969) (examining interrelationship between two offerings and concluding that second offering was investment contract, notwithstanding a disclaimer).

[338] *See generally* Hercules Inc. v. United States, 516 U.S. 417, 424 (1996) ("An agreement implied in fact is 'founded upon a meeting of minds, which, although not embodied in an express contract, is inferred, as a fact, from conduct of the parties

But the examination of economic reality under *Howey* does *not* allow the courts to ignore the text of the Securities Act — or the original public meaning of investment contract. If the facts indicate there was no contractual right in the offering, express or implied, to receive a share of the profits generated solely from the offeror's efforts — what the *Howey* Court described as "the shares in the enterprise"[339] — the economic reality is there was no investment contract.

SEC v. C. M. Joiner Leasing Corp. is instructive.[340] Although the decision preceded *Howey*'s definition of investment contract, the Court examined the economic reality of the financial instruments involved:

> (1) [T]he offer of oil leases at "no substantial cost"[341] to the buyers ("the great majority of purchases amounted to $25 or less," equivalent to $560 in 2024[342]); and
>
> (2) offer letters and documents that "assured the prospect that the Joiner Company was engaged in and [that it] would complete the drilling of a test well so located as to test the oil-producing possibilities of the offered leaseholds."[343]

In examining these documents, the Court focused on whether they went beyond a simple oil lease to encompass a contract that gave to investors a right to profit from Joiner's efforts.[344] It did.

Joiner's documents touted the offering as an "investment where [the investors] have a *good chance for splendid returns on the investment*."[345] The offering told the investors it was their opportunity to "really be in the oil business" — with Joiner doing all the work.[346] Based on these several

showing, in the light of the surrounding circumstances, their tacit understanding.'" (citations omitted)).

339 *W.J. Howey Co.*, 328 U.S. at 298-99.

340 320 U.S. 344 (1943).

341 *Id.* at 349.

342 Ian Webster, *$25 in 1940 is Worth $561.68 Today*, OFF. DATA FOUND., https://www.in2013dollars.com/us/inflation/1940?amount=25 (last visited Aug. 21, 2024) [https://perma.cc/YV8H-UG35].

343 *C.M. Joiner Leasing Corp.*, 320 U.S. at 346.

344 *Id.* at 346-49.

345 *Id.* at 346 n.3 (emphasis added).

346 *Id.*

documents, the Supreme Court had no trouble concluding that the offering didn't involve a simple oil lease that "[p]urchasers then would have been left to their own devices for realizing upon their rights."[347] Instead, Joiner's oil lease was a way for investors to invest in Joiner's oil venture without prospecting for oil themselves.[348] Joiner's offering involved the sale of "an economic interest in this well-drilling undertaking," which was "brought into being [by] the instruments that defendants were selling and gave to the instruments most of their value and all of their lure."[349] The form of the main instrument was an oil lease, but the substance of Joiner's offering was "an investment and . . . participation in an enterprise" of Joiner.[350] Put simply, "no one's leases had any value"[351] without Joiner's venture. Everything hinged on Joiner.

Joiner and *Howey* are both cases in which the Supreme Court looked to the economic reality by focusing on what the financial documents said.[352] Although the source of potential profits offered by Joiner (i.e., increased value of the oil leases upon Joiner's discovery of oil) differed from the potential profits from Howey's orange-growing business, both cases involved offerings of contractual rights of the investors to such profits.[353] In *Howey*, the service contract recognized "*an allocation of the*

[347] *Id.* at 348.

[348] *See id.* (concluding that "defendants offered no such dismal prospect" of having purchasers to test for oil themselves).

[349] *Id.* at 349.

[350] *Id.* at 346.

[351] *Id.* at 349. Selling stakes in oil prospecting venture through leases was common during that period. *See, e.g.*, Atherton v. United States, 128 F.2d 463, 465 (9th Cir. 1942) ("The leases were sold at prices ranging from $50 to $200 per acre upon the promise and representation that the proceeds of the sale would be used for bringing a well into production on the drill site, thus proving the productivity of the whole area under lease."); *id.* (discussing similar case involving oil and gas leases); *supra* note 193.

