CRYPTOCURRENCIES, NFTS, AND THE EXPANDING DEFINITION OF "INVESTMENT CONTRACT": HAS THE SEC ALREADY TORPEDOED THE *HOWEY* TEST?

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The U.S. Supreme Court in SEC v. W.J. Howey Co. *in 1946 famously defined the term "investment contract"—the catch-all term in the definition of "security" in the Securities Act of 1933—to mean (1) an investment of money, (2) in a common enterprise, (3) with an expectation of profits solely from the efforts of others. While the* Howey *test has endured as the standard definition of an investment contract, the* Howey *Court did not define the term "common enterprise," and for more than fifty years,* Howey*'s common enterprise prong has eroded.*

Since 2017, the Securities and Exchange Commission has further eroded the Howey *test. In the course of a broad enforcement initiative against issuers of cryptocurrencies and non-fungible tokens, the SEC has systematically ignored* Howey*'s common enterprise prong and declared that a common enterprise is not a distinct element of an investment contract. In a series of related cases, the Southern District of New York has largely accepted the SEC's position. By 2024, the SEC and the Southern District appeared ready to find an "investment contract" wherever there was (1) an investment of money and (2) investor profits depended on the promoter's efforts.* Howey*'s common enterprise prong has been eliminated, and the decisive inquiry has become only* Howey*'s "profits from the efforts of others" prong. The* Howey *test—in part due to its own internal weaknesses—has collapsed back into its blue sky precedents.*

Has the SEC already torpedoed the Howey *test? This Essay concludes that the answer is yes. Commentators and dissenting SEC commissioners have questioned whether the SEC has expanded* Howey *to apply to a range of commercial transactions beyond the reasonable scope*

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of the federal securities laws. Public policy limits are needed on any investment contract test.

INTRODUCTION

The U.S. Supreme Court in *SEC v. W.J. Howey Co.* in 1946 famously defined the term "investment contract"—the catch-all term in the definition of "security" in the Securities Act of 1933—to mean (1) an investment of money, (2) in a common enterprise, (3) with an expectation of profits solely from the efforts of others.[1] While the *Howey* test has endured in federal courts as the standard definition of an investment contract, the *Howey* Court did not define the term "common enterprise," and perhaps as a consequence, for more than fifty years *Howey*'s common enterprise prong has eroded. Since the early 1970s, *Howey*'s "common enterprise" prong has split into at least three conflicting versions—"horizontal," "strict vertical," and "broad vertical" that are variously accepted or rejected in different federal circuits.[2] The U.S. Supreme Court has declined to resolve this circuit split.[3]

Since 2017, the Securities and Exchange Commission (the "SEC") has further eroded the *Howey* test. In the course of a broad new enforcement initiative against issuers of cryptocurrencies and non-fungible tokens ("NFTs"), the SEC has resolutely ignored *Howey*'s common enterprise prong and rather more dramatically declared that a common enterprise is not even a "distinct element" of an investment

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1. SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946). *But see* Brian Elzweig & Lawrence J. Trautman, *When Does a Non-Fungible Token (NFT) Become a Security?*, 39 GA. ST. U. L. REV. 295, 312 (2023) ("Modern courts now characterize the *Howey* test as having four elements: '(i) there is an investment of money (or something else of value); (ii) in a common enterprise; (iii) where the purchaser expects to receive profits; and (iv) the expectation of profits is from the essential entrepreneurial efforts of others'" (citation omitted)); *see also* James D. Gordon III, *Defining a Common Enterprise in Investment Contracts*, 72 OHIO ST. L.J. 59, 60 (2011) (noting lower courts' subsequent interpretation of "solely" to mean "predominantly" or "largely"). On the definition of "security," see Securities Act of 1933, Pub. L. No. 22, 48 Stat. 74 (1933) (codified as amended at 15 U.S.C. § 77aa–bbbb (2023)); Section 2(a)(1), 15 U.S.C. § 77b(a)(1) (2023).

2. *See, e.g.*, Gordon, *supra* note 1, at 61; Marc G. Alcser, *The Howey Test: A Common Ground for the Common Enterprise Theory*, 29 U.C. DAVIS L. REV. 1217, 1219 (1996); Maura K. Monaghan, *An Uncommon State of Confusion: The Common Enterprise Element of Investment Contract Analysis*, 63 FORDHAM L. REV. 2135, 2137 (1995); Susan G. Flanagan, *The Common Enterprise Element of the Howey Test*, 18 PAC. L.J. 1141, 1142 (1987); and Susan S. McDonald, *Toward Consistent Investor Protection Under the Federal Securities Laws: The Solution to the Conflict Among the Circuits Regarding the So-Called "Commonality" Requirement for an "Investment Contract*," 40 No. 2 SEC. REGUL. L.J. art. 5, at 2 (2012).

3. *See* Monaghan, *supra* note 2, at 2171; Miriam R. Albert, *The Howey Test Turns 64: Are the Courts Grading This Test on a Curve?*, 2 WM. & MARY BUS. L. REV. 1, 18 (2011) (citation omitted).

contract.[4] In a series of related cryptocurrency and NFT cases (which, collectively with the SEC enforcement actions, this Essay terms the "Digital Cases"), the Southern District of New York (the "Southern District") appears to have substantially accepted—indeed, to have adopted and relied upon significant components of—the SEC's position.[5]

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4. *See* U.S. SEC. & EXCH. COMM'N, FRAMEWORK FOR "INVESTMENT CONTRACT" ANALYSIS OF DIGITAL ASSETS n.10 (2019), https://www.sec.gov/about/divisions-offices/division-corporation-finance/framework-investment-contract-analysis-digital-assets [https://perma.cc/QUC4-DWMY] [hereinafter *Framework*]; *see also* Carol R. Goforth, *How Nifty! But Are NFTs Securities, Commodities, or Something Else?*, 90 UMKC L. REV. 775, 788 (2022) [hereinafter Goforth, *Nifty*] (noting that "while cases and academic commentators alike have relied on these [*Howey*] elements for decades, officials at the SEC have taken issue with the 'common enterprise' requirement, suggesting in recent documents that the SEC 'does not . . . view a 'common enterprise' as a distinct element of the term 'investment contract.'"); Carol R. Goforth, *Cinderella's Slipper: A Better Approach to Regulating Cryptoassets as Securities*, 17 HASTINGS BUS. L.J. 271, 272 (2021) [hereinafter, Goforth, *Cinderella*] (observing that "[t]o date, the SEC has worked to force cryptocurrencies into the definition of investment contract as described in [*Howey*] . . . and to impose disclosure obligations . . . . . .that are ill-fitting at best"). While the SEC has also recently launched a parallel series of enforcement actions against cryptocurrency and other digital asset exchanges and platforms, this Essay focuses on the SEC's enforcement actions and related claims in the Southern District of New York against the issuers of such digital assets on the primary market, because—despite limited overlap—the parallel claims against exchanges and platforms also involve a range of different secondary market issues under the Securities Exchange Act of 1934. *See, e.g.*, SEC v. Coinbase, Inc., 726 F. Supp. 3d 260, 290 (S.D.N.Y. 2024). On January 7, 2025, the Southern District granted a motion by Coinbase to certify an order for interlocutory appeal to the Second Circuit. *See* SEC v. Coinbase, Inc., No. 23-CV-4738, 2025 WL 40782 (S.D.N.Y. 2025). On February 27, 2025, the SEC settled its case against Coinbase by dismissing it with prejudice. *See* Hester M. Peirce, Comm'r, SEC, *Getting Back on Base: Statement of Commissioner Hester M. Peirce on the Dismissal of the Civil Enforcement Action Against Coinbase* (Feb. 27, 2025), https://www.sec.gov/newsroom/speeches-statements/peirce-statement-coinbase-022725 [https://perma.cc/NE7Q-F2GW].

5. The Digital Cases are: The DAO, Exchange Act Release No. 81,207, 117 SEC Docket 745 (July 25, 2017) [hereinafter *The DAO Report*]; Munchee Inc., Securities Act Release No. 10445, 118 SEC Docket 975 (Dec. 11, 2017) [hereinafter Munchee Inc.]; Balestra v. ATBCoin, LLC, 380 F. Supp. 3d 340 (S.D.N.Y. 2019); SEC v. Telegram Grp., Inc., 448 F. Supp. 3d 352 (S.D.N.Y. 2020); SEC v. Kik Interactive Inc., 492 F. Supp. 3d 169 (S.D.N.Y. 2020); SEC v. Ripple Labs, Inc., 682 F. Supp. 3d 308 (S.D.N.Y. 2023); SEC v. Terraform Labs Pte. Ltd., 684 F. Supp. 3d 170 (S.D.N.Y. 2023); Friel v. Dapper Labs, Inc., 657 F. Supp. 3d 422 (S.D.N.Y. 2023); *Impact Theory, LLC*, Securities Act

The decisive inquiry in the Digital Cases has been increasingly—as the SEC has publicly advocated—only whether investors had "an expectation of profit from the efforts of others," *i.e.*, *Howey*'s third prong.[6] The net effect is to eliminate *Howey*'s common enterprise prong.

Commentators have questioned whether the SEC, by reformulating the *Howey* test in this manner, has expanded *Howey* to apply to a range of commercial transactions beyond the reasonable scope of the federal securities laws.[7] Doubts have arisen even within the SEC. In 2023, after *Impact Theory*, the SEC's first enforcement action against an NFT issuer, two SEC commissioners publicly dissented, objecting that the facts of the case did not give rise to an investment contract and questioning whether

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Release No. 11226 (Aug. 28, 2023) [hereinafter *Impact Theory*]; *Stoner Cats 2, LLC*, Securities Act Release No. 11233 (Sept. 13, 2023) [hereinafter *Stoner Cats*].

6. *Framework*, *supra* note 4, at 2.

7. *See, e.g.*, Eric Wessan & Phil Pillari, *Problems with Rulemaking by District Court Enforcement Action: The SEC's Improper Cryptocurrency Regulation*, 2024 HARV. J.L. & PUB. POL'Y PER CURIAM 31, 1 (2024) (alleging that "the SEC has decided, without Congressional authorization, that regulating cryptocurrencies is its job—and has decided to take on that new role without following the Administrative Procedures Act"); Yuliya Guseva, *When the Means Undermine the End: The Leviathan of Securities Law and Enforcement in Digital Asset Markets*, 5 STAN. J. BLOCKCHAIN L. & POL'Y 1, 2–4 (2022) (describing the SEC's enforcement of "pre-crypto securities laws" as "antithetical to the Commission's core mission of protecting investors"); Goforth, *Cinderella*, *supra* note 4, at 274 ("[c]ryptoassets, unfortunately, do not fit easily into this [investment contract] framework, with the SEC's explanation of how to apply this test changing rather significantly in a relatively short period of time"); Joseph A. Hall, Howey, Ralston Purina *and the SEC's Digital Asset Framework*, 52 REV. SEC. & COMMOD. REG. 137, 141 (2019) ("Simply reading [*Howey* prongs (i) and (ii)] out of the *Howey* test risks expanding the definition of 'investment contract' to encompass a wide variety of investable assets that the *Howey* Court apparently did not think Congress intended to sweep under the aegis of the federal securities laws"); *see also* Michael J. O'Connor, *Overreaching Its Mandate: Considering the SEC's Authority to Regulate Cryptocurrency Exchanges*, 11 DREXEL L. REV. 539 (2019) (regarding the extent of the SEC's authority to regulate cryptocurrency exchanges); Brief for Senator Cynthia M. Lummis as Amicus Curiae Supporting Petitioners at 4, 16, *Coinbase, Inc. v. SEC*, 726 F. Supp. 3d (S.D.N.Y 2024) (No. 25-1451) (urging the Second Circuit to weigh in on the SEC's "novel interpretation" and expansion of the *Howey* test and the SEC's "attempted power grab").

the enforcement action was in any event an unwarranted expansion of the SEC's jurisdiction.[8]

Part II of this Essay briefly outlines the *Howey* test and the conflicting versions of the common enterprise prong developed by federal courts interpreting *Howey*. Part III examines how the SEC and the Southern District in the Digital Cases have redefined *Howey*'s common enterprise prong. In this Part, the Essay considers *Revak v. SEC Realty Corp*, the leading case on *Howey* in the Second Circuit, in which the Second Circuit (1) required horizontal commonality and (2) defined horizontal commonality as the "pooling" of investor funds "usually combined with the pro-rata distribution of profits."[9] The Essay then examines the Southern District's changing treatment of "pooling" and "pro rata distributions" in the Digital Cases, particularly *ATBCoin* and *Dapper Labs*, and its acceptance of strict vertical commonality in *Telegram*.[10] I argue that by 2024, in clear contrast to the standard articulated by the Second Circuit in *Revak*, the Southern District appeared ready to find a common enterprise wherever there was (1) an investment of money and (2) investor profits depended on the promoter's efforts.[11] This standard not only seems functionally identical to the broad vertical version of commonality or even *Howey*'s third prong, an "expectation of profits from the efforts of others," but threatens to encompass fundraising

8. *See* Hester M. Peirce & Mark T. Uyeda, Comm'rs, SEC, *NFTs & the SEC: Statement on Impact Theory, LLC* (Aug. 28, 2023), https://www.sec.gov/newsroom/speeches-statements/peirce-uyeda-statement-nft-082823 [https://perma.cc/H62H-4E34]. On January 21, 2025, Commissioner Uyeda was named acting chairman of the SEC. Press Release, SEC, Mark T. Uyeda Named Acting Chairman of the SEC (Jan. 21, 2025), https://www.sec.gov/newsroom/press-releases/2025-29 [https://perma.cc/37AC-UGBA]. On January 21, 2025, Chairman Uyeda launched a crypto task force to be led by Commissioner Peirce to develop a regulatory framework for crypto assets. Press Release, SEC (Jan. 21, 2025), https://www.sec.gov/newsroom/press-releases/2025-30 [https://perma.cc/A266-MNGD].

9. Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994) (citations omitted). *See also* Gordon, *supra* note 1, at 66–67; Monaghan, *supra* note 2, at 2152–53; Alcser, *supra* note 2, at 1226.

10. *See ATBCoin*, 380 F. Supp. 3d 340; *Dapper Labs*, 657 F. Supp. 3d 422; and *Telegram*, 448 F. Supp. 3d 352.

11. *See infra* Section III.C.

efforts by almost any commercial enterprise, including through sales of commodities.[12]

Part IV examines the origins of the *Howey* test in state law blue sky cases, such as *State v. Gopher Tire & Rubber Co.*, [13] which did not include any common enterprise component. Despite its continuing citations of *Howey*, the SEC's definition of "investment contract" since at least 2004—as outlined by the SEC itself in releases and pleadings—ultimately appears to be based on *Gopher Tire* and other pre-*Howey* blue sky cases. In the Digital Cases, the SEC and the Southern District have collapsed *Howey* back into these blue sky precedents. Part V concludes that the SEC has effectively torpedoed the *Howey* test. The Second Circuit commonality standard enunciated in *Revak* is in shambles. I examine potential causes of *Howey*'s instability in the Digital Cases and ask whether there should be public policy limits on what constitutes an investment contract under any test.

