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Intellectual Property Alert

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Court rules NBA-branded “Top Shot Moments” NFTs may be investment contracts

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Intellectual Property law and NFTs — Can Non-Fungible Tokens be subject to federal securities laws?



What's the Impact

- / The Southern District of New York denied a motion to dismiss by blockchain company Dapper Labs and held that plaintiffs adequately alleged that NBA Top Shot Moments NFTs are “investment contracts.”
- / Fundamental to the court’s conclusion was that Dapper Labs created and maintains a *private* blockchain.
- / The court’s decision provides guidance on how to structure an NFT project to minimize securities risks.

Summary of the Dapper Labs case

Dapper Labs developed a blockchain technology called “Flow,” which supports the sale of non-fungible tokens (NFTs). Dapper Labs then partnered with the NBA to launch an NFT platform called “NBA Top Shot,” which sells NFTs called NBA Top Shot Moments (or “NBA Moments”) on Dapper’s Flow blockchain.

In 2021, plaintiffs filed a putative class action complaint against Dapper Labs, alleging that the NFTs sold by Dapper Labs on its platform constitute unregistered securities in violation of federal securities laws. Specifically, plaintiffs claim that the NBA Moments are “investment contracts” that must comply with federal securities requirements.

Under the “*Howey*” test developed by the U.S. Supreme Court, “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.” *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). Plaintiffs allege that Dapper Labs “used their control over NBA Top Shot” to prevent investors from “cashing out,” which “ensured that money stayed on the platform” and “propp[ed] up the market for Moments as well as the overall valuation of NBA Top Shot.” Plaintiffs also alleged that Dapper Labs created scarcity by selling Moments in limited edition packs and requiring all subsequent sales to take place on the NBA Top Shot platform. On August 31, 2022, Dapper Labs filed a motion to dismiss, arguing that plaintiffs can’t “make a federal securities case over basketball cards” and “Basketball cards are not securities. Pokémon cards are not securities. Baseball cards are not securities. Common sense says so. The law says so. And courts say so.” Plaintiffs opposed the motion to dismiss.

On February 23, 2023, the Southern District of New York issued an order denying Dapper Labs’ motion to dismiss. The court ruled that “what Dapper Labs offered was an investment contract under *Howey*,” primarily because “Dapper Labs created and maintained a private blockchain.” According to the court, the privatization of the Flow blockchain and the restriction of the trade of NBA Moments to only the Flow blockchain “are what distinguish [NBA] Moments from cardboard basketball cards.”

Takeaways

By the court’s own admission, its decision is a “narrow” one; “not all NFTs offered or sold by any company will constitute a security,” and “each scheme must be assessed on a case-by-case basis.” What was determinative for the court in this case is that Dapper Labs maintains private control over the Flow blockchain, which “significantly, if not entirely dictates NBA Moments’ value”; that Dapper Labs touts NBA Moments as a means for purchasers to realize substantial profits; and that “without Dapper Labs’s essential efforts in maintaining the Flow Blockchain and Marketplace, [NBA] Moments would be valueless.”

Although many sellers of NFTs do not maintain private control over the blockchain on which the NFTs are marketed and traded, those that do should consider taking steps to ensure that they are complying with federal securities laws. For entities considering whether to offer NFTs on a public blockchain or on a privately controlled blockchain, the Dapper Labs decision offers excellent guidance on how to best structure an NFT project to minimize securities risks.

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