[352] *See* SEC v. W.J. Howey Co., 328 U.S. 293, 295-96 (1946); *C.M. Joiner Leasing Corp.*, 320 U.S. at 346-49.

[353] *See W.J. Howey Co.*, 328 U.S. at 300 (concluding that offering involved "shares in this enterprise . . . evidenced *by land sales contracts and warranty deeds, which serve as a convenient method of determining the investors' allocable shares of the profits*" (emphasis added)); *C.M. Joiner Leasing Corp.*, 320 U.S. at 349 (concluding that "the acceptance of the offer quoted made a *contract* in which payments were timed and contingent upon completion of the well and therefore a form of investment contract in which the purchaser was paying both for a lease and for a development project" (emphasis added)).

net profits based upon a check made at the time of picking."[354] In *Joiner*, the contract was the oil lease whose value derived from whatever success Joiner's oil drilling had.[355] Joiner's offer letter solicited people to invest in its oil lease with the pitch: "[I]f you do not make money on your investment, it will be impossible for us to make money."[356] Given these documents, the oil lease was "a contract in which payments were timed and contingent upon completion of the well [by Joiner], and therefore a form of investment contract in which the purchaser was paying both for a lease and for a development project" of Joiner, the Court concluded.[357]

Like the land sale in *Howey*, the oil lease was in name only. People weren't buying "naked leasehold rights" for them to use, but instead, as Joiner's documents touted, "a chance, without undue delay or additional cost, of *sharing in discovery values* which might follow a current exploration enterprise" by Joiner's business.[358] By buying an oil lease from Joiner, the quid, investors received the quo: the chance of sharing profits — "a good chance for splendid returns" — from Joiner's oil discovery venture.[359] This quid pro quo was an investment contract.

The lesson of *Joiner* and *Howey* is not that economic reality can replace the need to prove a contractual offering to fall within the meaning of investment contract under the Securities Act. Instead, the lesson is that economic reality can *establish* such offering. As Justice Jackson explained in *Joiner*, the offeror's several instruments may be "proved as matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts' . . . ."[360]

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[354] *W.J. Howey Co.*, 328 U.S. at 296 (emphasis added).

[355] *See C.M. Joiner Leasing Corp.*, 320 U.S. at 348 ("Their proposition was to sell documents which offered the purchaser a chance, without undue delay or additional cost, of sharing in discovery values which might follow a current exploration enterprise.").

[356] *Id.* at 346 n.3.

[357] *Id.* at 349.

[358] *Id.* at 348 (emphasis added).

[359] *Id.* at 346 n.3.

[360] *Id.* at 351; *see also id.* at 349 (holding that, under federal law, "the acceptance of the offer quoted made a contract in which payments were timed and contingent upon

In situations where no investment contract exists, the lack of securities regulation does not leave investors helpless. As explained above, fraud and misrepresentations already provide the basis of criminal and tort liability. And Congress has the ultimate authority to decide whether federal legislation is needed to regulate NFTs, as well as cryptocurrency and other digital assets.[361] But the Constitution does not permit courts or the SEC "to rewrite the statute that Congress has enacted."[362]

B. Sales of Artworks, Including Artwork NFTs, Do Not Constitute Investment Contracts

This Section sets forth how the sale of artwork NFTs should be analyzed under securities law. Such sales do not establish investment contracts. And the grant of intellectual property rights as a part of such sales does not constitute an investment contract, either. When purchasers buy artwork NFTs, they are typically entitled to own and use the artwork NFTs according to the terms of use, but nothing else.

1. Sales of Artworks, Artwork NFTs, and Other Collectibles Involve Items for Personal Consumption and Enjoyment

As shown in Figure 10 below, the sale of artworks is a far different relationship than an investment contract. Sales of artworks do not constitute investment contracts, as courts have correctly held.[363] When collectors buy art and other collectibles, there is no quid pro quo of the kind required for an investment contract. First, the purchase of a collectible involves the use of money *to buy something* — an artwork of Picasso, a Pokémon card, a Barbie doll, Birkin bag, a Rolex watch, Nike sneakers, or other collectible — as opposed to a financial instrument or

completion of the well and therefore a form of investment contract in which the purchaser was paying both for a lease and for a development project").