I. *HOWEY* AND ITS PROGENY

A. Howey

The facts of *Howey* and the components of the *Howey* test are well-known. *Howey* involved an offering to relatively unsophisticated out-of-state investors of a contract to invest in portions of a Florida citrus grove, typically, though not always, coupled with a second contract for cultivating, marketing, and remitting the net proceeds of the venture to the investor.[14] The *Howey* Court considered whether the arrangement constituted an "investment contract" as set forth in the definition of

12. *See, e.g.*, Goforth, *Nifty*, *supra* note 4, at 792 (discussing treatment of cryptocurrencies as commodities); Gunjan D. Devnani, *Creating a Path to Regulation: Digital Assets,* Howey *and the Regulatory Dilemma*, 27 N.C. BANKING INST. 399, 400 (2023) (stating that "[t]he debate over how exactly to regulate digital assets stems primarily from a lack of consensus as to whether digital assets and related products should be categorized as securities or commodities") (citation omitted). *See also* Peirce & Uyeda, *supra* note 8.

13. 146 Minn. 52 (1920). *See also* discussion *infra* accompanying note 304.

14. *See* SEC v. W.J. Howey Co., 328 U.S. 293, 294 (1946).

"security" in the U.S. Securities Act of 1933.[15] The term "investment contract" had not otherwise been defined by the Securities Act or relevant legislative reports.[16] After considering the treatment of the term in state "blue sky" laws, the Court formulated its famous definition: "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."[17] The Court concluded that, because the investors provided the capital, shared in the earnings and profits, and the promoters managed, controlled and operated the enterprise, the arrangement in *Howey* indeed constituted an investment contract, so defined, and therefore an unregistered offering of a security.[18] Lower courts subsequently interpreted the *Howey* test's requirement that profits come "solely" from the efforts of others to mean "predominantly," "largely," or "principally."[19]

B. Conflicting Versions of Common Enterprise: Circuit Split

The Supreme Court in *Howey* did not define or explain the term "common enterprise" and has since declined to do so.[20] Beginning in the 1970s, lower courts fractured over the meaning of the term; an enduring split of authority developed, with circuit courts increasingly reading the *Howey* test as a list of three or four separate components and propounding

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15. *Id.* at 297 (citation omitted).

16. *See id.* at 298.

17. *Id.* at 301. *See infra* notes 300–06 and accompanying text regarding the definition of "investment contract" under state blue sky laws.

18. *See Howey*, 328 U.S. at 300.

19. *See* SEC v. Glenn W. Turner Enters., 474 F.2d 476, 482 (9th Cir. 1973); *see also* Monaghan, *supra* note 2, at 2149 (citation omitted); Albert, *supra* note 3, at 19–20. The Fifth Circuit expressly adopted the *Turner* standard a year later in SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 483 (5th Cir. 1974). A year after *Koscot*, the Supreme Court revisited the *Howey* test in United Housing Found. Inc. v. Forman, and did not mention the word "solely." 421 U.S. 837, 852 (1975) (holding that "[t]he touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others"); *see also* Monaghan, *supra* note 2, at 2151 (noting that several other circuit courts have adopted the "undeniably significant" test that the Supreme Court noted in *Forman*) (citations omitted).

20. *See* Albert, *supra* note 3, at 18; Monaghan, *supra* note 2, at 2155.

at least three different conflicting interpretations of *Howey*'s common enterprise component.[21]

1. Horizontal Commonality

The "horizontal" interpretation of commonality focuses on the horizontal relationship among investors. As articulated in 1994 in *Revak*, the leading Second Circuit case on *Howey*, horizontal commonality can be established by showing:

> [T]he tying of each individual investor's fortunes to the fortunes of the other investors by the pooling of assets, usually combined with the pro-rata distribution of profits.[22]

Somewhat confusingly, the *Revak* court added that "[h]orizontal commonality ties the fortunes of each investor in a pool of investors to the success of the overall venture."[23] Courts relying on the horizontal test have sometimes pointed to the multiple investors, pooled funds, and pro-rata returns in *Howey*.[24]

2. Strict or Narrow Vertical Commonality

The "strict" or "narrow" vertical approach examines the vertical relationship between the investor and the promoter of an enterprise. This approach was pioneered[25] in 1973 by the Ninth Circuit in a footnote, in *SEC v. Glenn W. Turner Enterprises, Inc.*, which indicated that "[a]

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21. *See* McDonald, *supra* note 2, at 1–3, 8–9; Gordon, *supra* note 1, at 61–62; Monaghan, *supra* note 2, at 2137–38, 2171; Alcser, *supra* note 2, at 1219–20. For a discussion on the remaining components of the *Howey* test, *see supra* note 1.

22. *Revak v. SEC Realty Corp.*, 18 F.3d 81, 87 (2d Cir. 1994) (citations omitted).

23. *Revak*, 18 F.3d at 87 (citation omitted)*; see also* Gordon, *supra* note 1, at 66–67; Monaghan, *supra* note 2, at 2152–53; Alcser, *supra* note 2, at 1226; *infra* note 50 and accompanying text.

24. *See, e.g.*, Flanagan, *supra* note 2, at 1150 (citing Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 622 F.2d 216, 222 (6th Cir. 1980) as requiring pooling or pro-rata distribution of profits for horizontal commonality); Monaghan, *supra* note 2, at 2155. *But see* McDonald, *supra* note 2, at 7.

25. Monaghan, *supra* note 2, at 2158.

common enterprise is one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties."[26]

Pooling of investor funds, pro-rata or correlated distributions of profits or losses, and other horizontal relationships among investors generally are disregarded; what matters is whether the investor—even a single investor—and the promoter share the risks of the enterprise.[27] The investor's and promoter's profits or losses must rise and fall together.[28]

3. Broad Vertical Commonality

The broad vertical interpretation requires only that the investor's economic fortunes depend on the promotor's efforts and expertise.[29] The Fifth Circuit developed the broad vertical approach in 1973 in *SEC v. Koscot Interplanetary, Inc.*, holding that, "a common enterprise is one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties."[30]

Pooling of funds, pro-rata or correlated returns, and sharing of risks between the investor and the promotor are not required for broad vertical commonality, only that the investor's success is inextricably tied to the promotor's effectiveness and skill.[31] Broad vertical commonality is generally considered the easiest to satisfy of the commonality tests.[32]

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26. 474 F.2d 476, 482 n.7 (9th Cir. 1973) (citation omitted).

27. *See, e.g.*, SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 483 (5th Cir. 1974) (stating that *Howey* emphasized not whether profits were pooled, but whether the feasibility and success of the enterprise rested on company management). *See also* Gordon, *supra* note 1, at 67; Monaghan, *supra* note 2, at 2157–58; and Alcser, *supra* note 2, at 1228.

28. *See* Monaghan, *supra* note 2, at 2157; Gordon, *supra* note 1, at 67; Alcser, *supra* note 2, at 1228; and Flanagan, *supra* note 2, at 1155.

29. *See Koscot*, 497 F.2d at 483 (citing SEC v. Glenn W. Turner Enter., Inc., 474 F.2d 476, 482 (9th Cir. 1973)). *See also* Monaghan, *supra* note 2, at 2160; Alcser, *supra* note 2, at 1230; and Gordon, *supra* note 1, at 67.

30. *Koscot*, 497 F.2d at 478 (citing *Turner*, 474 F.2d at 482 n.7).

31. *See* Monaghan, *supra* note 2, at 2160; Flanagan, *supra* note 2, at 1153.

32. *See, e.g.*, SEC v. ETS Payphones, Inc., 300 F.3d 1281, 1284 (11th Cir. 2002) (indicating that broad vertical commonality is the easiest to satisfy of the alternative tests

4. Circuit Split

Circuit courts have for decades remained split among these three interpretations of commonality under *Howey*. The Third, Sixth and Seventh Circuits require horizontal commonality;[33] the First, Fourth and D.C. Circuits require horizontal commonality but have not yet ruled on strict or broad vertical commonality;[34] the Second Circuit accepts horizontal commonality, has not yet ruled on strict vertical commonality, yet it has rejected broad vertical commonality.[35] The Ninth Circuit recognizes both horizontal and strict vertical commonality.[36] The Fifth and Eleventh Circuits accept broad vertical commonality.[37] Finally, the Tenth Circuit has developed its own separate "economic reality" test.[38] To date, the Supreme Court has not explicitly endorsed any of the three versions of commonality—unless we interpret *Howey* to require horizontal commonality—and has otherwise declined to settle the controversy.[39] The split among the circuits has widened over time.[40] The *Howey* test remains frequently litigated.[41]

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because it only requires a demonstration that the investors depend on the expertise or efforts of the promoter).

33. *See* Gordon, *supra* note 1, at 68; Alcser, *supra* note 2, at 1226; Monaghan, *supra* note 2, at 2164 (with respect to the Third Circuit); and McDonald, *supra* note 2, at 6.

34. *See* Gordon, *supra* note 1, at 68. *But see* Alcser, *supra* note 2, at 1228 (stating that the First Circuit follows strict vertical).

35. Revak v. SEC Realty Corp., 18 F.3d 81, 88 (2d Cir. 1994). *See also* Gordon, *supra* note 1, at 68; *infra* note 47 and accompanying discussion.

36. *See* Gordon, *supra* note 1, at 68. *But see* Monaghan, *supra* note 2, at 2164 (stating that the Ninth Circuit follows strict vertical).

37. *See* Gordon, *supra* note 1, at 68; Monaghan, *supra* note 2, at 2164 (with respect to the Fifth Circuit as pioneer of broad vertical). *But see* Alcser, *supra* note 2, at 1230 (noting that only the Fifth Circuit follows broad vertical). *See also* discussion of the Eleventh Circuit standard *infra* note 310 and accompanying text.

38. *See* Gordon, *supra* note 1, at 69.

39. *See supra* note 3 and accompanying text.

40. *See* Monaghan, *supra* note 2, at 2163–64.

41. *See id.* at 2164.

II. COMMON ENTERPRISE REVISITED: THE DIGITAL CASES

A. The Second Circuit Standard: Revak

The Second Circuit in *Revak* in 1994 required a showing of horizontal commonality in order to satisfy *Howey*'s common enterprise prong.[42] The Second Circuit had not previously considered whether vertical commonality (strict or otherwise) satisfied the common enterprise requirement.[43] *Revak* declined to address the question of whether strict vertical commonality gave rise to a common enterprise but held that broad vertical commonality did not:

> If a common enterprise can be established by the mere showing that the fortunes of the investors are tied to the efforts of the promoter, two separate questions posed by *Howey*—whether a common enterprise exists and whether the investors' profits are to be derived solely from the efforts of others—are effectively merged into a single inquiry: "whether the fortuity of the investments collectively is essentially dependent upon promoter expertise."[44]

In *Revak*, the Second Circuit thus rejected broad vertical commonality without accepting or otherwise ruling on strict vertical commonality. To establish horizontal commonality, *Revak* required "the tying of each individual investor's fortunes to the fortunes of the other investors by the pooling of assets, usually combined with the pro-rata distribution of profits."[45] *Revak* was a putative class action suit brought by New York investors who purchased, and often entered into service agreements relating to, condominium apartments in a Chattanooga, Tennessee housing development.[46] In articulating the horizontal standard, the court cited precedent from other circuits that the "investment must be 'part of a pooled group of funds'" and that the "success or failure of other contracts must have 'a direct impact on the profitability of plaintiffs'

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42. Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994) (citations omitted).

43. *See id.* at 88.

44. *Id.* (citations omitted).

45. *See id.* at 87 (citations omitted). *See also* Gordon, *supra* note 1, at 66–67; Monaghan, *supra* note 2, at 2152–53; and Alcser, *supra* note 2, at 1226.

46. *See Revak,* 18 F.3d at 83.

contract[.]'"[47] The rents and expenses attributable to plaintiffs' condominium units in *Revak*, however, "were not shared or pooled in any manner, but were instead the sole responsibility of the unit owner. Plaintiffs owned individual units, and could make profits or sustain losses independent of the fortunes of the other purchasers."[48] Because there was no "rent-pooling arrangement" among investors, *Revak* held that there were "simply no indicia of horizontal commonality" and no investment contract.[49]

Somewhat puzzlingly, however, to the "pooling" and "pro-rata distribution" components, the *Revak* court added that "[h]orizontal commonality ties the fortunes of each investor in a pool of investors to the success of the overall venture."[50] Investor dependence on the success of the overall venture sounds less like a horizontal relationship among investors than a vertical relationship between investors and the promoter's enterprise.[51] This added language in *Revak*, it will be seen, becomes functionally an alternative standard in the Digital Cases.

In addition to its puzzling inclusion of the "success of the overall venture" concept, other than as discussed above, *Revak* also did not define

47. *See id.* at 87 (citations omitted).

48. *See id.* at 88.

49. *See id.*

50. *Id.* at 87 (citations omitted). *See also* Gordon, *supra* note 1, at 66–67; Monaghan, *supra* note 2, at 2152–53; and Alcser, *supra* note 2, at 1226.

51. *See* Audet v. Fraser, 605 F. Supp. 3d 372, 390 (D. Conn. 2022) (distinguishing this standard as set forth in *Kik* from the standard required by *Revak*). The plaintiffs in *Audet* had argued that "horizontal commonality was present because the 'key feature' of horizontal commonality is that 'investors' profits at any given time are tied to the success of the enterprise." *Id*. (citing *SEC v. Kik Interactive, Inc.*, 492 F. Supp. 3d 169, 179 (S.D.N.Y. 2020)). But as the court noted, "the Second Circuit has made clear that horizontal commonality requires 'the tying of each individual investor's fortunes to the fortunes of other investors.'" *Id*. at 390 (citing *Revak*, 18 F.3d at 87). *Howey* itself placed little or no emphasis on the success of the promoter's overall citrus-growing venture; rather, the Court expressly rejected the lower court's suggestion that an investment contract was necessarily missing where an enterprise was not speculative or promotional in character. If the *Howey* test was satisfied, the Court opined, "it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value." *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946) (citation omitted).

"pooling of assets," "pool of investors," or "usually" in relation to pro-rata distribution of profits. Perhaps not surprisingly, as outlined below, it is the "pooling" and "pro-rata distribution" concepts in *Revak* that have become unstable and shift in the Digital Cases, so that *Revak*'s horizontal commonality standard, via *Revak*'s "success of the overall venture" language, threatens to merge into a single inquiry—much like the broad vertical version critiqued in *Revak*—with the "profits from the efforts of others" prong.[52] This confusion in *Revak* appears to have set the stage for the revision of *Howey* in the Digital Cases.

