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Commissioner Hester M. Peirce
Chair of SEC Crypto Task Force
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Recommendations for Treatment of NFTs for Digital Art Under Securities Law and the First Amendment

Dear Commissioner Peirce and Members of the SEC Crypto Task Force:

I am a professor of law at Santa Clara University School of Law. I am an expert in how NFTs are used in innovative ways for creative production that offer promising sources of revenue especially for digital artists. I published seminal writings explaining this use case for NFTs by digital artists, including my book *Creators Take Control* ([Harper Business](#) 2023); *NFTs as Decentralized Intellectual Property*, [2023 UNIV. ILL. L. REV. 1049](#); and *Decentralized Collaboration Through Private Ordering*, [73 AM. U. L. REV. 67](#) (2023). Germane to the Task Force’s inquiry, I published articles related to securities law and NFTs used for digital art, including by businesses such as the one behind the Stoner Cats project that faced an SEC enforcement action. These articles are: *The Original Public Meaning of Investment Contract*, [58 U.C. DAVIS L. REV. 667](#) (2024); a [summary](#) of the article in Harvard Law School Forum on Corporate Governance; and *Why the SEC Is Wrong About NFTs*, [COINDESK](#) (Sept. 3, 2024).

RECOMMENDATIONS TO THE TASK FORCE

I applaud the Task Force’s solicitation of public comments to formulate sensible rules or guidance to govern digital assets and cryptocurrency—something, as you note in “[There Must Be Some Way Out of Here](#),” have been lacking over the past several years. I submit this comment (in my personal capacity) to support Commissioner Peirce’s recent [suggestion](#) that the SEC should issue a public guidance taking the legal position that **NFTs used for digital art, including by business projects for fundraising, do not constitute securities or “investment contracts.”** This approach comports not only with the original public meaning of “investment contract” in the Securities Act of 1933, but it also avoids the First Amendment violation that would occur if securities registration is required *before* artists can offer or disseminate digital art NFTs to the public. The latter is an unlawful prior restraint, in direct violation of the First Amendment.

1. Return to the Original Public Meaning of Investment Contract: It Requires a Public Offering of an Investment Opportunity with the Right to Receive Profits from the Offeror's Venture

When a new technology raises novel issues of securities law, it is important for the SEC and the courts to return to the text of the statute, along with Supreme Court precedent, to ensure that the law is not being stretched to cover situations beyond the statutory text that provides the sole basis for an agency's authority. The U.S. Supreme Court reminded us of this important principle in 2024 when [it held](#) that the National Firearms Act of 1934 did not support the Bureau of Alcohol, Tobacco, Firearms and Explosives' broad interpretation of "machinegun" to encompass the new technology of bump stocks added to semiautomatic rifles. Recently, Judge Stephanos Bibas of the Third Circuit [warned](#) against unclear and amorphous use of securities law to the new technology of cryptocurrency and digital tokens.

Like the National Firearms Act of 1934, the Securities Act of 1933 has its own limiting principle: the text. As I have recounted in my law review article "[The Original Public Meaning of Investment Contract](#)" (pp. 709-40), the term "investment contract" is not a legal term of art created by Congress. Instead, it is a term that businesses in the late 19th century and early 20th century used. The businesses offered investments in *contracts*, financial instruments that promised the chance of obtaining profits from the offeror. My law review article includes representative advertisements these businesses used before the passage of the Securities Act; the ads offered to sell "investment contracts." For example, one business in 1887 offered this "investment contract" that "guaranteed [the investor's] money back and 6 per cent interest and a share of the profits."¹



Other investment contracts were similar in promising "a share of the profits." *Id.* at 712-24.

The conclusion to draw from this historical research is not that the Securities Act of 1933 is limited to only financial instruments titled "investment contracts." In 1946, in the seminal case [SEC v. W.J. Howey](#), the U.S. Supreme Court instructed that courts should examine the "economic reality" of an offering to the public to determine if it offers an investment contract. This approach is sensible to avoid evasion of securities regulation by artful drafting. The Court defined investment contract, drawing from the Minnesota Supreme Court's definition of the same term in

¹ 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>].

the state's blue sky law in [State v. Gopher Tire & Rubber Co.](#) The Court set forth what is now called the *Howey* test (328 U.S. at 298-99, emphasis added):

By including an investment contract within the scope of § 2(1) of the Securities Act, Congress was using a term the meaning of which had been crystalized by this prior judicial interpretation. It is therefore reasonable to attach that meaning to the term as used by Congress, especially since such a definition is consistent with the statutory aims. In other words, *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, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise....*

It permits the fulfillment of the statutory purpose of compelling full and fair disclosure relative to the issuance of “*the many types of instruments that, in our commercial world, fall within the ordinary concept of a security.*” H. Rep. No.85, 73rd Cong., 1st Sess., p. 11. It embodies a flexible, rather than a static, principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.