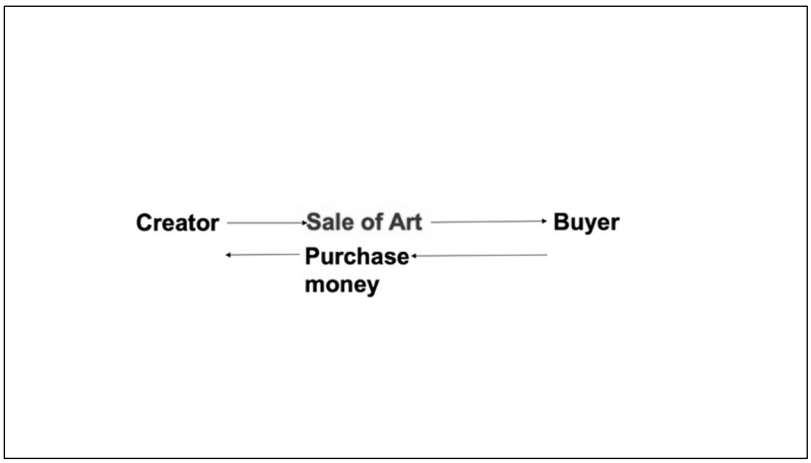
[361] *See generally* Jason Brett, *Congress Creates a Storm of Crypto Legislation*, FORBES (Aug. 3, 2023, 10:25 AM), https://www.forbes.com/sites/jasonbrett/2023/08/03/congress-creates-a-storm-of-crypto-legislation/?sh=139ec0c73aa4 [https://perma.cc/7EGR-YSDJ].

[362] Puerto Rico v. Franklin Cal. Tax-Free Tr., 579 U.S. 115, 130 (2016) (internal quotation and citation omitted).

[363] *See supra* notes 123–130 and accompanying text.

financial interest. The sales payment for a collectible differs from an investment in money made in exchange for a contractual right to receive profits generated by the offeror. With an artwork sale, the money is in exchange for *the item purchased*, which the buyer possesses and controls after the sale. The collector's own efforts greatly affect the collectible's resale value, especially keeping it in mint condition and being able to prove its authenticity and provenance. Plus, the collector enjoys the ownership and *use* of the collectible itself. As the Supreme Court recognized, *Howey* simply does not apply to sales "when a purchaser is motivated by a desire to use or consume the item purchased."[364]

FIGURE 10. A SALE OF ARTWORK AND RELATIONSHIP BETWEEN CREATOR AND BUYER



This art sale does not involve a situation in which a person's money is invested in a venture entitling the person to share in more money generated by the venture through its sole efforts. Instead, the art sale involves a simple transaction. Money is paid by the buyer, who receives the art in exchange. The same holds true for artwork NFTs. Money is paid by the buyer, who receives the artwork NFT in exchange — and who can use the NFT by displaying the artwork, for example.

[364] United Hous. Found., Inc. v. Forman, 421 U.S. 837, 852-53 (1975).

2. The Expected Appreciation in Value of Artworks, Artwork NFTs, and Other Collectibles Does Not Create an Investment Contract

The SEC's two orders against Impact Theory and Stoner Cats failed to identify what instrument, if any, established a contractual right for NFT owners to share income generated solely by the NFT projects' efforts.[365] Instead, the SEC's order in the Stoner Cats case focuses on the sales pitch of the project: "SC2's public communications tied the success of the show to the value of the NFTs and thus led investors reasonably to expect to profit from the managerial and entrepreneurial efforts of SC2."[366] "In doing so, it led investors to expect profits from their entrepreneurial and managerial efforts, because a successful web series *could cause the resale value of the Stoner Cats NFTs* to rise in the secondary market."[367] The SEC's order against Impact Theory espoused a similar theory of investor expectation of NFT appreciation, quoting even more extensively the statements by the company.[368]

But this overbroad view of investment contract cannot be squared with the original public meaning of the term "investment contract," which requires an investment of money in exchange for a contractual right to share in the income generated by the offeror, as explained above.[369] Indeed, the SEC's overbroad view threatens to transform the sale of every artwork or collectible into a security because the purchaser reasonably expected the artwork's value to increase based on the artist's development.