B. The SEC Standard in The Digital Cases

Prior to 2017, the SEC had issued little public guidance on whether offers and sales of cryptocurrencies and other digital assets constituted investment contracts subject to the federal securities laws. The SEC's opening salvo in the Digital Cases came in 2017 in the form of an Exchange Act release that would become known as *The DAO Report*.[53]

1. The DAO Report

The DAO Report was the outcome of an SEC investigation of The DAO, an unincorporated, virtual "decentralized autonomous organization," or DAO, embodied in software code and executed on a blockchain ledger.[54] The DAO had been created by Slock.it UG, a German company, and its founders as a "crowdfunding contract" to raise funds to grow a company in the crypto space.[55] The company was to operate as a for-profit entity that would create and hold a corpus of assets through the sale of digital DAO Tokens, which would then be used to fund a series of projects.[56] According to promotional materials, The DAO would fund projects that, if approved by The DAO's "curators," would provide DAO Token holders a return on investment.[57] DAO Token holders were free to re-sell their DAO Tokens in various ways on the

52. *See infra* notes 44, 115 and accompanying text.
53. *See The DAO Report*, *supra* note 5.
54. *See id.* at 1.
55. *See id.* at 4.
56. *See id.* at 1.
57. *See id.* at 5–77.

secondary market.[58] In early 2016, The DAO offered and sold approximately 1.15 billion DAO Tokens in exchange for a total of approximately 12 million Ether, a virtual currency used on the already existing Ethereum blockchain, with a value of approximately US$150 million at the time of the offering.[59] All funds raised in the offering as well as any future profits earned by The DAO were to be pooled and held at The DAO's Ethereum blockchain address.[60]

Perhaps prompted by a hacker attack on The DAO in mid-2016, the SEC launched an investigation.[61] In its ensuing report, the SEC applied a test apparently based on *Howey* to determine whether the DAO Tokens were investment contracts and thus securities. The SEC indicated that, "[a]n investment contract is an investment of money in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."[62]

The SEC first concluded that purchasers' exchange of Ether for DAO Tokens constituted an investment of money.[63] The SEC also concluded that purchasers of DAO Tokens reasonably expected to earn profits through their investment in the enterprise.[64] Such profits were to be derived from the managerial efforts of others, specifically Slock.it and The DAO's curators, on whom investors relied, and whose expertise and efforts were the "undeniably significant" ones essential to the overall success and profitability of the enterprise.[65] The SEC concluded that the DAO Tokens were investment contracts and therefore unregistered

58. *See id.* at 6.
59. *See id.* at 2–3.
60. *See id.* at 4, 6.
61. *Id.* at 9.
62. *Id.* at 11 (citing SEC v. Edwards, 540 U.S. 389, 393 (2004); SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946); United Housing Found., Inc. v. Forman, 421 U.S. 837, 852–53 (1975)).
63. *Id.* at 11.
64. *Id.* at 11–12.
65. *Id.* at 12, 15.

securities.[66] *The DAO Report* was the first time the SEC had found that digital or cryptocurrency tokens themselves could be securities.[67]

What is surprising about *The DAO Report*'s analysis is the virtual absence of discussion of *Howey*'s common enterprise prong. The report contains separate analyses, each under their own section headers of "2. Investors in The DAO Invested Money," "3. With a Reasonable Expectation of Profits," and "4. Derived from the Managerial Efforts of Others," but there is no such section or header for common enterprise. The report's sole mention of the term is a conclusory statement under the report's discussion of reasonable expectation of profits, where the SEC notes: "[i]nvestors who purchased DAO Tokens were investing in a common enterprise and reasonably expected to earn profits through that enterprise when they sent ETH to The DAO's Ethereum Blockchain address in exchange for DAO Tokens."[68] A discussion of profits follows, together with a lone statement—perhaps in reference to the requirements of *Revak*'s horizontal commonality approach—that "[t]he ETH was pooled and available to The DAO to fund projects."[69]

Ultimately the SEC determined that while the DAO Tokens were indeed investment contracts, it would not pursue an enforcement action, evidently opting to issue *The DAO Report* instead.[70] Against the background of prior *Howey* jurisprudence, however, the absence from *The DAO Report* of any discussion of *Howey*'s common enterprise prong is conspicuous.

2. *Munchee*

Shortly after *The DAO Report*, in late 2017, the SEC brought another enforcement action against Munchee, Inc., a California corporation that, in conjunction with its creation of an iPhone application for people to review restaurants, launched an ICO of digital MUN tokens to be issued and distributed, like the DAO Tokens, on the Ethereum blockchain

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66. *Id.* at 1, 11, 16.

67. *See* Elzweig & Trautman, *supra* note 1, at 315; Goforth, *Nifty*, *supra* note 4, at 784.

68. *The DAO Report*, *supra* note 5, at 11; *see also* Elzweig & Trautman, *supra* note 1, at 318.

69. *The DAO Report*, *supra* note 5, at 12.

70. *Id.* at 1, 16.

ledger.[71] In October 2017, Munchee posted on its website a "white paper" describing the MUN tokens, the offering, the use of proceeds to develop its business, the "ecosystem" it would create, and the ways in which MUN tokens would increase in value.[72] Munchee created 500 million MUN tokens, of which it intended to sell 225 million tokens, raising about $15 million in Ether, and to retain for itself the remaining 275 million tokens, which it would use to support its business.[73] Munchee said it would spend seventy-five percent (75%) of the offering proceeds to hire people for its development team and to market and promote the Munchee app, fifteen percent (15%) for maintenance and to ensure the smooth operation of the MUN token "ecosystem," and ten percent (10%) for "legals."[74] The MUN token did not promise investors any dividend, periodic payment or other distribution.[75] The Munchee whitepaper described how increased participation in the "ecosystem" and the way the company would run its business would cause MUN tokens to rise in value.[76] Munchee said it would ensure that a secondary market for MUN tokens would be available.[77] Munchee and its agents also engaged in a variety of online efforts to market the MUN tokens.[78] On or about October 31, 2017, Munchee started selling MUN tokens; the next day, after being contacted by SEC staff, Munchee shut down the offering, did not deliver any tokens to purchasers, and returned to purchasers the proceeds it had received.[79]

The SEC in its *Munchee* release applied the same purportedly *Howey*-based test for an investment contract as in *The DAO Report*, indicating that "[a]n investment contract is an investment of money in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."[80]

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71. *See* Munchee, Inc., *supra* note 5, at 1.
72. *See id.* at 2–3.
73. *See id.* at 2.
74. *See id.* at 2–3.
75. *See id.* at 6–7.
76. *See id.* at 3.
77. *See id.* at 4.
78. *See id.* at 4–5.
79. *See id.* at 2.
80. *Id.* at 8 (citing SEC v. Edwards, 540 U.S. 389, 393 (2004); SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946); United Housing Found., Inc. v. Forman, 421 U.S. 837,

In its ensuing analysis, the SEC stated, first, that investors' payment for MUN tokens in Ether or Bitcoin was "the type of contribution of value that can create an investment contract."[81] The SEC then outlined why MUN token purchasers had a "reasonable expectation of profits from their investment in the Munchee enterprise."[82] Although the MUN token did not promise any dividend or periodic payment, Munchee would use the proceeds of the MUN token offering "to build an 'ecosystem' that would create demand for the MUN tokens and make MUN tokens more valuable."[83] Investors had a reasonable expectation of profit if Munchee were successful in its efforts to develop the business.[84] Finally, the SEC concluded that "[i]nvestors' profits were to be derived from the significant entrepreneurial and managerial efforts of others—specifically Munchee and its agents . . . Investors had little choice but to rely on Munchee and its expertise."[85] The MUN tokens were therefore investment contracts under *Howey* and unregistered securities.[86] The SEC ordered Munchee to cease and desist from offering the MUN tokens.[87]

Once again, conspicuously absent from the *Munchee* release is any analysis of *Howey*'s common enterprise prong. *Munchee*'s sole reference to a common enterprise appears in its definition of an investment contract.[88] Nor does the *Munchee* release, in contrast to *The DAO Report*, reference any kind of pooling of investor funds or otherwise make any obvious nod to any circuit court standard of commonality. Instead, the release appears to repeatedly emphasize investors' participation in, and dependence for profits on, the MUN token "ecosystem" to be created by Munchee.[89]

Several further points may be noted. First, it remains possible that the SEC's repeated emphasis on investors' dependence on the success of

852–53 (1975)). *See also id.* at 1–2 (citing *Howey* "and its progeny, including the cases discussed by the Commission" in The DAO Report).

81. *Id.* at 6.
82. *Id.*
83. *See id.*
84. *See id.* at 4.
85. *Id.* at 7.
86. *See id.* at 1.
87. *Id.* at 8.
88. *Id.* at 6.
89. *See id.* at 1–7.

the Munchee "ecosystem" is intended as a reference to the statement in *Revak* that "[h]orizontal commonality ties the fortunes of each investor in a pool of investors to the success of the overall venture."[90] In the absence of any discussion of *Revak*, however, any such reference would appear tenuous. Second, as noted above in connection with *Revak*, investor dependence for profits on the success of the promoter "ecosystem" would appear to be a vertical relationship between investors and a promoter, rather than a horizontal relationship among investors, and therefore at odds with any horizontal standard. Investor dependence on the promoter "ecosystem" already sounds less like any kind of commonality at all, but rather, more like *Howey*'s third prong, which requires an expectation of profits from the efforts of others. Finally, while *Munchee* cites it only sparingly, the SEC's investment contract analysis and conclusions in *Munchee* appear to be based directly on the foundations laid in *The DAO Report*.

C. The Cryptocurrency Cases

1. ATBCoin

Balestra v. ATBCoin, LLC, decided in 2019, was the first Digital Case in the Southern District following *The DAO Report* and *Munchee*.[91] *ATBCoin* was a putative class action involving, like The DAO and Munchee, an ICO to the general public by the defendant, ATBCoin ("ATB") and its two co-founders.[92] ATB was a technology startup aimed at facilitating low-cost digital financial transactions.[93] The primary purpose of the ICO was to raise funds to enable defendants to create and launch a new blockchain, the ATB blockchain, on which the ATB coins would operate.[94] During the ICO, defendants issued a range of

90. *See* Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994) (citations omitted). *See also* Gordon, *supra* note 1, at 66–67; Monaghan, *supra* note 2, at 2152–53; Alcser, *supra* note 2, at 1226.
91. *See* Balestra v. ATBCoin LLC, 380 F. Supp. 3d 340 (2019).
92. *See id.* at 346.
93. *See id.*
94. *See id.* at 347.

promotional materials touting the ICO as an investment opportunity.[95] The ICO raised over $20 million from thousands of investors.[96] When the ATB blockchain failed to perform, plaintiffs brought a class action alleging that the ATB coin offering constituted an investment contract under *Howey* and an unregistered offering.[97]

To analyze plaintiffs' claims, the Southern District applied the *Howey* test. Defendants did not dispute that *Howey*'s "investment of money" prong was satisfied.[98] To meet the common enterprise prong, the ATBCoin Court recited *Revak* and required a pleading of horizontal commonality, noting that "[i]n an enterprise marked by horizontal commonality, 'the fortunes of each investor in a pool of investors' are tied to one another and to the "success of the overall venture."[99] The court further recounted that a finding of horizontal commonality *required* a sharing or pooling of funds.[100]

The plaintiff alleged that the fortunes of all ATB coin investors were tied to one another because the offering proceeds were pooled under the control of ATB.[101] Defendant ATB countered that plaintiff had "merely parroted" the pooling standard.[102] However, the court noted, plaintiff had also alleged that the primary goal of the ICO "was to raise capital to create and launch a new blockchain," and "[t]hus, the funds raised through the ICO were pooled together to facilitate the launch of the ATB Blockchain, the success of which, in turn, would increase the value of the Plaintiff's ATB Coins."[103] The court accepted this allegation as a plausible pleading of pooling, noting that "'potential profits stemming from the future valuation of ATB Coins [ ] w[ere] entirely reliant' on the success of Defendants' new blockchain."[104]

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95. *See id.*
96. *See id.*
97. *See id.* at 347, 352.
98. *See id.* at 353.
99. *See id.* (citing Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994)).
100. *See id.* (citing In re J.P. Jeanneret Assocs., Inc., 769 F. Supp. 2d 340, 359 (S.D.N.Y. 2011)).
101. *See id.*
102. *See id.*
103. *Id.* (citation omitted).
104. *Id.* at 354 (citations omitted, alterations in original).

The court then turned to *Revak*'s "pro-rata distribution of profits" requirement. The court acknowledged that ATB coins did not entitle purchasers to a pro-rata share of the profits derived from any ATB-managed transaction.[105] The court went on to note:

> However, such a formalized profit-sharing mechanism is not required for a finding of horizontal commonality. In a recent administrative proceeding, the SEC determined that a similar ICO run by Munchee, Inc. constituted a securities offering, even though the terms of the offer did not provide for a pro-rata distribution of profits The SEC concluded that the MUN token was a security, even though it "did not promise investors any dividend or other periodic payment." Rather, investors were led to believe that as more individuals began using the MUN "ecosystem," the value of investors' MUN tokens would increase.[106]

"Like the MUN token," the court concluded, the value of ATB coins was "dictated by the success of the ATB enterprise as a whole, thereby establishing horizontal commonality."[107] The court separately analyzed *Howey*'s "expectation of profits solely from the efforts of others" prong, finding that plaintiffs' allegations established that purchasers of ATB coins reasonably believed the coins would increase in value based primarily on defendants' entrepreneurial and managerial efforts.[108] The court concluded that the ATB coins thus constituted an investment contract under *Howey*.[109]

Several aspects of *ATBCoin* seem important. First, in *ATBCoin*, the Southern District—despite its citation of *Revak* for the proposition that "a finding of horizontal commonality requires a sharing or pooling of funds"[110]—appears to have adopted and relied on a very different

105. *Id.* (citations omitted).

106. *Id.* (citations omitted).

107. *Id.* (citing Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994)).

108. *Id.* Defendants had launched a marketing campaign promoting the ATB coins as an investment, highlighting potential profits of holding the ATB coins, touting future revenues from the investment, and comparing purchasers to investors in a start-up. *Id.* Purchasers, the court found, had no control over whether the new ATB blockchain technology worked, nor over the management of defendant's business. *Id.* at 356.

109. *Id.* at 357.

110. *Id.* at 353 (citations omitted).

definition of "pooling." In contrast to the "rent-pooling arrangement" required and determined to be absent in *Revak*, where the success or failure of other investors' contracts had to have "a direct impact on the profitability of plaintiffs' contract,"[111] the Southern District in *ATBCoin* accepted the plaintiffs' argument that the value of ATB Coins were "'entirely reliant' on the success of Defendants' new blockchain" as a sufficient pleading of pooling.[112] *ATBCoin*, thus, appears to have based its definition of "pooling" not on *Revak*'s pooling analysis *per se*, but rather, on the *Revak* court's additional statement that "[h]orizontal commonality ties the fortunes of each investor in a pool of investors to the success of the overall venture."[113] While the *ATBCoin* court does not say so, the idea is presumably that "the success of the overall venture" would necessarily have a "direct impact" on the value of all ATB coins, and that this impact would be felt by all ATB coin holders, as if pooled, pro-rata to their ATB coin holdings. It must be emphasized, however, that the impact on investors in *ATBCoin*, rather than coming from the success or failure of the contracts of other investors as in *Revak*, now depends on the fortunes of the enterprise as a whole—*i.e.*, the horizontal relationship among investors is now mediated by a vertical relationship between investors and the "overall venture."[114]

Second, the Southern District in *ATBCoin*—its first case after *Munchee*—also appears to have expressly abandoned, in reliance on *Munchee*, any requirement of "pro-rata distributions" as a required component of horizontal commonality. Faced with the acknowledged absence of any pro-rata distributions, dividends, or periodic payments of any kind to investors, the Southern District concluded that "such a formalized profit-sharing mechanism is not required."[115] The *Revak* standard that there are usually pro-rata distributions of profits to investors has become, in effect, inoperative.

Third, *ATBCoin* thus appears fundamentally to have shifted the emphasis of *Revak*'s horizontality test. *Revak*'s horizontal "pooling of

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111. Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994) (citations omitted).

112. *See ATBCoin*, 380 F. Supp. 3d at 354 (citations omitted).

113. *See Revak*, 18 F.3d at 87 (citations omitted). *See also* Gordon, *supra* note 1, at 66–67; Monaghan, *supra* note 2, at 2152–53; and Alcser, *supra* note 2, at 1226.

114. *See supra* note 51 and accompanying discussion.

115. *See ATBCoin*, 380 F. Supp. 3d at 354 (citations omitted).

funds" and "usually pro-rata distributions" components have been collapsed into a single vertical requirement that investor profits be reliant or depend on the success of the promoter "ecosystem." The "success of the overall venture"—*Revak*'s puzzling addition to its "pooling" and "pro-rata distributions" components—is now the sole criterion for determining horizontal commonality.