As explained at length in “[The Original Public Meaning of Investment Contract](#)” (pp. 729-43), the term investment contract involves a quid pro quo: an investor's money (quid) is given in exchange for a “promise of profits” from the offeror's business or efforts (quo). Or, under *Gopher Tire's* formulation that the *Howey* Court quoted, one invests “money ... to secure income or profit from its employment” by the offeror. Put simply, an investor pays money for the right to a return of profits made by the offeror's enterprise and efforts. Some cryptocurrency companies, such as Coinbase in its [comment](#) to this Task Force, correctly describe the nature of this financial relationship as involving a “*post-sale obligation* with respect to right, title, interest or profit in a business enterprise.” This right is what investors buy in investment contracts. As *Howey* teaches (at 299), the out-of-state investors bought, not land to live on, but instead, “an opportunity ... to share in the profits of a large citrus fruit enterprise.” The right entitled them to “shares of the profits.”

This requirement does not mean that the SEC or courts must find a binding contract under state law. Instead, the requirement is the proof “as matter of fact that [financial instruments] were widely offered or dealt in under terms or courses of dealing which established their character in commerce as ‘investment contracts,’” as Justice Jackson explained in [SEC v. C.M. Joiner Leasing Corp.](#) If the facts indicate there was no offering of a contemplated contractual right to receive a share of the offeror's profits—what the Supreme Court described as “[the shares in the enterprise](#)”—the economic reality is there was *no* investment contract under the 1933 Act. Every Supreme Court decision finding an investment contract has involved the offering of such a contractual right of the investor, as summarized by the [Brief of Securities Law Scholars](#) as *Amici Curiae* in Support of Coinbase's Motion. In my law review article, I included my own table reproduced here as an appendix to this letter.

It is possible some lower courts have strayed too far beyond the text of the Securities Act of 1933 by eliminating the word “contract” when determining whether an offering of an investment contract had been made. To interpret “investment contract” more broadly to situations completely lacking any such offering of a contemplated contractual right would [impermissibly](#) read the word “contract” right out of the statute, rendering every “investment” opportunity a security. 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.” It is for Congress alone to revise the Act to eliminate “contract” from the requirement of investment contract.

2. NFTs for Digital Art Do Not Constitute Investment Contracts

Courts have consistently rejected attempts to expand “investment contract” and securities registration to the sales of artwork. *See* “The Original Public Meaning of Investment Contract,” at p. 697 n.123. That same principle should apply to NFTs for digital art, as they are commonly used. NFTs are simply sales of digital artwork.

Specifically, NFTs are tokenized versions of digital art that entitle the owner of the NFTs to various rights, including ownership of the NFT and corresponding use of the digital art. Some people who do not understand NFTs think they are simply receipts of a sale. That is erroneous. NFTs used with digital art include a specific (tokenized) version of the art itself—what we might analogize to the original painting of an artist—to create an original, “nonfungible” version of the digital artwork. As Professor Amy Whitaker and Nora Burnett Abrams, the Director of MCA Denver, explained in their book, *The Story of NFTs: Artists, Technology, and Democracy* (p. 45): NFTs “*single out an image and preserve it as an entity to be owned and valued distinctly from its digital brethren.*”

NFTs’ embodiment of digital art makes NFTs a collectible that falls outside the definition of investment contract. A sale of digital art, like the sale of physical art, gives its investor no contractual or other right of return of profits from the artist. At bottom, the NFT sale involves an investment in an artwork or collectible, not an investment contract. The investor can display and enjoy the digitalwork art just as they can with a physical artwork.

Any appreciation in value of art, whether digital or physical, does not magically turn it into an investment contract. The same conclusion applies to the artwork NFTs sold by business projects such as the NFTs for cartoon characters sold by the Stoner Cats. As I explained at length in my law review article (“The Original Public Meaning of Investment Contract,” at pp. 703-707, 758-67), the appreciation in value of digital artwork NFTs (here embodying animated cartoon characters) is not evidence of an investment contract. Instead, it is the desideratum of every art investor, as well as every investor of other collectibles, such as Birkin bags. Just because Hermès undertakes substantial efforts to increase the value of Birkin bags through scarcity and brand building doesn’t mean the sale of a Birkin bag is an investment contract—even if investors reasonably expect the bags to appreciate in value based on their [outstanding historical performance](#) and Hermès’ prodigious [efforts](#) to return value and prestige to their customers. In sum, the SEC should no more attempt to regulate NFT sales than attempt to regulate the sales of modern art or other collectibles, such as Birkin bags or Pokémon cards.