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[365] *See* Stoner Cats Order, *supra* note 10, at ¶ 1 (asserting that "Stoner Cats 2, LLC ('SC2') conducted an unregistered offering of crypto asset securities in the form of non-fungible tokens called Stoner Cats," but failing to identify any contractual right to profits included); Impact Theory Order, *supra* note 10, at ¶ 1 (asserting that Impact Theory "sold crypto asset securities known as Founder's Keys ('KeyNFTs')," but failing to identify any contractual right to profits included).

[366] Stoner Cats Order, *supra* note 10, at ¶ 2.

[367] *Id.* ¶ 19 (emphasis added).

[368] *See* Impact Theory Order, *supra* note 10, at ¶¶ 6-9.

[369] *See supra* notes 209–223 (historical examples before passage of Securities Act of 1933 of "investment contracts" offering a share of profits); *see also supra* notes 166–208, 233–307 (explaining Supreme Court's and other courts' interpretation of "investment contract," consistent with its contemporaneous ordinary meaning).

Securities law was never intended to regulate all investments, however. The original public meaning of investment contract draws the line: investments that lack a contractual right of the investor to share in income solely generated by the offeror fall outside of securities regulation.[370] For example, if a collector purchased a Barbie doll, a Birkin bag, a Picasso painting, a Rolex watch, Nike sneakers, or a Pokémon card, that investment is not an investment contract. The reason is simple: the collector receives no *contractual* right to share in income solely generated by Mattel, Hermès, the Picasso Administration, Rolex, Nike, or The Pokémon Company. Even though purchasers may reasonably expect these items to appreciate in value, purchasers' expectations do not make an investment contract. Instead, a contractual right does.

As the federal courts have recognized:

> The mere presence of a speculative motive on the part of the purchaser or seller does not evidence the existence of an 'investment contract' within the meaning of the securities acts. In a sense anyone who buys or sells a horse or an automobile hopes to realize a profitable "investment." But the expected return is not contingent upon the continuing efforts of another. In the words of the Supreme Court [the purchaser] "has been left to its own devices for realizing upon its rights."[371]

This principle applies here. Even if the efforts of Mattel, Hermès, the Picasso Administration, Rolex, Nike, or The Pokémon Company in cultivating their respective brands brings great value to their collectors, the appreciation of value in collectibles are far too speculative[372] and removed from income generated "solely through the efforts of" the offeror.[373] This scenario is far different from the Howey Company

[370] *See id.*

[371] Sinva, Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 253 F. Supp. 359, 367 (S.D.N.Y. 1966) (citation omitted).

[372] *Cf.* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 856 (1975) (shares of stock in corporation overseeing housing co-op that were required for room rental were not investment contracts; potential income generated by co-op through commercial leasing, which could lower rents for the tenants, was "far too speculative and insubstantial to bring the entire transaction within the Securities Act").

[373] SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1946).

generating income by selling oranges in its business and then sending a cut of the money back to investors as stipulated by a contractual right. Here, the collector is the one who makes a profit by deciding to sell the collectible when its value has appreciated, which may require significant efforts by the collector to promote the sale and find the right platform or auction house to conduct it. Any appreciation in the value of the collectible is due to market forces and the rarity and condition of the collectible, among other factors, instead of a profit "solely through the efforts of" Mattel, Hermès, the Picasso Administration, Rolex, Nike, or The Pokémon Company. Indeed, when a collectible is involved, it is entirely possible that the value can appreciate with no efforts undertaken by its creator. For art, the catalyst may simply be that the artist died.[374]

The same analysis applies to the sale of artwork NFTs. With an artwork NFT sale, the money is in exchange for *the NFT purchased*, which the buyer possesses and controls after the sale. The purchase of an artwork NFT does not give the purchaser a contractual right to share in profits generated by the NFT project itself. And any appreciation in value of the NFT purchased is not a profit generated "solely through the efforts of" the NFT project.[375] NFTs are typically subject to volatile market forces that have no relationship to the efforts of the NFT projects — indeed, the NFT market forces are often contrary to the wishes of the NFT projects, who face the public perception that NFTs are "totally worthless."[376] Just as buying the artwork of a new artist as an investment is highly speculative, so too is the buying of an artwork NFT. Even if a purchaser is led to believe by the artist that the artwork will appreciate in value, the sale does not create an investment contract.