Finally, it should be noted, the Southern District in *ATBCoin* based this new commonality standard perhaps indirectly on *The DAO Report*, but directly and explicitly on the SEC's position in *Munchee*. The court did so despite both SEC actions' near silence on any consideration or discussion of *Howey*'s common enterprise prong. *The* SEC's view of common enterprise in *ATBCoin* appears already to have won the day. Perhaps most curiously, *ATBCoin* appears to rely on *Munchee* for a conclusion that *Munchee* does not actually draw, namely, that investor dependence on the overall enterprise "thereby establish[es] horizontal commonality."[116] As noted above, the SEC's cease-and-desist order in *Munchee* repeatedly emphasizes investors' dependence for profits on the MUN token "ecosystem." But nowhere does *Munchee* expressly characterize such investor dependence as a component of any kind of common enterprise, horizontal or otherwise. *Munchee* simply does not discuss the common enterprise prong; its only mention of a common enterprise is in its definition of an investment contract.[117] Rather, *Munchee*'s clearest and most direct discussions of investor dependence on the MUN "ecosystem" are found in the section of the release titled "MUN Token Purchasers Reasonably Expected They Would Profit From The Efforts Of Munchee and Its Agents."[118] Perhaps for this reason, while directly analogizing to *Munchee*, the ATBCoin Court indicated that "[l]ike the MUN token, the value of ATB Coins was dictated by the success of the ATB enterprise as a whole, thereby establishing horizontal

116. *See id.* at 354 (citing *Revak*, 18 F.3d at 87).

117. *See Munchee*, *supra* note 5, at 8.

118. *See id.* at 6.

commonality," despite being able to cite only *Revak* for this proposition.[119]

In short, *ATBCoin* appears, advertently or inadvertently, to have conflated *Revak*'s "success of the overall venture" language with *Munchee*'s discussion of *Howey*'s efforts of others prong. As critiqued by *Revak* in its rejection of the broad vertical version of commonality, the Southern District in *ATBCoin*, while purporting to apply the horizontal standard of commonality, has merged *Howey*'s common enterprise and efforts of others prongs into a single inquiry. Logically, this cannot have been the intent of *Revak*.

2. Telegram

The next chapter in the Digital Cases was *SEC v. Telegram Group, Inc.*, an enforcement action decided in the Southern District in 2020.[120] In 2013, Pavel and Nikolai Durov, two Russian brothers, founded Telegram and released Telegram Messenger, an encrypted messaging app.[121] In 2017, Telegram began development of a proprietary blockchain, the "Telegram Open Network" or TON Blockchain, and a cryptocurrency to be called the "Gram" that would reside on the TON Blockchain.[122] In January 2018, Telegram released a "white paper" discussing the unique features of the TON Blockchain.[123] The initial supply of Grams would be limited to five billion; if the market price of Grams fell below a specified reference price, Telegram or an affiliate would have discretion to repurchase Grams, reduce the number in circulation, and thereby potentially prevent the market price from falling further.[124] The whitepaper and other offering materials explained Telegram's plans for

119. *See ATBCoin*, 380 F. Supp. 3d at 354 (citing Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994), for the proposition that "horizontal commonality exists where the fortunes of each investor are tied 'to the success of the overall venture[.]'").

120. *See* SEC v. Telegram Grp., Inc., 448 F. Supp. 3d 352 (S.D.N.Y. 2020).

121. *See id.* at 359.

122. *See id.* at 360.

123. *See id.* The TON Blockchain would operate as a "proof of stake" system relying on validator nodes to authenticate new blocks and to vote on rule changes; validators would earn Grams for their services and would be required to stake at least 100,000 Grams as collateral. *Id.*

124. *See id.* at 360–61.

distributing Grams and promoting Grams as a mass-market cryptocurrency, as well as the financial opportunity presented by Grams; four percent of Grams would be reserved for the Telegram developers who were to build the TON Blockchain, including one percent for each Durov brother.[125] The offering materials emphasized that Telegram would use any offering proceeds to fund the development of the TON Blockchain.[126]

In early 2018, Telegram sold interests in Grams to initial purchasers in two rounds. In round one, in a purported private placement under Regulation D, Telegram sold approximately 2.25 billion Grams to eighty-one purchasers for $850 million, which included $385.5 million from thirty-four U.S. purchasers.[127] The Grams were to be delivered when the TON Blockchain launched, and the round one purchase agreements contained a post-launch lock-up provision.[128] In round two, Telegram sold approximately 700 million Grams to ninety-four purchasers for $850 million, which included $39 million from five U.S. purchasers.[129] In total, the 2018 sales raised $1.7 billion from the sale of 2.9 billion Grams, which represented 58% of all Grams.[130] The SEC had contacted Telegram after the first round sales and subsequently filed suit seeking to enjoin Telegram from distributing the Grams.[131]

The Southern District applied *Howey* to the round one and round two sales as a single scheme.[132] Telegram did not dispute that the first prong, an investment of money, had been established.[133] With regard to the common enterprise prong, the *Telegram* Court initially cited *Revak*: "[h]orizontal commonality is established when investors' assets are

125. *See id.* at 362.
126. *See id.*
127. *See id.* at 361.
128. *See id.*
129. *See id.*
130. *See id.*
131. *See id.* at 358.
132. *See id.* at 367.
133. *Id.* at 369.

pooled and the fortunes of each investor is [sic] tied to the fortunes of other investors as well as to the success of the overall enterprise."[134]

In finding that the SEC had shown horizontal commonality, however—aside from two conclusory statements regarding pooling of money or assets—the *Telegram* Court did not otherwise address *Revak*'s "pooling" or "pro-rata distributions" components.[135] Instead, the court cited and relied upon *ATBCoin*'s new *Munchee*-derived test:

> After the 2018 Sales, Telegram pooled the money received from the Initial Purchasers and used it to develop the TON Blockchain as well as to maintain and expand Messenger . . . The ability of each Initial Purchaser to profit was entirely dependent on the successful launch of the TON Blockchain . . . The investors' fortunes are directly tied to the success of the TON Blockchain as a whole.[136]

In *Telegram*, then, as in *ATBCoin*, the SEC's discussion in *Munchee* of *Howey*'s efforts of others prong has been incorporated into and conflated with the definition of horizontal commonality. Perhaps more surprisingly, despite the Second Circuit decision in *Revak* refusing to address strict vertical commonality, the *Telegram* Court then proceeded to accept strict vertical commonality, citing precedents from the Ninth Circuit and other decisions in the Southern District: "[t]he second prong of *Howey*, the existence of a common enterprise, may be demonstrated through either horizontal commonality or vertical commonality . . . strict vertical commonality 'requires that the fortunes of investors be tied to the fortunes of the promoter.'"[137]

134. *Id.* (citing Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994), and referring to SEC v. SG Ltd., 265 F.3d 42, 49 (1st Cir. 2001); Balestra v. ATBCoin LLC, 380 F. Supp. 3d 353 (2019)).

135. *Telegram*, 448 F. Supp. 3d at 369 (finding that "Telegram pooled the money received from initial purchasers"); *id.* at 370 (stating that "the record demonstrates that there was a pooling of assets").

136. *Id.* at 370 (citing *ATBCoin*, 380 F. Supp. 3d at 354, for its "holding that 'the value of [a post-launch digital asset] was dictated by the success of the [blockchain] enterprise as a whole, thereby establishing horizontal commonality'").

137. *Id.* at 369 (citing *Revak*, 18 F.3d at 88 (in turn citing Brodt v. Bache & Co., Inc., 595 F.2d 459, 461 (9th Cir. 1978); In re J.P. Jeanneret Assocs. Inc., 769 F. Supp. 2d 340, 368 (S.D.N.Y. 2011) (stating that "strict vertical commonality (like horizontal commonality) is sufficient to establish a common enterprise under *Howey*").

The *Telegram* Court found that, in addition to horizontal commonality, the SEC had, alternatively, made a substantial showing of strict vertical commonality:

> Each Initial Purchaser's anticipated profits were directly dependent on Telegram's success in developing and launching the TON Blockchain. Telegram's own fortunes were similarly dependent on the launch of the TON Blockchain . . . Telegram's fortunes are directly tied to the fortunes of the Initial Purchasers, which will rise and fall with the success or failure of the TON Blockchain. As such, the Court finds that the SEC has made a substantial showing of strict vertical commonality.[138]

With regard to *Howey*'s third prong, the *Telegram* Court found that the SEC had shown a substantial likelihood of success in proving that a purchaser had a reasonable expectation of profit, and that such expectation of profit stemmed from the essential efforts of Telegram.[139] The SEC had thus also shown a substantial likelihood of success in proving that the offering, and intended distribution of Grams, constituted a securities offering under *Howey*.[140] The court enjoined the delivery of Grams to initial purchasers.[141]

Telegram, then, adopts the same shift seen in *ATBCoin*: away from pooling and pro-rata investor profits and toward dependence on the success of the promoter's overall enterprise. Horizontal commonality existed, the *Telegram* Court stated, because investors' ability to profit "was entirely dependent on the successful launch of the TON

138. *Id.* at 370–71.

139. *See id.* at 375, 378. Telegram had argued that first round purchasers of Grams had bought them with consumptive, rather than investment, intent to use as currency. *Id.* at 371. Based on the totality of the evidence, however, the court found that a reasonable first round investor would have purchased Grams with investment intent, citing investors' ability to resell Grams into the secondary market; Telegram's and its affiliate's promotion of their power to support the market price of Grams; the size and concentration of investors' Gram purchases; the existence of lockup provisions in the Grams purchase agreements; and Telegram's offering materials, which targeted buyers with investment intent and highlighted the opportunity for profit by capital appreciation and resale. *Id.* at 371–74.

140. *See id.* at 379.

141. *See id.* at 382.

Blockchain."[142] Vertical commonality existed because both investors' anticipated profits and Telegram's own fortunes "were similarly dependent on the successful launch of the TON Blockchain" and would rise or fall together.[143] Investors reasonably expected profits from the efforts of others, based on the court's reasoning, because they "were entirely reliant on Telegram's efforts to develop, launch and provide ongoing support for the TON Blockchain and Grams."[144] All three analytical frameworks, in other words, are largely satisfied by investors' dependence or reliance on the success of the TON Blockchain.

Telegram thus continued a trend within the Southern District to merge *Howey*'s common enterprise and efforts of others prongs into a single inquiry.

3. Kik

SEC v. Kik Interactive Inc. was decided by the Southern District in 2020 after *ATBCoin* and *Telegram*.[145] Founded in 2009, Kik launched a messaging app in 2010 and created and sold a cryptocurrency, Kin, to fund its business operations.[146] Kin would be stored, transferred, and recorded in the already-existing Ethereum blockchain.[147] Kik launched a roadshow to promote Kin, explaining that purchasers could make money from Kin due to the "guaranteed scarcity" of a fixed supply.[148] In connection with a purportedly private "pre-sale" offering, Kik produced a private placement memorandum, which explained that proceeds from the offering would be used to create a minimum viable product, advance the development of the "Kin Ecosystem," and build an application to make the Kin Ecosystem available via Kik's messenger app.[149] The private offering raised $50 million in Ether in summer 2017 and was followed by a "token distribution event" in early fall 2017 that distributed one trillion Kin and raised another approximately $49.2 million in Ether

142. *Id.* at 369.
143. *See id.* at 370.
144. *See id.* at 369–75.
145. *See* SEC v. Kik Interactive Inc., 492 F. Supp. 3d 169 (S.D.N.Y. 2020).
146. *See id.* at 173, 176.
147. *See id.* at 173–74.
148. *See id.* at 174.
149. *See id.*

from roughly 10,000 purchasers.[150] Kik retained an additional three trillion Kin, or thirty percent of issued and outstanding tokens.[151] The payments made in Ether were converted into dollars and deposited into two bank accounts.[152]

In late July 2017, prior to Kik distributing its Kin token to purchasers, the SEC released *The DAO Report*.[153] In June 2019, the SEC brought an enforcement action against Kik based on its alleged offering and sale of securities without a registration statement or exemption.[154] The Southern District again undertook a *Howey* analysis to analyze Kik's distribution of Kin tokens.[155] Like the defendants in *ATBCoin* and *Telegram*, Kik conceded that the first element of *Howey*, an investment of money, had been met.[156] The *Kik* court then analyzed the common enterprise prong under the horizontal commonality standard.[157] Without further elaborating, the court initially noted that *ATBCoin* and *Telegram* "present important distinctions in their facts" and noted that it "had to decide this case without benefit of direct precedent in relation to cryptocurrencies."[158] Quoting the "pooling" and "pro-rata distributions" language of *Revak*, *Kik* defined horizontal commonality as "'the tying of each individual investor's fortunes to the fortunes of the other investors by the pooling of assets, usually combined with the pro-rata distribution of profits.' Where horizontal commonality is present, 'the fortunes of each investor depend upon the profitability of the enterprise as a whole.'"[159]

With respect to pooling of assets, in contrast to *ATBCoin* and *Telegram*, the *Kik* court found that Kik had deposited investor funds into

150. *See id.* at 174–75.
151. *See id.* at 175.
152. *See id.* at 175–76.
153. *See The DAO Report*, *supra* note 5; *Kik*, 492 F. Supp. 3d at 176.
154. *Kik*, 492 F. Supp. 3d at 176.
155. *See id.* at 177.
156. *See id.* at 177–78.
157. *See id.* at 178.
158. *Id.* 177.
159. *Id.* at 178 (citing Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d. Cir. 1994)).

a single bank account.[160] Like *ATBCoin* and *Telegram*, however, *Kik* determined that pro-rata distributions were not required. The *Kik* Court suggested that, "[r]ather than receiving a pro-rata distribution of profits, which is not required for a finding of horizontal commonality, investors reaped their profits in the form of the increased value of Kin."[161] The court held that Kik had established a common enterprise since it used investors' pooled funds for its operations, including the construction of the "digital ecosystem" it promoted, with the promise of increasing the value of Kin.[162] The court emphasized:

> With respect to horizontal commonality, the key feature is not that investors must reap their profits at the same time; it is that investors' profits at any given time are tied to the success of the enterprise. This is not a scenario where the funds of each investor were segregated and separately managed, allowing for profits to remain independent.[163]

The court then turned to *Howey*'s "profits from the efforts of others" prong and concluded that the value of Kin would rely heavily on Kik's entrepreneurial and managerial efforts.[164] Kik's efforts "were crucial because without the promised digital ecosystem, Kin would be

160. *Id.* at 178. *BNut see id.* at 176 (stating that investor funds were pooled into two bank accounts).

161. *Id.* at 178 (citing Balestra v. ATBCoin LLC, 380 F. Supp. 3d 340, 354 (S.D.N.Y. 2019)).

162. *See id.* at 178.

163. *Id.* at 179 (distinguishing Savino v. E.F. Hutton & Co., Inc., 507 F. Supp. 1225, 1236–37 (S.D.N.Y. 1981), which rejected the theory of horizontal commonality where "[t]he money invested in each . . . account was not merged into a single investment fund," but instead, "[t]he profitability of each plaintiff's account was purely a function of the transactions executed on behalf of that account, and was not causally related to the profitability of the . . . accounts as a whole").