3. Requiring Securities Registration of NFTs for Digital Art Violates the First Amendment by Imposing Prior Restraints on Creators of Artistic Expression

The First Amendment supports this interpretation of investment contract as applied to NFTs for digital artwork. If the SEC classifies as securities NFTs involving artworks or creative expression, it would violate the First Amendment rights of the artists who created those NFTs to

require them to seek agency approval before offering them to the public. Indeed, pre-publication registration is a blatant prior restraint analogous to a licensing requirement for the publication of printed works that the Framers of the Constitution abhorred. See [Thomas v. Chi. Park Dist.](#), 534 U.S. 316, 320 (2002); “The Original Public Meaning of Investment Contract,” at pp. 687-97.

Commissioner Peirce suggested that securities law should be interpreted to allow NFT projects to raise funding through the sale of their NFTs. I believe both the First Amendment and the Securities Act support—indeed, compel—this conclusion.

Both NFT projects (Stoner Cats and Impact Theory) that were 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). 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. To require securities registration of artwork NFTs *before* an artist can distribute them constitutes an unlawful prior restraint in violation of the artist’s freedom of expression. A digital [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 in violation of the First Amendment. Adhering to the original public meaning of “investment contract” avoids this First Amendment problem. Artwork NFTs are not investment contracts because they typically do not entitle, by contract, their holders to share the profits solely generated by the NFT project. Instead, the NFTs convey ownership in an embodiment of a digital artwork.

To quote Justice Holmes, “a page of history is worth a volume of logic.” Walt Disney was one of the greatest American creators in history. But Disney was not just a creator, he was also a shrewd businessman—perhaps one of the most successful in the entertainment industry. 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 iconic films. Disney even launched Mickey Mouse clubs to cultivate a national community of families interested in Disney movies to become owners of its merchandise. 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*,” which was “the first feature-length animated movie in color” (citation omitted).

Although the SEC orders against the Stoner Cats and Impact Theory took a dim view of their attempts to build the “next Disney,” the Task Force should welcome, not hinder, these efforts of U.S. businesses, startups, and artists to create animated movies, video games, and other works for Americans and people around the world to enjoy. Aspiring to be the next Disney shouldn’t be treated as evidence of unlawful conduct. Nor should artists’ collection of royalties from owners’ resales of NFTs, which, contrary to the SEC orders, cuts *against* an investment contract by showing the *absence* of any right of NFT owners to a profit from NFT projects. See “The Original Public Meaning of Investment Contract,” at pp. 704-05. Imposing burdensome pre-publication securities requirements on these businesses would be as ill-conceived—and unconstitutional—a decision today as it would have been had it applied to Walt Disney in the 1930s.

Yours truly, /s/ Edward Lee

APPENDIX

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: "If you send in an order for 20 acres . . . , you will get 10 acres Free in the next block of acreage <i>we drill</i> 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 <i>the purchaser was paying both for a lease and for a development project.</i> " "Their proposition was to sell <i>documents which offered the purchaser a chance</i> , without undue delay or additional cost, of <i>sharing in discovery values which might follow a current exploration enterprise.</i> "	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 " <i>an allocation of the net profits based upon a check made at the time of picking.</i> "	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 <i>pro rata share of what the portfolio of equity interests reflects.</i> "	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 <i>entitled to his proportionate share of the total fund</i> , and may withdraw all or part of this interest. The purchaser is also <i>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</i> "	Yes
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 " <i>receive dividends declared by an association's board of directors and based on the association's profits.</i> "	Yes
S.E.C. v. Edwards (2004)	Payphones "offered with an agreement under which ETS leased back the payphone from the	Yes. "[A]greement under which [offeror] ETS leased back the payphone from the purchaser for a fixed monthly payment, thereby	Yes

	purchaser for a fixed monthly payment, thereby giving purchasers a fixed 14% annual return on their investment.”	giving purchasers <i>a fixed 14% annual return on their investment.</i> ”	
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 insubstantial to bring the entire transaction within the Securities Acts.”	No
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