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[374] *See* Daniel Grant, *The Value of Artwork After an Artist's Death*, WALL ST. J. (Oct. 21, 2018, 10:00 PM), https://www.wsj.com/articles/the-value-of-artwork-after-an-artists-death-1540173601.

[375] *W.J. Howey Co.*, 328 U.S. at 298.

[376] Miles Klee, *Your NFTs Are Actually — Finally — Totally Worthless*, ROLLING STONE (Sept. 20, 2023), https://www.rollingstone.com/culture/culture-news/nfts-worthless-researchers-find-1234828767/ [https://perma.cc/N44S-NMJD].

3. Artists' Grant of Intellectual Property Rights Does Not Create an Investment Contract

When their artworks are being sold in NFTs, NFT projects typically include a nonexclusive license entitling their NFT owners to make certain limited uses of the artwork embodied in their NFTs, such as for noncommercial uses.[377] Both projects subject to the SEC's orders, Impact Theory and Stoner Cats, granted noncommercial use licenses to their NFT owners.[378] The inclusion of an intellectual property ("IP") license — granting buyers certain rights to use the artwork — with the sale of NFTs does not make them investment contracts. If anything, an IP license tends to cut against the existence of an investment contract by signaling a purchase of an embodiment of artwork with accompanying IP rights granted to the purchaser. It is also common for NFT projects to prohibit their NFT owners from using the trademarks of the NFT project.[379] That restriction undercuts the existence of any "common enterprise" under *Howey*.

Some NFT projects even grant their NFT owners the right to commercialize and monetize the artworks and to keep any revenues the NFT owners make by their own efforts.[380] Indeed, a majority of the Top 25 NFT projects in January 2023 did so.[381] This kind of decentralized collaboration among NFT owners in a project has been referred to by

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[377] *See* Melanie J. Howard and Anthony Traina, *Brands and NFTs: Licensing and Contracting Considerations*, LOEB & LOEB LLP (Apr. 2022), https://www.loeb.com/en/insights/publications/2022/04/brands-and-nfts-licensing-and-contracting-considerations [https://perma.cc/XY4P-SMBQ].

[378] *See Impact Theory Site Terms and Terms of Sale*, *supra* note 138 ("With respect to the KeyNFTs, each purchaser of a KeyNFT is granted an exclusive, limited license to such KeyNFT and its content to access, use, or store such KeyNFT and its content solely for their personal, non-commercial purposes. KeyNFTs are a limited-edition digital creation based upon content that may be trademarked and/or copyrighted by Company."); *Terms of Service*, *supra* note 138 (granting "a limited license to use, copy, view, and display such Stoner Cat, and a limited license to view and display any associated Digital Content, for your own personal, non-commercial use and in connection with a proposed sale or transfer of the Stoner Cats NFT").

[379] *See* Lee, *Decentralized Collaboration*, *supra note* 73, at 112.

[380] *See id.* at 102-06.

[381] *See id.*

the media as the aspiration to build a "decentralized Disney."[382] Instead of a company making all the decisions on building its business, it cedes some control over its IP to consumers who can make their own independent decisions on how to exploit the IP (such as a visual character embodied in an NFT they purchased) under the terms of a commercial license set forth by the NFT project.[383] As Kyle Chayka of *The New Yorker* described the concept of a decentralized Disney: "[A] new form of culture in which fans are responsible for co-creating the universes they're consuming."[384]