164. *See id.* at 180. In public statements and at public events, Kik had extolled Kin's profit-making potential; Kik was offering only a limited supply of Kin, so as demand increased, the value of Kin would increase; Kin would be tradeable on the secondary market through cryptocurrency exchanges; and while Kik characterized Kin as a medium for consumptive uses, none of those uses was available at the time of the distribution. *Id.* at 179-80. Kik had described in its white paper how it would integrate Kin into its messenger app, create new incentives to attract development of new uses for Kin, and generally "foster an ecosystem" rooted in Kin. Kik's insistence in its briefs that "market forces" would drive the value of Kin ignored "the essential role of Kik in establishing the market." *Id.*

worthless."[165] The court suggested that "[i]t is undisputed that Kik had to be the primary driver of that ecosystem."[166] The elements of *Howey* were thus satisfied. The court found that Kik's sales of Kin were unregistered offerings of securities.[167]

Kik thus differs from *ATBCoin* and *Telegram* in that the *Kik* Court applied *Revak*'s "pooling" requirement literally and found that investor funds had been pooled in a single bank account. Unlike *Telegram*, the *Kik* Court also did not accept or apply strict vertical commonality. *Kik* resembles *ATBCoin* and *Telegram*, however, in emphasizing *Revak*'s "success of the overall venture" concept over *Revak*'s "usually" "pro-rata distribution" language. Through this shift in emphasis, the common enterprise prong in *Kik* may be seen as a step closer, though not as close as in *ATBCoin* and *Telegram*, to *Howey*'s "profits from the efforts of others" prong. A requirement that investor profits depend on "the success of the ecosystem,"[168] where "Kik had to be the primary driver of that ecosystem,"[169] remains difficult to distinguish from the requirement that investors expect "profits from the efforts of others." *Kik* may thus be seen as a transitional case, with one foot still in *Revak* and the other set in *Munchee* and *ATBCoin*.

4. Ripple Labs

The SEC's next cryptocurrency enforcement action was *SEC v. Ripple Labs, Inc.*, brought in the Southern District and decided in July 2023.[170] Like many of the other Digital Cases, *Ripple Labs* involved a newly created blockchain and several digital tokens or cryptocurrencies. The new blockchain, known as the XRP Ledger, was intended to create an improved global payments network for international currency transfers.[171] The XRP Ledger generated a fixed supply of 100 billion XRP

165. *Id.* at 180.
166. *Id.* at 180.
167. *See id.* at 182.
168. *Id.* at 178.
169. *Id.* at 180.
170. *See* SEC v. Ripple Labs, Inc., 682 F. Supp. 3d 308 (S.D.N.Y. 2023).
171. *See id.* at 317.

tokens, which the XRP Ledger required in order to operate.[172] Three source code developers, including one defendant, founded Ripple in 2012, received 20 billion XRP themselves, and provided 80 billion XRP to Ripple.[173] Before the end of 2020, Ripple engaged in various distributions of XRP, including (1) sales of $728.9 million to institutional buyers, hedge funds and other institutional customers (the "Institutional Sales"), (2) sales of $757.6 million on digital asset exchanges through blind bid/ask exchanges (the "Programmatic Sales"), and (3) payments of $609 million as compensation to employees and funding to third party contractors (the "Other Distributions").[174] Ripple used the proceeds from the Institutional Sales and the Programmatic Sales to fund its operations.[175] The SEC alleged that in 2013, Ripple and two of its founders began a years-long marketing campaign representing that they would search for purported "use" and "value" for XRP and casting XRP as an investment opportunity.[176] The SEC filed suit in December 2020.[177]

The *Ripple Labs* court applied the usual *Howey* test to each of the Institutional Sales, Programmatic Sales, and Other Distributions, respectively.[178] The court granted defendants' motion for summary judgment with respect to the Programmatic Sales[179] and the Other Distributions.[180] With respect to the Institutional Sales, however, the court found that they met all three elements of *Howey*. The first prong was established by the purchasers' payments of money.[181] The second prong required a showing of horizontal commonality, or a pooling of assets

172. *See id.* at 316.
173. *See id.* at 317.
174. *See id.* at 317–18.
175. *See id.* at 318.
176. *See id.*
177. *See id.* at 320.
178. *Id.* at 321 (citing SEC v. W.J. Howey Co., 328 U.S. 293, 298–99 (1946)).
179. The court found that the Programmatic Sales did not meet *Howey*'s third prong, since they were blind bid/ask transactions, buyers could not have known if their payments went to Ripple or some other seller of XRP, Ripple did not make any promises or offers because it did not know who was buying, and buyers therefore could not have reasonably expected that profits would be derived from Ripple's efforts. *Id.* at 328–29.
180. The court found that the Other Distributions did not satisfy *Howey*'s first prong, which requires an investment of money, since there had been no payment of money or any other consideration to Ripple. *Id.* at 330.
181. *See id.* at 325.

along with the fortunes of investors being tied to the fortunes of other investors and to the success of the overall enterprise.[182]

The court found that pooling had been established because Ripple pooled the proceeds of its Institutional Sales "into a network of bank accounts under the names of its various subsidiaries," all of which Ripple controlled.[183] Ripple also used the funds raised from the Institutional Sales to finance its operations.[184] Citing *Kik*, the court noted that defendants did not dispute that Ripple did not "segregate and separately manage" investor funds or "allow for profits to remain independent."[185]

Further, each investor's ability to profit was tied to the fortunes of the enterprise as a whole and to those of the other Institutional Buyers, because all Institutional Buyers had received the same fungible XRP. In evidence of that, the *Ripple Labs* Court found that "[w]hen the value of XRP rose, all Institutional Buyers profited in proportion to their XRP holdings."[186] On that reasoning, the court found the existence of a common enterprise.[187]

With respect to *Howey*'s third prong, the court found that reasonable Institutional Buyers would have purchased XRP with the expectation that they would derive profits from Ripple's efforts.[188] Based on the totality of the foregoing analysis, the court held that Ripple's Institutional Sales constituted an unregistered offer and sale of investment contracts under *Howey*.[189]

182. *See id.* (citing Revak v. SEC Realty Corp., 18 F.3d 81, 88 (2d Cir. 1994); SEC v. SG Ltd., 265 F.3d 42, 49 (1st Cir. 2001); Balestra v. ATBCoin LLC, 380 F. Supp. 3d 340, 353 (S.D.N.Y. 2019)).

183. *Id.* at 325.

184. *See id.*

185. *Id.* (citing SEC v. Kik Interactive Inc., 492 F. Supp. 3d 169, 179 (S.D.N.Y. 2020)).

186. *Id.* at 325–26.

187. *See id.* at 326.

188. Institutional Buyers would have understood from Ripple's communications and marketing campaign that Ripple would use the sales proceeds to improve the market for XRP and to develop uses for the XRP Ledger, thereby increasing the value of XRP. *Id.* Additionally, some Institutional Buyers had agreed to lockups or resale restrictions, which the court found inconsistent with use as a currency or some other consumptive use. *Id.* at 328.

189. *See id.*

As in *Kik*, and in a manner generally consistent with *Revak*, the *Ripple Labs* Court found that pooling of investor funds, and investors' ability to profit being tied to the success of the enterprise, were sufficient to establish horizontal commonality. Like *Kik*, but unlike *ATBCoin* and *Telegram*, the *Ripple Labs* Court seems to have maintained *Revak*'s more traditional focus on the horizontal relationship among investors—emphasizing that the fortunes of each investor were tied to those of other investors since they all had the same fungible token and would profit "in proportion," or pro-rata, to their holdings—rather than the vertical tie between investors and the "success of the overall enterprise" or "ecosystem." *Ripple Labs*, like *Kik*, should thus be seen as a transitional case in the Southern District's remaking of *Howey*.

5. Terraform Labs

Terraform Labs was yet another SEC enforcement action brought in the Southern District and decided in late July 2023, only a few weeks after *Ripple Labs*.[190] Terraform Labs was a Singapore-based company that had launched a blockchain in 2019 to house transactions using the UST coin, a cryptocurrency pegged to the U.S. dollar, and a companion cryptocurrency called the LUNA coin, among others.[191] LUNA coins could only be used on the Terraform blockchain, though other versions of the LUNA coin existed.[192] Owners of UST coins could swap their coins for LUNA coins and vice-versa.[193] Upon the launch of the Terraform blockchain, Terraform and its founders created one billion LUNA tokens and began producing UST coins.[194] In 2018, defendants contracted to sell close to 200 million LUNA coins to institutional investors in the United States and elsewhere.[195] In 2020 defendants began marketing UST coins as profitable investment opportunities, and in 2021, defendants launched the "Anchor Protocol," a mechanism that sought to transform UST coins into "yield-bearing" stablecoins.[196] The Anchor Protocol was an

190. *See* SEC v. Terraform Labs Pte. Ltd., 684 F. Supp. 3d 170 (S.D.N.Y. 2023).
191. *See id.* at 181–182.
192. *See id.* at 182.
193. *See id.*
194. *See id.*
195. *See id.* at 183.
196. *See id.* at 183–84.

investment pool into which UST coins could deposited to earn a share of any profits the pool generated.[197] Defendants represented to investors that the profitability of UST coins and the Anchor Protocol depended on the development of the broader Terraform "ecosystem" and promised that they would devote much of the company's earnings to expanding and improving the "ecosystem" and its crypto-products.[198] In 2022 the market for UST coins crashed, and the value of both UST and LUNA coins plummeted to under a penny, wiping out more than $40 billion of market value for investors.[199]

When the SEC brought an enforcement action against Terraform Labs, the court applied *Howey* to analyze defendant's digital asset offerings.[200] As in most of the Digital Cases, defendants did not dispute that purchasers had made an investment of money.[201] To establish a common enterprise the court required a showing of horizontal commonality, citing *Revak*.[202] The court found that horizontal commonality existed because the UST coins were pooled together in the Anchor Protocol and were expected to generate profits that would then be redistributed to coin depositors on a pro-rata basis.[203]

In addition, even though not all UST coins were deposited—and it was not possible to deposit LUNA coins—into the Anchor Protocol, the court accepted the SEC's allegation for horizontal commonality on "a different but equally plausible theory," namely, that defendants used proceeds from LUNA coin sales to develop the Terraform blockchain and represented that these improvements would increase the value of the LUNA coins themselves. In the words of the *Terraform Labs* Court, "by alleging that the defendants 'pooled' the proceeds of the LUNA purchases together and promised that further investment through these purchases would benefit all LUNA holders, the SEC has adequately pled that the

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197. *See id.*
198. *See id.*
199. *See id.* at 184.
200. *See id.* at 193 (citing SEC v. W.J. Howey Co., 328 U.S. 293, 298–99 (1946)).
201. *See id.* at 195.
202. *Id.* (citing Revak *v. SEC Realty Corp.*, 18 F.3d 81, 87 (2d Cir. 1994).
203. *See id.*

defendants and the investors were joined in a common, profit-seeking enterprise."[204]

The court found that the SEC had met the requirements of *Howey*'s third prong by alleging that defendants had repeatedly touted the profitability of the Anchor Protocol and encouraged UST coin purchasers to deposit their coins into that investment vehicle.[205] The SEC had adequately alleged that UST coins were investment contracts under *Howey*.[206]

In finding that horizontal commonality was established through a pooling of investor funds, and a pro-rata distribution of profits to investors, *Terraform Labs* appears to have followed the more traditional reading of *Revak* set forth to some extent in *Kik* and *Ripple Labs*, rather than the *Munchee*-based version in *ATBCoin* and *Telegram*. It should be noted, however, that the *Terraform Labs* Court also expressly accepted the SEC's "different but equally plausible theory" for horizontality, based on defendants use of proceeds from the sale of LUNA coins— which, after all, could not be deposited into, or receive pro-rata profits from, the Anchor Protocol—to develop the Terraform blockchain and increase the value of the LUNA coins, thereby benefiting all LUNA holders.[207] The SEC's "different but equally plausible theory" of horizontal commonality as accepted in *Terraform Labs* appears fundamentally consistent with the redefined version of the *Howey* test in *Munchee* and *ATBCoin*.

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204. *Id.* at 195–196 (citing Balestra v. ATBCoin LLC, 380 F. Supp. 3d 340, 353 (S.D.N.Y. 2019); SEC v. Kik Interactive Inc., 492 F. Supp. 3d 169, 178 (S.D.N.Y. 2020)).

205. *See id.* at 196. Defendants had also said that profits from the continued sale of LUNA coins would be used for the further development of the Terraform ecosystem. *Id.*

206. *Id.* at 197 (citing Friel v. Dapper Labs, Inc., 657 F. Supp. 3d 422, 433 (S.D.N.Y. 2023)).

207. *See id.* at 195; *see also* Jones Day, *Ripple and Terraform Labs: Two New York District Courts Address the Status of Certain Crypto Assets as Securities* (Aug. 17, 2023), https://www.jonesday.com/en/insights/2023/08/ripple-and-terraform-labs-two-new-york-district-courts-address-the-status-of-certain-crypto-assets-as-securities [https://perma.cc/4CFM-24QT] (last visited Feb. 3, 2025) (noting that *Terraform Labs*' finding that cryptocurrency sales were investment contracts whether offered via written contract or via blind bid/ask transactions through exchanges, expressly declined in this regard to follow *Ripple Labs*, which had found that sales through blind bid/ask transactions on exchanges did not constitute investment contracts).

D. The NFT Cases

An NFT is a unique token with a coded identifier linked to a digital image hosted on a blockchain (usually Ethereum). Unlike cryptocurrencies, NFTs are non-fungible. The NFT is not the underlying digital image or artwork; ownership of the NFT does not typically convey any copyright or other intellectual property right to the underlying digital image; and anyone can view the NFT or the digital image. What one "owns" with an NFT is ultimately only a unique encrypted unit of data that is linked to the digital image and stored and registered on the applicable blockchain as being assigned to a particular digital wallet.[208]

NFTs surged into public prominence in March 2021 when a single NFT was sold at a highly publicized auction at Christie's for $69.3 million in Ether currency.[209] Purchasers reportedly spent almost $30 billion on NFTs in 2021 alone.[210] Commentators quickly noted a variety of fraud in the NFT markets.[211] NFTs were soon the subject of lawsuits from disgruntled purchasers and enforcement actions from the SEC.

1. Dapper Labs

Prior to 2023, the Digital Cases had involved the application of *Howey* to sales of cryptocurrencies. The Southern District's decision in *Friel v. Dapper Labs, Inc.* in 2023 was the first case in U.S. federal courts applying *Howey* to the sale of an NFT.[212]

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208. *See generally* Elzweig & Trautman, *supra* note 1, at 307–308; Goforth, *Nifty*, *supra* note 4, at 777–79; Wee Min, *Put on the Spot: Damien Hirst's The Currency and the Future of NFTs*, 26 VA. J.L. & TECH 1, 5 (2022).

209. The NFT by the artist Beeple was titled *Everydays: The First 5000 Days*. *See* Lawrence J. Trautman, *Virtual Art and Nonfungible Tokens*, 50 HOFSTRA L. REV. 361, 363 (2022); Elzweig & Trautman, *supra* note 1, at 298; Goforth, *Nifty*, *supra* note 4, at 775; Min, *supra* note 210, at 5–6 (citation omitted).

210. *See* Elzweig & Trautman, *supra* note 1, at 309 (internal citation omitted).

211. *See* Goforth, *Nifty*, *supra* note 4, at 776.

212. *See* Friel v. Dapper Labs, Inc., 657 F. Supp. 3d 422, 433 (S.D.N.Y. 2023) ("To the Court's knowledge, no other courts have addressed either the exact substance or posture of the dispute here: whether allegations that an unregistered offer for purchase or sale of, specifically, an NFT constitutes an investment contract under *Howey*[.]").

Dapper Labs was a Canadian-based corporation that developed blockchain technologies.[213] Dapper Labs' founder worked on the development of its own private blockchain, the Flow Blockchain, as a "scaling solution" for the business.[214] In 2019, Dapper Labs announced its first blockchain application, NBA Top Shot, in a joint venture with the National Basketball Association ("NBA") and the NBA Players Association ("NBAPA").[215] NBA Top Shot was a Dapper Labs application built on the Flow Blockchain, primarily to provide a platform to sell NFTs known as NBA Top Shot Moments ("Moments").[216] Moments were digital clips of highlights from NBA games, which Dapper Labs "minted" in collaboration with the NBA and NBAPA.[217] The minting process created each Moment with its own unique identifier, or serial number, recorded on the FLOW Blockchain, making each Moment nonfungible and unique.[218] Moments could be acquired in "packs" from Dapper Labs or on a secondary market created and controlled by Dapper Labs on the NBA Top Shot application called "Marketplace."[219] More than 800,000 people purchased Moments,[220] and some Moments became highly valuable, with a single Moment selling on Marketplace for $208,000 and another purchaser reportedly buying Moments for more than $15.6 million.[221]

Dapper Labs received revenues reportedly in the tens of millions from the sale of packs of Moments, as well as a five percent fee for sales on Marketplace, and an additional fee when purchasers "cashed out" of their Dapper wallets.[222] Some purchasers were eventually not able to cash out their funds, and a class action ensued, alleging that the offer and sale

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213. *See id.* at 426.
214. *See id.* at 428.
215. *See id.* at 429.
216. *See id.*
217. *See id.*
218. *See id.*
219. *See id.* at 429–30.
220. *See id.* at 430.
221. *See id.*; *see also* Trautman, *supra* note 211, at 386 (citing an article in Forbes stating that "NBA Top Shot alone was responsible for a third of the $1.5 billion NFT trading volume seen in the first quarter" (citation omitted)).
222. *Dapper Labs*, 657 F. Supp. 3d at 430.

of Moments to the public had violated federal securities laws.[223] In a case of first impression, the Southern District first had to determine whether Moments were more like commodity cardboard baseball cards or crypto tokens.[224] Defendants cited several fine art-related cases for the argument that Moments were like the "rare collectibles" in those cases, but the court rejected this argument.[225]

The court then applied *Howey*.[226] Dapper Labs did not dispute that Moments involved an investment of money.[227] The court determined—as in *Telegram*—that a common enterprise could be established "under either of the two theories accepted in this Circuit," horizontal or strict vertical commonality.[228] The court cited *Revak* for the horizontal commonality standard in the Second Circuit, which requires a sharing or pooling of funds from investors and investors' fortunes being tied to the fortunes of the other investors and the success of the venture.[229]

With respect to the first Revak factor, the court indicated that, "[g]enerally, pooling occurs when the funds received by the promoter through an offering are, essentially, reinvested by the promoter into the business. In turn, such reinvestment increases the value of the instrument offered."[230] These conditions, the court continued, are what "tie[ ] the fortunes of each investor in a pool of investors to the success of the overall venture."[231] Courts in the other Digital Cases had found pooling satisfied "where allegations plausibly tied the funds received by the promoter through the offering to an improvement of the ecosystem (*i.e.* the private blockchain) that consequently increases the value of the token offered

223. *See id.* at 425, 430.

224. *See id.* at 433.

225. *See id.* at 439 (discussing Stenger v. R.H. Love Galleries, Inc., 741 F.2d 144 (7th Cir. 1984); Dahl v. English, 578 F. Supp. 17 (N.D. Ill. 1983); Wells v. Jackie Fine Arts., Inc., 1989 WL 140912 (S.D. Ohio 1989)). Unlike "unique pieces of artwork," there was a causal connection between Moments and the success of the promoter making the offering; the value of Moments depended on the success of Dapper Labs. *Id.*

226. *Id.* at 433 (citing SEC v. W.J. Howey Co., 328 U.S. 293, 433 (1946)).

227. *See id.* at 435.

228. *Id.*

229. *See id.* (citing Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994)).

230. *Id.* at 436 (citing Milnarik v. M-S Commodities, Inc., 457 F.2d 274, 278 (7th Cir. 1972)).

231. Id. (citing Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994)).

during the ICO."[232] After a consideration of the findings in *Kik*, *Telegram* and *ATBCoin*, and after rejecting Dapper Labs' argument that pooling was absent because each Moment was non-fungible and unique, the court found that pooling had indeed been sufficiently pled: plaintiffs had alleged that Dapper Lab's sales of Moments and other revenues were used to support and grow the blockchain, an assertion which alone "would be sufficient to support a reasonable finding of pooling."[233] Plaintiffs had also alleged that purchasers' funds were held by Dapper Labs in Dapper-controlled wallets.[234]

The court had "an easier time" finding the second factor in the horizontal approach:

> The common thread pulled from the [Digital] Cases is that this second consideration is satisfied where the digital asset's value is tied, and depends upon, the continued success of the blockchain. Plaintiffs adequately allege that the purchasers' fortunes were tied to the overall success of Dapper Labs. Specifically, Plaintiffs assert that "Dapper Labs controls the enterprise," including the "Flow Blockchain" that Moments sit atop. Plaintiffs have also alleged that Moments, once purchased in packs, can be sold only in the Marketplace, which again, is controlled by Dapper Labs.[235]

No finding of pro-rata distribution of profits was needed; the court cited *ATBCoin* for the proposition that "such a formalized profit-sharing mechanism is not required," as well as *Revak*, emphasizing that in the latter, pooling was only "*usually*" combined with pro-rata distributions.[236] Plaintiffs had thus adequately alleged horizontal commonality.

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232. *See id.* The court then cited *Kik* in support of this determination. *Id.* (citing SEC v. Kik Interactive Inc., 492 F. Supp. 3d 169, 178 (S.D.N.Y. 2020)).

233. *See id.* at 438.

234. *See id.*

235. *Id.* (citing SEC v. Telegram Group, Inc., 448 F. Supp. 3d 352, 369–70 (S.D.N.Y. 2020); SEC v. Kik Interactive Inc., 492 F. Supp. 3d 169, 178 (S.D.N.Y. 2020); Balestra v. ATBCoin, LLC, 380 F. Supp. 3d 340, 353 (S.D.N.Y. 2019)).

236. *See Dapper Labs*, 657 F. Supp. 3d at 435 (citing *ATBCoin*, 380 F. Supp. 3d at 354 (internal citations omitted); Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994)) (emphasis added on "usually").

Dapper Labs also characterized strict vertical commonality as "accepted in this Circuit."[237] "Strict vertical commonality requires that the fortunes of investors be tied to the *fortunes* of the promoter," such that there was an interdependence of both profits and losses of the investment, and the fortunes of the investors and the promoter would rise and fall together.[238] The court found, however, that strict vertical commonality did not exist. Plaintiffs' argument in this respect hinged on their allegation that Dapper Labs collected a five percent fee on every transaction in the Marketplace, but the court found this linkage insufficient.[239]

With respect to *Howey*'s third prong, the court found plaintiff's allegations sufficient to establish that Moments were purchased primarily for an investment purpose, and that purchasers' profits were dependent on the efforts of Dapper Labs.[240] Plaintiffs had persuasively argued that Moments' value was derived almost entirely from the continued operation by Dapper Labs of the Flow Blockchain.[241] The court cited *Kik* for the same conclusion.[242] The court concluded that Moments were an investment contract under *Howey*.[243]

Dapper Labs, then, as in the majority of the previous Digital Cases, focused not on *Revak*'s requirements of pooling of funds and "usually" pro-rata distribution of profits to investors, but on the additional factor in

237. *Id.* at 435 (citing *Revak*, 18 F.3d at 87; *In re* J.P. Jeanneret Assocs., Inc., 769 F. Supp. 2d 340, 360 (S.D.N.Y. 2011)). In footnote 10 to its opinion, the *Dapper Labs* court noted: "The Second Circuit did not 'address the question of whether *strict* vertical commonality gave rise to a common enterprise' in *Revak*, but also did not reject it. Since *Revak*, courts in this Circuit have continued to assess the common enterprise prong under the theory of strict vertical commonality." *Id.* at 435 n.10 (emphasis in original) (internal citations omitted).

238. *See id.* (emphasis in original) (citations omitted).

239. *See id.* at 440. The court distinguished the circumstances in *Telegram*, where the company held a large reservoir of the same crypto token, Grams, that it had offered to investors, thereby linking the fortunes of the two. While Dapper Labs held a large reserve of FLOW tokens, none of the purchasers claimed to own FLOW tokens. The court concluded that "[t]his breaks the required linkage." *Id.* at 441.

240. *See id.* at 445–46.

241. *See id.* at 446.

242. *See id.* at 447 (citing SEC v. Kik Interactive Inc., 492 F. Supp. 3d 169, 180 (S.D.N.Y. 2020)).

243. *Id.* at 450.

Revak's horizontal approach—that investors' fortunes were tied to the "success of the overall enterprise"—which the court had "an easier time" finding.[244] For reasons that seem unclear, the *Dapper Labs* court again stated, with *Telegram*—apparently contra *Revak*—that the strict vertical approach had been accepted in the Second Circuit.[245] In *Dapper Labs*, then, in reliance on *ATBCoin*, *Telegram* and *Kik*, the court appears to have continued its drift toward broad verticality and *Howey*'s third "profits from the efforts of others" prong.

2. Impact Theory

In August 2023, roughly six months after *Dapper Labs*, the SEC launched its first enforcement action against an issuer of NFTs.[246] Impact Theory, LLC was a Delaware limited liability company based in Los Angeles in the media and entertainment business.[247] From October to December 2021, Impact Theory offered and sold crypto assets in the form of NFTs known as "Founder's Keys" ("KeyNFTs") to the public.[248] Each KeyNFT contained a digital graphic featuring a combination of four out of 50 possible symbols.[249] In the SEC's view, Impact Theory publicly invited investors to view the purchase of KeyNFTs as an investment that investors would profit from if Impact Theory was successful in its efforts "to build the next Disney."[250] Impact Theory emphasized that the value of KeyNFTs would be derived from the company's efforts, and that Impact Theory would use the offering proceeds for "development," "bringing on more team," and "creating more projects."[251] Impact Theory also stated publicly that the fortunes of KeyNFT purchasers, the company, and the

244. *See id.* 438.
245. *See id.* at 435; *see also supra* note 240.
246. *See Impact Theory, supra*, note 5. On *Impact Theory* being the SEC's first enforcement action against an issuer of NFTs, see Latham & Watkins, *SEC Targets NFTs as Securities for the First Time*, GLOBAL FINTECH & DIGITAL ASSETS BLOG (Aug. 30, 2023), https://www.fintechanddigitalassets.com/2023/08/sec-targets-nfts-as-securities-for-the-first-time/ [https://perma.cc/3X7E-G2K5] (last visited Feb. 3, 2025).
247. *See Impact Theory*, *supra* note 5, at 2.
248. *See id.*
249. *See id.*
250. *See id.* at 3.
251. *See id.*

company's founders were all linked together.[252] Impact Theory sold nearly 14,000 KeyNFTs to at least hundreds of investors in multiple U.S. states for approximately $29.9 million in Ether.[253] Impact Theory collected the offering proceeds in a single crypto asset wallet.[254] KeyNFTs began trading on various secondary market crypto asset trading platforms after the offering.[255]

In August 2023, the SEC issued a cease-and-desist order accepting an offer of settlement from Impact Theory, which included repurchasing KeyNFTs, destroying all KeyNFTs, complying with various undertakings to the SEC, disgorging funds, and paying a civil money penalty to the SEC.[256] In its cease-and-desist order, without going through any explicit *Howey* analysis, the SEC simply stated that KeyNFTs were investment contracts "pursuant to the test laid out in [*Howey*] and its progeny, including the cases referenced by the Commission in [*The DAO Report*.]"[257] Despite its reference to *Howey*, however, the SEC in *Impact Theory* did not once use the words, "common enterprise" or "commonality." The SEC merely noted, among other things, that: (1) Impact Theory offered and sold KeyNFTs to investors; (2) Impact Theory publicly stated it would deliver "tremendous value" to KeyNFT purchasers; (3) Impact Theory also stated that it would use the offering proceeds for "development," "bringing on more team," and "creating more projects"; (4) Impact Theory collected the proceeds from KeyNFT sales in "a single crypto asset wallet"; (5) purchasers had "a reasonable expectation of obtaining a future profit based on Impact Theory's managerial and entrepreneurial efforts"; (6) Impact Theory publicly shared its view that the fortunes of KeyNFT purchasers, Impact Theory and Impact Theory's founders "were all linked together"; and (7) purchasers viewed KeyNFTs as investments and understood Impact Theory's statements to mean that "the company's development of its

252. *See id.* at 4.
253. *See id.*
254. *See id.* at 2.
255. *See id.* at 5.
256. *Id.* at 7.
257. *Id.* at 2.

projects could translate to appreciation of the KeyNFT's value over time."[258]

The SEC's reference to "a single crypto asset wallet" could be understood as a finding of pooling, and its other references to Impact Theory using the offering proceeds for "development," along with the fortunes of purchasers, Impact Theory and its founders all being "linked together," could be read as a determination of horizontal commonality under what I have called the additional language in *Revak*, *i.e.* that "[h]orizontal commonality ties the fortunes of each investor in a pool of investors to the success of the overall venture."[259] *Impact Theory* is conspicuously silent in this regard. Even read in this most favorable light, however, *Impact Theory* in its treatment of common enterprise seems substantially closer to *Munchee*, *ATBCoin* and *Kik* than to *Revak* and *Terraform Labs*.

Interestingly, after *Impact Theory*, two of the five SEC commissioners issued a public statement dissenting from its conclusions, "in part because we disagreed with the application of the *Howey* analysis."[260] The dissenting commissioners did not explain their dissent from the SEC's application of *Howey* in any detail, but rather, expressed a variety of concerns and questions on a broader public policy level:

> The handful of company and purchaser statements cited by the order are not the kinds of promises that form an investment contract. We do not routinely bring enforcement actions against people that sell watches, paintings, or collectibles along with vague promises to build the brand and thus increase the resale value of those tangible items. Even if the NFT sales here fit squarely within *Howey*, is this set of facts one that warrants an enforcement action?[261]

The continuing collapse in Impact Theory' of *Howey*'s common enterprise prong—into either a single "overall success of the enterprise" standard or even into *Howey*'s "profits from the efforts of others" prong (to the extent those two can be distinguished, since both may be seen as

258. *See id.* at 2–4.

259. *See* Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994) (citations omitted); *see also* Gordon, *supra* note 1, at 66–67; Monaghan, *supra* note 2, at 2152–53; Alcser, *supra* note 2, at 1226.

260. *See* Peirce & Uyeda, *supra* note 8.

261. *Id.* at 1.

"vague promises to build the brand and thereby raise resale value")[262]—does not appear to have been lost on the dissenting SEC commissioners.

3. Stoner Cats

A month later, in September 2023, the SEC issued an enforcement order against Stoner Cats for selling unregistered NFTs.[263] Stoner Cats 2, LLC ("SC2") was a limited liability company organized in Delaware that sought to produce an adult animated television show about house cats that became sentient after being exposed to their owner's medical marijuana.[264] To finance production of the television show, SC2 created and sold to the public Stoner Cats NFTs, which were recorded on the Ethereum blockchain and linked to a uniquely generated image, allocated to purchasers at random, of one of the Stoner Cats characters.[265] The Stoner Cats NFTs provided purchasers with the ability to view the Stoner Cats series on the internet.[266] SC2 promised on its website that it would facilitate the creation of a decentralized autonomous organization or DAO comprised of Stoner Cats NFT holders and that it would work with the DAO to develop at least one new animation project a year for the next three years, to which Stoner Cat NFT holders would also have access.[267] SC2 would receive a 2.5 percent royalty for each Stoner Cats NFT transaction on a certain secondary market platform, which helped assure investors that SC2 would remain committed to the success of the animated show.[268] SC2 also engaged in an extensive public media campaign to promote the Stoner Cats NFTs. During the campaign, SC2 stated, among other things, that the proceeds of the offering would fund the production of the Stoner Cats web series and told investors that "the more successful the show, the more successful your NFT."[269]

262. *See id.*
263. *See Stoner Cats, supra* note 5, at 1–2.
264. *See id.* at 2–3.
265. *See id.* at 3.
266. *See id.*
267. *See id.*
268. *See id.*
269. *See id.* at 5.