When NFT projects grant commercial IP rights to their NFT purchasers — authorizing the purchasers to use their own efforts to monetize the artworks in their NFTs and to keep their own profits — the purchasers' own commercial rights further militate against the existence of an investment contract.[385] When NFT purchasers' own efforts (such as by selling merchandise with the artwork) can yield their own profits, those expectations do not satisfy the *Howey* test, which focuses on the "expectation that they would earn a profit *solely through the efforts of the promoter*."[386] When someone buys NFTs with commercial IP rights to monetize the artwork, the purchase more likely "is motivated by a desire to use or consume the item purchased."[387] And, similar to a partnership, "[a]n investor who has the ability to control the profitability of his investment . . . *by his own efforts* . . . is not dependent upon the managerial skills of others," thereby falling outside of the *Howey* test.[388] That same principle applies where, as here, purchasers are

[382] *See id.* at 104.

[383] *See id.*

[384] Kyle Chayka (@chaykak), X (July 30, 2021, 12:42 PM), https://x.com/chaykak/status/1421194419865374723 [https://perma.cc/9CHK-WFVL].

[385] *See* State v. Heath, 153 S.E. 855, 858 (N.C. 1930) (discussing profits derived from third party's own efforts in exploiting licensed copyrighted system).

[386] SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1946) (emphasis added).

[387] SEC v. Edwards, 540 U.S. 389, 396 (2004) (quoting United Hous. Found., Inc. v. Forman, 421 U.S. 837, 852-53 (1975)).

[388] Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc., 840 F.2d 236, 242 (4th Cir. 1988) (emphasis added) (quoting Gordon v. Terry, 684 F.2d 736, 741 (11th Cir. 1982)).

granted rights to monetize artwork NFTs they own.[389] This situation is also analogous to a franchisor-franchisee relationship, in which the franchisee exercises its own efforts, discretion, and authority to run its business. Courts have recognized that such franchisee arrangements do not constitute investment contracts.[390]

4. Securities Law Should Not Thwart Creators' Efforts in Fundraising and Community-Building

The SEC took a dim view of Impact Theory's statements to prospective NFT collectors that the company was "trying to build the next Disney."[391] The Stoner Cats' project, which was developing an animated web series, might also be characterized as having similar "Disney" aspirations.[392] However, the aspiration to build the "next Disney" does not establish an investment contract. Securities law should not thwart fundraising and community-building efforts to support the artistic endeavors of creators in the United States.[393] To do so raises serious problems under the First Amendment.

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[389] *See* Faircloth v. Jackie Fine Arts, Inc., 682 F. Supp. 837, 844 (D.S.C. 1988), *aff'd in part and rev'd in part*, 938 F.2d 513 (4th Cir. 1991) ("There is no question that Lynch could have marketed the art master himself, and the fact that he chose not to do so cannot, according to the Fourth Circuit, render this investment a security.").

[390] *See, e.g.*, Martin v. T.V. Tempo, Inc., 628 F.2d 887, 890-91 (5th Cir. 1980) (agreements for magazine distribution and ad sale franchise were not investment contracts); Bitter v. Hoby's Int'l, Inc., 498 F.2d 183, 184-85 (9th Cir. 1974) (agreement for roast beef restaurant franchise was not investment contract); Lino v. City Investing Co., 487 F.2d 689, 693 (3rd Cir. 1973) (agreement for sales center franchise was not investment contract); Nash & Assocs., Inc. v. Lum's of Ohio, Inc., 484 F.2d 392, 394-95 (6th Cir. 1973) (agreement for restaurant franchise was not investment contract); Wieboldt v. Metz, 355 F. Supp. 255, 261 (S.D.N.Y. 1973) (agreement for business and tax center franchise was not investment contract); Mr. Steak, Inc. v. River City Steak, Inc., 324 F.Supp. 640, 646 (D. Colo. 1970) (agreement for restaurant franchise not an investment contract), *aff'd*, 460 F.2d 666 (10th Cir. 1972).

[391] Impact Theory Order, *supra* note 10, at ¶ 6.

[392] *See* Adi Robertson, *NFT Makers are Trying to Build the Next Disney*, THE VERGE (Nov. 17, 2021, 6:24 AM), https://www.theverge.com/22785051/nft-collectibles-intellectual-property-decentralized-disney [https://perma.cc/6BMX-52C8].