In late July 2021, in an offering that was publicly available to buyers in the United States and the rest of the world, SC2 sold 10,320 of the Stoner Cats NFTs for Ether then worth about $8.2 million.[270] SC2 used the offering proceeds to pay producers, voice actors, writers, animators, a composer, web designers and other expenses.[271] SC2 minted an additional 100 Stoner Cats NFTs after the offering, transferred some to third parties, and continued to hold the remainder.[272] Stoner Cats NFTs began to trade in the secondary market immediately after the offering, with purchasers spending more than $20 million.[273] Six short episodes of the Stoner Cats series were eventually produced in 2021 and 2022.[274]

The SEC determined that the Stoner Cats NFTs were investment contracts under *Howey*.[275] SC2 made an offer of settlement, which the SEC accepted, undertaking, among other things, to destroy all Stoner Cats NFTs in its possession, pay a civil money penalty to the SEC, and comply with various additional written undertakings going forward.[276]

The *Stoner Cats* order followed much the same format as in *Impact Theory*. Without going through any explicit *Howey* analysis, the SEC simply stated that Stoner Cats NFTs were investment contracts "pursuant to the test laid out in [*Howey*] and its progeny, including the cases referenced by the Commission in [*the DAO Report]*."[277] As in *Impact Theory*, however, the SEC in *Stoner Cats* did not once use the words, "common enterprise" or "commonality." The SEC merely noted, among other things, that (1) SC2 sold Stoner Cats NFTs to investors; (2) the purpose of the offering was to fund the production of an animated web series called Stoner Cats; (3) purchaser funds were automatically transferred to a digital wallet controlled by SC2; (4) SC2 told investors it would develop the web series based upon the managerial and entrepreneurial efforts of SC2 and its agents; (5) SC2 offered and sold the Stoner Cats NFTs as an investment into SC2's efforts to create this

270. *See id.* at 4.
271. *See id.*
272. *See id.*
273. *See id.* at 6.
274. *See id.* at 3.
275. *Id.* at 2.
276. *See id.* at 1, 6–7 (indicating that SC2 would, *inter alia*, undertake to modify the public of the order and certify compliance).
277. *Id.* at 2.

content; and (6) SC2's public communications "tied the success of the show to the value of the NFTs and thus led investors reasonably to expect profit from the managerial and entrepreneurial efforts of SC2."[278]

As in *Impact Theory*, the SEC's reference to investor funds being kept in "a digital wallet" could be understood as a finding of pooling. The SEC's other references to SC2 tying "the success of the show to the value of the NFTs" could be read as a determination of horizontal commonality under the additional language in *Revak* tying investor fortunes to the "success of the overall venture." Like *Impact Theory*, *Stoner Cats* is silent in this regard. Significantly, however, the SEC in *Stoner Cats*—like the *ATBCoin* Court—adduces such a tie not as evidence of horizontal commonality, but as part of its analysis of *Howey*'s third prong: a reasonable expectation of "profit from the managerial and entrepreneurial efforts of SC2."[279] Like the Southern District, the SEC has overtly conflated the second and third prongs of *Howey* into a single inquiry. Importantly, the influence of the SEC on the *Howey* test in cryptocurrency and related cases has not been limited to the Southern District or the Second Circuit.[280] Absent contrary guidance, additional similar decisions

278. *Id.*

279. *See id.* at 4 (stating that SC2 "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"). For a discussion on *ATBCoin*, *see supra* note 119 and accompanying text.

280. *See, e.g.*, Dettmering v. VBit Technologies Corp., No. 22-CV-1482, 2023 WL 4824955, at *6 (D. Del. July 27, 2023) (citing Friel v. Dapper Labs, Inc., 657 F. Supp. 3d 422, 436 (S.D.N.Y. 2023); SEC v. Dalius, No. 18-CV-08497, 2023 WL 3988425, at *8 (C.D. Cal. May 24, 2023) (citing *Dapper Labs*, 657 F. Supp. 3d at 436, for the same conclusion regarding pooling); Audet v. Fraser, 605 F. Supp. 3d 372 (D. Conn. 2022) (citing SEC v. Kik Interactive Inc., 492 F. Supp. 3d 169, 178 (S.D.N.Y. 2020); SEC v. Telegram Grp. Inc., 448 F. Supp. 3d 352, 369 (S.D.N.Y. 2020); Balestra v. ATBCoin LLC., 380 F. Supp. 3d 340, 353 (S.D.N.Y. 2019), for the finding that a pro-rata distribution of profits "is not required for a finding of horizontal commonality"); SEC v. Binance Holdings Ltd., 738 F. Supp. 3d 20, 46 (D.D.C. 2024) (citing *Kik*, 492 F. Supp. 3d at 178–79 for the proposition that showing pro-rata distributions "was not necessary for horizontal commonality as 'investors reaped their profits in the form of the increased value of Kin'"); Dufoe v. DraftKings Inc., No. 23-CV-10524, slip op. at 4 (D. Mass. July 2, 2024) (citing SEC v. Ripple Labs, 682 F. Supp. 3d 308, 325 (S.D.N.Y. July 13, 2023); SEC v. Terraform Labs Pte. Ltd., 684 F. Supp. 3d 170, 195–96 (S.D.N.Y. 2023); and *Kik*, 492 F. Supp. 3d at 178–79, for the sweeping proposition that "In cryptocurrency cases,

from other federal courts relying on the Digital Cases' reformulation of *Howey* seem likely to follow.

By 2024, the SEC's version of the *Howey* test appears to have become (1) an investment of money (2) where investor profits depend on the managerial and entrepreneurial efforts of is promoters.[281] This test seems remarkably close, if not identical, to the formulation rejected by the Second Circuit in *Revak*, in which the court saw broad vertical commonality as merging *Howey*'s second and third prongs into an impermissible single inquiry, namely, "whether the fortuity of the investments collectively is essentially dependent upon promoter expertise."[282] In any event, not much remains here of *Howey*'s common enterprise prong. Under the circumstances, *Howey*'s "profits from the efforts of others prong" is indeed likely to be the decisive factor. As it happened, a subgroup of the SEC—albeit with disclaimers—explicitly advanced this view of *Howey* in its "Framework for 'Investment Contract' Analysis of Digital Assets."[283]

IV. *HOWEY*'S ORIGINS AND THE SEC'S CHANGING VIEW OF COMMON ENTERPRISE

The U.S. Supreme Court in *Howey* found that the term "investment contract" had not been defined by the Securities Act or relevant legislative reports.[284] The Court turned to state blue sky laws, in which, the Court

courts generally conclude that the [sic] horizontal commonality is satisfied where promoters invest proceeds back into the ecosystem upon which the value of the cryptocurrency depends or into further investments from which investors would be paid[.]").

281. *See* Goforth, *Cinderella*, *supra* note 4, at 274 (noting in 2021 "the SEC's explanation of how to apply [the *Howey*] test changing rather significantly in a relatively short period of time[.]").

282. *See* Revak v. SEC Realty Corp., 18 F.3d 81, 88 (2d Cir. 1994) (citations omitted).

283. *Framework*, *supra* note 4. The *Framework* was released by the SEC's Strategic Hub for Innovation and Financial Technology with disclaimers that the *Framework* "is not a rule, regulation, or statement of the Commission, and the Commission has neither approved nor disapproved its content. Further, this framework does not replace or supersede existing case law, legal requirements, or statements of guidance from the Commission or Staff. Rather, the framework provides additional guidance in the areas that the Commission or Staff has previously addressed." *Id.* at 1.

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

said, the meaning of the term had "crystallized" prior to enactment of the Securities Act.[285] In particular, the Court cited the Minnesota Supreme Court in *Gopher Tire* for the proposition that "[a]n 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."[286] In formulating the *Howey* test, the Supreme Court cited seven other state court blue sky decisions in which it said that *Gopher Tire*'s definition "was uniformly applied" to a variety of situations "where individuals were led to invest money in a common enterprise with the expectation that they would earn profits solely through the efforts of a promoter or of some one other than themselves."[287]

As at least one commentator—perhaps not coincidentally an SEC senior litigation counsel—has pointed out, however, the *Gopher Tire* definition does not itself use the words, "common enterprise," nor was there any common enterprise requirement for an investment contract under *Gopher Tire*, or any of the other state law blue sky precedents:

> The unifying thread that runs through these decisions is simply that the investor paid her money with the expectation that she would receive an income or profit from the use of the money in an enterprise operated by the promoter or third parties; the investor was passive and had no managerial role in the enterprise. The focus in all the cases is on the relationship between the investor and the person or entity that will operate the enterprise in which the investor's money is to be used; none focuses on the relationship between investors. Nor do the pre-*Howey* cases focus on whether there is a correlation between the investor's and the promoter's profits or losses.[288]

Under this view, *Howey*'s reference to a common enterprise was never intended to establish a distinct requirement for an investment

285. *Id.*

286. *Id.* (citing State v. Gopher Tire & Rubber Co., 146 Minn. 52, 56 (1920)).

287. *See Howey*, 328 U.S. at 298.

288. McDonald, *supra* note 2, at 4. It should be noted that McDonald, at the time of publication of her article, was Senior Litigation Counsel, Office of the General Counsel, at the SEC. *See id.* at n.1. McDonald also appears to have been one of the co-authors of the SEC's 2004 brief in *ETS Payphones*. *See* SEC Brief, *infra* note 313, at C-1.

contract.[289] Instead, the differing versions of commonality developed only decades after *Howey*, in the mid-1970s as federal circuit courts' approaches to *Howey* began to fracture.[290]

The SEC has adopted and asserted this view of *Howey* since at least 2004, most recently in its 2019 Framework. In the body of the Framework, the SEC—as in its enforcement actions—gives short shrift to the common enterprise prong of *Howey*, stating only that "[c]ourts generally have analyzed a 'common enterprise' as a distinct element of an investment contract. In evaluating digital assets, we have found that a 'common enterprise' typically exists."[291] In a revealing footnote, however, the SEC elaborates:

> In order to satisfy the "common enterprise" aspect of the *Howey* test, federal courts require that there be either "horizontal commonality" or "vertical commonality" . . . The Commission, on the other hand, does not require vertical or horizontal commonality *per se*, nor does it view a "common enterprise" as a distinct element of the term "investment contract."[292]

Accordingly, the SEC Framework notes, "[u]sually the main issue in analyzing a digital asset under the *Howey* test is whether a purchaser has a reasonable expectation of profits (or other financial returns) derived from the efforts of others."[293] Accordingly, only the third prong of *Howey* is usually the decisive one.

While the SEC was careful in its Framework to disclaim any new rulemaking, change in existing law, or approval or disapproval by "the Commission" of the Framework's content, the SEC had, in fact, advanced the same view of common enterprise that it advocates in the Framework since at least 2004.[294] *In re Anthony H. Barkate* ("*Barkate*") in 2004 involved a broker-dealer principal who had engaged in private securities

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289. *Id.* at 6.
290. *Id.* at 8–12.
291. Framework, *supra* note 4, Section II.B (citations omitted).
292. Id. at n.10 (citing Revak v. SEC Realty Corp., 18 F.3d 81, 87–88 (2d Cir. 1994)). *See also* Hall, *supra* note 7, at 139 (noting that the Framework suggests "that prong II of the *Howey* analysis is irrelevant").
293. Framework, *supra* note 4, Section II.C.
294. *See supra* text accompanying note 295.

transactions in violation of NASD rules.[295] The SEC agreed with the conclusions of the Central District of California that the instruments at issue "represented an investment in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial efforts of others" and were therefore investment contracts.[296] In a revealing footnote to this statement in *Barkate*, however, the SEC emphasized:

> Although we agree that there was a common enterprise in this case (as the district court held, based on so-called strict or narrow vertical commonality), we do not believe a "common enterprise" is a distinct requirement for an investment contract under *SEC v. W.J. Howey Co*. As the Supreme Court recently affirmed, *Howey* recognized that Congress adopted the term "investment contract" from state Blue Sky laws, where the meaning of the term had been "crystallized" as '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." *SEC v. Edwards*, 540 U.S. 389, 394 (2004), quoting *Howey,* 328 U.S. at 298, in turn quoting *State v. Gopher Tire & Rubber Co.,* 146 Minn. 52, 56, 177 N.W. 937, 938 (1920). *See also In re Natural Res. Corp.*, 8 S.E.C. 635 (1941), cited in *Howey,* 328 U.S. at 299 n.5, to demonstrate that the Commission "followed the same definition [as the state courts and *pre-Howey* federal decisions such as *SEC v. Universal Serv. Ass'n.*, 106 F.2d 232, 237 (7th Cir. 1939)] in its administrative proceedings." *Natural Res.* described investment contracts as transactions which "in substance . . .involve the laying out of money by the investor on the assumption and expectation that the investment will return a profit without any active effort on his part, but rather as the result of the efforts of someone else." 8 S.E.C. at 637.[297]

Shortly after *Barkate*, in May 2004, the SEC advanced the same view at length in a supplemental brief filed with the Eleventh Circuit (the "2004 Brief") in *SEC v. ETS Payphones, Inc.*, which had originated as another

295. *See In re* Anthony H. Barkate, Exchange Act Release No. 49542, 82 SEC Docket 2130, 2004 WL 762434 (Apr. 8, 2004).

296. *Id.* at *3.

297. *Id.* at n.13.

SEC enforcement action.[298] At the trial court level, the Northern District of Georgia held that the payphone sale-and-leaseback contracts offered by defendant ETS and its founder, Charles Edwards, constituted investment contracts. The court found broad vertical commonality based on *Koscot*, which articulated that "the fortunes of all investors are tied to the efficacy of the promoter," and rejected the defendants' contention that horizontal commonality was required under *Revak* and other cases, since "that is not the definition this court must apply."[299] The court further found that profits were derived solely from the efforts of the defendant.[300]

At the appellate level, the Eleventh Circuit reversed, holding that the respondent's scheme was not an investment contract on two grounds. First, the Eleventh Circuit indicated that an investment contract required either capital appreciation or participation in the earnings of the enterprise, neither of which was satisfied by the contractually fixed rate of return offered by the defendant on its payphone contracts. Second, where purchasers had a contractual entitlement to a fixed return, the requirement that profits be "derived solely from the efforts of others" was also not satisfied.[301]

The Supreme Court in *SEC v. Edwards* then reversed the Eleventh Circuit, holding that the Eleventh Circuit had erred on both grounds.[302] Citing the *Howey* test, the Court looked to whether the ETS scheme involved "an investment of money in a common enterprise with profits to come solely from the efforts of others."[303] The Court then cited the standard language from *Howey* that this definition of "investment contract" embodied "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" and that when Congress included "investment contract" in the definition of security, it "was using a term the meaning of which had been 'crystallized' by the state courts' interpretation of their 'blue sky'

298. *See* Supplemental Brief for Appellee at 7–8, 14–15, SEC v. ETS Payphones, Inc., 408 F.3d 727 (2005) (No. 01-10107) (11th Cir. May 11, 2004).