[393] *But cf.* Lewis Rinaudo Cohen, *Ain't Misbehavin': An Examination of Broadway Tickets and Blockchain Tokens*, 65 WAYNE L. REV. 81, 87-93 (2019) (analyzing fundraising for a Broadway show).

The SEC's approach to the Stoner Cats NFTs appears to have ignored the *economic realities* of the sales: they involved artwork collectibles featuring cat characters, similar to Pokémon trading cards. Even if the sales of artwork NFTs can help the artist or the project raise funds to sustain their business and to create more artworks, and even if the future success of the artist or project may help to increase the value of the artwork NFTs, the sale of collectibles does not magically turn them into the quid pro quo required for an investment contract, an investment of money in exchange for the contractual right to share in profits solely generated by the artist or project.

Indeed, starting with Walt Disney in the 1930s,[394] the United States has a rich history of American businesses selling collectibles to raise funds and cultivate a loyal community of collectors and consumers. Such activities have never been understood as investment contracts. As Commissioners Peirce and Uyeda stated in their dissent:

> While updated for the digital age, the Stoner Cats NFTs are not that different from Star Wars collectibles sold in the 1970s. On the heels of the very successful release of Star Wars in 1977, fan excitement was high. To the delight of millions of children that holiday season, the toy company Kenner sold "Early Bird Certificate Packages," redeemable for future Luke Skywalker, Princess Leia, and R2-D2 action figures and membership in the Star Wars fan club. The sales of these certificates helped to build a die-hard community of Star Wars fans. Would those I.O.U.

[394] *See* Renee Bugden, *A Short History of Disney Merchandising*, MEDIUM (May 2, 2019), https://medium.com/the-wonderful-world-of-disney/a-short-history-of-disney-merchandising-b9441a94bbb4 [https://perma.cc/5SVC-QSYG]. *See generally McDonald's Unveils New Online Merchandise Shop*, MCDONALDS (Dec. 4, 2019), https://corporate.mcdonalds.com/corpmcd/our-stories/article/online-merch-shop.html [https://perma.cc/A5DS-4R6Z] (McDonald's offers merchandise and apparel in "an online shop full of merchandise specifically designed for the McDonald's lover"); Jennifer Levasseur, *Star Wars: A Merchandising Empire*, SMITHSONIAN (Dec. 20, 2017), https://airandspace.si.edu/stories/editorial/star-wars-merchandising-empire [https://perma.cc/RF7F-P8CR] (*Star Wars* producer sold merchandise as a part of "Star Wars toy universe, a universe that also included plush toys, fake lightsabers, children's costumes, games, and literally hundreds of other products"); *infra* notes 396–403 and accompanying text (discussing merchandising and collectibles for Mickey Mouse, Star Wars, and Barbie).

> certificates, which could be re-sold, constitute investment contracts? Using the analysis of today's enforcement action, the SEC should have parachuted in to save those kids from Star Wars mania.[395]

In 1977, the Early Bird Certificate retailed for $7.99; in 2023, one sold on eBay for $2,750.[396] And the highest amount ever paid for a Star Wars toy is $204,435 at auction.[397]

Or consider Mattel's current offering of the "Barbie Signature Digital Membership," which entitles the member to "exclusive access to members-only dolls" and other special perks.[398] Even if a collector purchased this membership and a new, members-only Barbie doll with the expectation of the collectible appreciating in value based on the continued efforts of the Barbie franchise to develop its global brand, that purchase of a membership and doll is not an investment contract. That is the case even if the collector has a reasonable expectation that members-only dolls will appreciate, given that the highest-priced Barbie sold for $302,500.[399] A doll is a doll.

If the Securities Act had treated the sales of collectibles as investment contracts, it would have thwarted one of the greatest business success stories in American history. In the 1930s, Walt Disney pioneered the successful business model of selling merchandise of Mickey Mouse and other Disney characters to finance the production of Disney's now

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[395] Peirce & Uyeda, *Dissent in Stoner Cats*, *supra* note 29.

[396] *See Star Wars Kenner Vintage Collection Early Bird Certificate*, ACTIONFIGURE411, https://www.actionfigure411.com/star-wars/kenner-vintage-collection/star-wars-action-figures/early-bird-certificate-4506.php#ebayTabs (last visited Aug. 23, 2024) [https://perma.cc/FMJ9-R68J].

[397] Rae Grimes, Darby Harn, Robert Vaux, Cole Kennedy & Christopher Raley, *The 20 Rarest Star Wars Toys (& How Much They Cost)*, CBR, https://www.cbr.com/star-wars-rarest-toys-how-much-cost/#the-boba-fett-action-figure-prototype-is-hard-to-come-by (last updated July 23, 2024) [https://perma.cc/DWH2-QEN4].

[398] *Barbie Club 59 Membership*, MATTEL CREATIONS, https://creations.mattel.com/pages/barbie-signature-membership (last visited Aug. 23, 2024) [https://perma.cc/X7DC-MRGT].

[399] Anakin, *World's Most Expensive Barbie Auctioned*, LUXUO (Oct. 22, 2010), https://www.luxuo.com/culture/auctions/barbie-stefano-canturi-auction.html [https://perma.cc/GZX8-QCZH].

iconic films.[400] Disney even launched Mickey Mouse clubs to cultivate a national community of families interested in Disney movies to become owners of its merchandise.[401] Under Disney's innovative business model, "[p]rofits from the Mickey Mouse merchandising and films enabled Disney to finance a $2 million production in 1938 — then a staggering amount — for the film *Snow White and the Seven Dwarfs*,"[402] which was "the first feature-length animated movie in color."[403]

It would have violated the First Amendment if Disney had been forbidden from selling Mickey Mouse collectibles until he obtained the approval of the SEC through securities registration. That is so, even if people bought the collectibles with the reasonable expectation they would appreciate in value due to Disney's meteoric business success.[404] Indeed, when artistic expression is involved, securities registration is especially problematic because such a prior restraint on collectibles would also curb Disney's future production of movies and expressive works. Nothing in the Securities Act contemplates such an overbroad regulation. The First Amendment forbids it.

CONCLUSION

The SEC has failed to provide the public with any guidance on its treatment of artwork NFTs. Instead, it has resorted to ad hoc and overbroad treatment of NFTs as so-called "crypto asset securities" in the settlement orders against two NFT projects in 2023. This Article explains why the SEC's treatment of artwork NFTs raises a serious First Amendment problem. Requiring the registration of artwork NFTs as

[400] *See* LEE, *supra* note 8, at 157-63.

[401] *See id.* at 159.

[402] *Id.* at 160.

[403] *Id.*

[404] *See Early European Mickey Mouse Toys Roar at Morphy's $1.6M Auction*, LIVEAUCTIONEERS, (Mar. 23, 2020), https://www.liveauctioneers.com/news/early-european-mickey-mouse-toys-roar-at-morphys-1-6m-auction [https://perma.cc/W3JE-GDU7] (Mickey Mouse merchandise auctioned for $64,575, $35,670, and $25,830); *Most Expensive Toy of Mickey Mouse*, GUINESS WORLD RECORDS, https://www.guinnessworldrecords.com/world-records/73933-most-expensive-toy-of-mickey-mouse (last visited Aug. 23, 2024) [https://perma.cc/G5BG-8DGP] (highest Mickey Mouse merchandise sale at $110,000).

securities *before* they can be offered to the public constitutes an unlawful prior restraint. One way to avoid this First Amendment violation is to adhere to the original public meaning of "investment contract" in the Securities Act of 1933. Providing original historical research of newspapers and dictionaries before and contemporaneous with the enactment of the Securities Act in 1933, this Article demonstrates that under the term's original public meaning, an investment contract requires a certain type of quid pro quo: a person's *investment* of money, the quid, in exchange for a *contractual* right to receive a share in the profit generated solely by the offeror's efforts, the quo. A quid without the quo cannot create an investment contract. Like the sale of paintings, the sale of artwork NFTs typically lacks any such contractual right. The federal courts have correctly rejected attempts to extend securities registration to art sales. That approach should govern the sale of artwork NFTs.