299. *See* SEC v. ETS Payphones, Inc., 123 F. Supp. 2d 1349, 1353 (N.D. Ga. 2000)).

300. *See id.* at 1354.

301. *See ETS Payphones, Inc.*, 300 F.3d at 1284–85; *see also* SEC v. Edwards, 540 U.S. 389, 392–93 (2004).

302. *See Edwards*, 540 U.S. at 392–93.

303. *Id.* at 393 (quoting SEC v. W.J. Howey, 328 U.S. 293, 301 (1946)).

laws."[304] Again citing *Howey* and its reference to *Gopher Tire*, the Court reiterated:

> The state courts had defined an investment contract as "a contract of scheme for 'the placing of capital or laying out of money in a way intended to secure income or profit from its employment,'" and had "uniformly applied" that definition 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 [a third party]."[305]

Without otherwise addressing *Howey*'s common enterprise requirement or any of the different circuit court standards for commonality, the Court found no reason to distinguish between promises of fixed returns and promises of variable returns "for purposes of the test, so understood,"[306] and held "that an investment scheme promising a fixed rate of return can be an 'investment contract'[.]"[307]

On remand to the Eleventh Circuit, the SEC, acknowledged that *Edwards* reiterated and applied the *Howey* test, but proceeded to draw from *Edwards* several novel and remarkable conclusions. The SEC first claimed that:

> The Supreme Court's decision, however, also provides guidance on two questions this Court [the Eleventh Circuit] left open in its earlier decision in this case—whether the evidence shows that those who purchased the payphone investments did so "with the expectation that they would earn a profit solely through the efforts of the promoter or [a third party]," and whether, under this Court's "broad vertical commonality" analysis, the evidence shows they invested their money in "a common enterprise." Further, *Edwards* confirms the correctness of this Court's "broad vertical commonality" approach to common enterprise because it supports the Commission's recent clarification,

304. *See id.* at 393–94 (quoting *Howey*, 328 U.S. at 298).

305. *Id.* at 394 (citations omitted); *see also* SEC v. Binance Holdings Ltd., 738 F. Supp. 3d 20, 40 (D.D.C. 2024) ("And fifty-eight years after *Howey*, the Supreme Court repeated that it looks to 'whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others'").

306. *See Edwards*, 540 U.S. at 394.

307. *See id.* at 397.

> consistent with that approach, that "common enterprise" is not a "distinct requirement for an investment contract" under *Howey*.[308]

The SEC's 2004 Brief rejected horizontal commonality, "the meaning of which," it said, "is subject to disagreement."[309] The Eleventh Circuit had described horizontal commonality as "the 'pooling' of investors' funds as a result of which the individual investors share all the risks and benefits of the business enterprise."[310] But, the SEC said, the decisions of other circuits relied upon by the Eleventh Circuit imposed a different requirement for horizontal commonality, namely that investors have "an undivided interest in an enterprise, entitling the owner to a pro rata share in the enterprise's profits."[311] The SEC concluded that "[t]he recognition in *Edwards* that the 'profit' referred to in *Howey* includes a fixed return precludes imposing a pro rata sharing requirement."[312] Accordingly, in the SEC's view, neither "pooling" nor "pro rata distributions" was required for horizontal commonality, and the latter was, in some if not all cases, "precluded."[313] Based on this logic, the SEC would appear to have read *Edwards* as having superseded or perhaps even overruled the "common enterprise" standard in *Revak*. However, the SEC went further:

> The Supreme Court's decision here furthermore confirms the correctness of "broad vertical commonality." . . . In *Edwards*, the Supreme Court . . . recognized that the "pertinent substance" of the *Howey* test is "[t]he investment of money with the expectation of profit through the efforts of other persons[.]" "Common enterprise" is not included in *Edwards*' description of that "substance." By holding that the term "profits" in *Howey* is not to be construed narrowly and mechanistically, and includes fixed payments, *Edwards* supports the view that "common enterprise" is also to be construed flexibly and does not impose a distinct requirement . . . Accordingly, *Edwards* supports broad vertical commonality and is consistent with the Fifth

308. SEC Brief, *supra* note 314, at 7–8 (citations omitted).
309. *See id.* at 12.
310. *See id.* (citing SEC v. ETS Payphones, Inc., 300 F.3d 1282, 1284 (11th Cir. 2002))
311. *See id.* (citing Wals v. Fox Hills Devel. Corp., 24 F.3d 1016, 1018 (7th Cir. 1994)).
312. *Id.* at 12–13.
313. *Id.*

> Circuit's holding in *Continental Commodities* that because there was an investment and the investors' returns were dependent on the efforts of the promoter, the arrangements were "investment contracts" within the meaning of the definition of "security."[314]

Again, in sweeping fashion, the SEC would appear to have read *Edwards* as having resolved the circuit split on "common enterprise" in favor of the broad vertical version, notwithstanding the absence of any such discussion in *Edwards,* and in spite of *Revak*'s criticism of that version as merging *Howey*'s second and third prongs into a "single inquiry."[315] In a significant footnote, the SEC refers to *Revak*'s criticism and acknowledges that "[a]lthough the Commission never endorsed this criticism of 'broad vertical commonality' in an adjudicatory opinion, it did endorse the criticism in some briefs, such as the one cited by *Edwards*. In light of the Commission's recent opinion in *In re Anthony Barkate*, . . . the view expressed in those briefs no longer reflects the Commission's interpretation of investment contract."[316]

The SEC brief cited by *Edwards*—submitted previously by the SEC in a case before the First Circuit in 2001—stated outright that, "[t]he Commission has also long taken the position that broad vertical commonality is not an appropriate test because it collapses the second prong of the *Howey* test (common enterprise) into the third prong (profits to come from the efforts of others)."[317] Furthermore, despite the SEC's

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314. *Id.* at 13–14 (citations omitted). It should be noted that the statement in *Edwards* cited by the SEC for the proposition that the "pertinent substance" of the *Howey* test is "[t]he investment of money with the expectation of profit through the efforts of other persons" was, in fact, a citation by the Court of the SEC's own position, as asserted by the SEC and accepted by the 7th Circuit. *See* SEC v. Universal Service Ass'n, 106 F.2d 232, 237 (7th Cir. 1939).

315. *See* Revak v. SEC Realty Corp., 18 F.3d 81, 88 (2d Cir. 1994).

316. *See* SEC Brief, *supra* note 314, at n.5 (citation omitted); *see also* McDonald, *supra* note 2, at 16 (noting that "[i]n a 1973 interpretative release, the SEC indicated that it did not view the *Howey* investment contract test as requiring either what would now be called 'horizontal commonality' (pooling of investor funds and pro rata sharing of profits among investors), or what would now be called 'strict vertical commonality' (profit-sharing between the promoter and the investor)").

317. *See* Brief for Appellant at 28 n.11, SEC v. SG Ltd., 265 F.3d 42 (1st Cir. 2001) (cited in *ETS Payphones*, 300 F.3d at 1286).

conclusions in its 2004 Brief, the Eleventh Circuit in *ETS Payphones*, in 2002, does not appear to have reached the issue of broad vertical commonality:

> Notwithstanding Edwards' argument [for horizontal commonality], we believe we are bound by precedent to apply a different test for commonality, "broad vertical commonality." Broad vertical commonality, the easiest to satisfy of the alternative tests, only requires a movant to show that the investors are dependent upon the expertise or efforts of the investment promoter for their returns. We need not explore the applicability of this prong to the present case, however, in light of our holding that the last prong, "expectation of profits," clearly is unsatisfied.[318]

To the extent the Eleventh Circuit reached the issue at all in 2002, its position was ambivalent. In a concurring opinion, one of the judges wrote "to state my disagreement with that portion of the opinion which reaffirms broad vertical commonality as the test for common enterprise in the Eleventh Circuit."[319] Judge Lay noted:

> I respectfully submit that horizontal commonality is the only valid test for a common enterprise . . . Proof of horizontal commonality is required because requiring only proof of broad vertical commonality makes *Howey*'s third prong—expectation of profits from the efforts of others—superfluous. Consequently, only a requirement of horizontal commonality is consistent with the *Howey* test for an investment contract.[320]

Admittedly, in its opinion on remand in 2005, the Eleventh Circuit stated that "[i]n our earlier ruling, we reaffirmed this Circuit's adherence to the 'broad vertical commonality' test . . . ."[321] But at the time of writing and submitting its 2004 Brief, the SEC, of course, did not know of the court's yet-to-be-issued 2005 opinion.[322] In its 2004 Brief, in any event,

318. SEC v. ETS Payphones, Inc., 300 F.3d 1281, 1284 (11th Cir. 2002), *rev'd*, SEC v. Edwards, 540 U.S. 389 (2004).

319. *Id.* at 1285 (citations omitted).

320. *Id.* at 1285–86 (citations omitted).

321. SEC v. ETS Payphones, Inc., 408 F.3d 727, 732 (11th Cir. 2005) (citing *ETS Payphones*, 300 F.3d at 1284).

322. Given that *ETS Payphones* was heard in both 2002 and 2005, and the opinions in both cases authored, by the same judges, one might wonder whether the court's views

the SEC has simply swept any such objections aside. Both in *Barkate* and its 2004 Brief, the SEC reversed itself on *Howey*'s common enterprise prong and adopted a new and expanded view of investment contract. According to the SEC, purportedly in reliance on *Edwards*, the definition of "investment contract" under *Howey* is no longer "an investment of money in a common enterprise with profits to come solely from the efforts of others,"[323] but rather, merely "an investment and investors' dependence on the efforts of others."[324] On this point, the SEC's 2004 Brief dispels any doubt:

> *Edwards* not only confirms broad vertical commonality as the correct interpretation of "common enterprise," but also supports the Commission's original interpretation of "investment contract" – first articulated in 1941 and recently reiterated in [*Barkate*]. As the Commission clarified in that recent opinion, a "common enterprise" does not impose "a distinct requirement for an investment contract." The Commission's 1941 decision in *Natural Resources* likewise broadly described investment contracts in a way that does not include "common enterprise" as an additional requirement . . . This approach (which reaches the same result as broad vertical commonality) is consistent with *Howey* . . . The authorities relied on in *Howey*, which included . . . *Natural Resources*, described an investment contract in a way that does not include "common enterprise" as an additional requirement . . . Thus *Howey* supports the interpretation that the essential features of an investment contract are those identified in *Edwards* as the "substance" of the test – an investment and investors' dependence on the efforts of others.[325]

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on broad vertical commonality had shifted in the interim, perhaps in response to the SEC's 2004 Brief. *See ETS Payphones*, 408 F.3d at 730–31; *ETS Payphones*, 300 F.3d at 1282.

323. *See* SEC v. Edwards, 540 U.S. 389, 393 (2004) (quoting SEC v. W.J. Howey, 328 U.S. 293, 301 (1946)).

324. *See* SEC Brief, *supra* note 314, at 16–17.

325. *Id.* (citation omitted). In *In re* Natural Resources Corp. the SEC found that transactions involving land leases were investment contracts "where, in substance, they involve the laying out of money by the investor on the assumption and expectation that the investment will return a profit without any active effort on his part, but rather as the result of the efforts of someone else." Securities Act Release No. 2470, 1941 WL 363308, at *2 (Feb. 14, 1941). The SEC also found, however, that "this community of interest

The SEC's statements in its 2019 Framework, and its systematic disregard for *Howey*'s "common enterprise" prong in the Digital Cases as a whole, should therefore not surprise us. *Edwards*, it should be recalled, cited the standard *Howey* test repeatedly and was silent as to commonality. In its 2004 Brief, however, based on its remarkable reading of *Edwards* and the *ETS Payphones* cases, along with *Gopher Tire*, *Natural Resources*, and its own position in *Barkate*, the SEC—in a complete reversal of its interpretation prior to 2004—has indeed redefined the *Howey* test: the common enterprise prong is gone.[326]

Based on the above, the SEC seems to have hung its redefinition of *Howey*—not to mention its ensuing enforcement blitz against issuers of cryptocurrencies and NFTs in the Digital Cases—from the slenderest of precedential reeds. Unlike some of the precedents it cited for this redefinition, however, the SEC's new version of *Howey*, at this writing, may be on its way to becoming the law of the land.

CONCLUSION

Has the SEC, then, in the Digital Cases already torpedoed the *Howey* test? In a word: Yes.

By 2024, *Revak* has been swept aside; *Howey*'s common enterprise prong has been eliminated; and the Southern District has largely adopted the SEC's *Munchee* standard in a majority of the ensuing Digital Cases. By all accounts, the *Howey* test—despite the SEC's and the Southern District's continuing citation of *Howey*—has become simply (1) an investment of money and (2) the dependence of investors on others. The SEC and the Southern District have collapsed *Howey* back into *Gopher Tire* and its other blue sky precedents.

Even leaving aside the SEC's new version of *Howey*, it seems clear that after the Digital Cases, the *Revak* horizontal commonality standard is in shambles. The meaning of *Revak*'s requirements of "pooling," "usually

between the registrant and the purchasers makes all the purchasers participants in a common enterprise." *Id.* at 3.

326. *Cf.* Gurbir S. Grewal, SEC Director of the Division of Enforcement, *What's Past is Prologue: Enforcing the Federal Securities Laws in the Age of Crypto*, 15 WM. & MARY BUS. L. REV. 475, 485 (2024) (claiming that in over 100 crypto-related actions brought by the SEC, "in every case, where federal courts have had to determine whether there were 'securities' at issue, the courts have applied the *Howey* test[.]").

combined with pro-rata distributions" has never been less clear. With regard to "pooling," the Digital Cases have shown that "pooling" has been reformulated. First, in *Kik*, holding investor funds in a single bank account constituted pooling.[327] Second, in *Ripple Labs*, holding investor funds in a network of bank accounts was sufficient for pooling.[328] Finally, in *ATBCoin*, *Telegram*, *Terraform Labs* and *Dapper Labs*, the use of investor funds to support a promoter's blockchain, "ecosystem," or "success of the overall venture" is enough to establish pooling.[329] "Pooling" in the Digital Cases is no longer—if it ever was—a coherent concept. With regard to *Revak*'s "usually" requiring "pro-rata distributions," the Southern District's digital asset case law appears to have reinterpreted *Revak*. First, in *Telegram* and *Ripple Labs*, the courts did not address the requirement. Second, *Terraform Labs* found that redistributing profits to coin holders constituted a pro-rata distribution.[330] Finally, in *ATBCoin*, *Kik*, and *Dapper Labs* the courts determined that *Revak* did not require pro-rata distributions at all.[331] The utility of *Revak* in determining the presence of a common enterprise would appear to have expired. At the SEC and in the Southern District, and perhaps elsewhere, broad vertical commonality—*i.e.* the third prong of *Howey*, as expressly rejected by *Revak*—now rules the day.

At least two possible explanations for the demise of *Howey*'s common enterprise prong exist. The first is based on the facts and circumstances of the Digital Cases. In every case, with minor exceptions, investors' fortunes were inextricably bound, through the purchased digital assets or the promoter's blockchain, which in turn constituted the promoter's "ecosystem" or "overall venture." The success or failure of one almost inevitably meant the success or failure of the other; investor and promoter fortunes were joined technologically at the hip. A common

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327. *See* SEC v. Kik Interactive, 492 F. Supp. 3d 169, 178–79 (S.D.N.Y. 2020).

328. *See* SEC v. Ripple Labs, Inc., 682 F. Supp. 3d 308, 325 (S.D.N.Y. 2023).

329. *See* Balestra v. ATBCoin LLC, 380 F. Supp. 3d 340, 354 (S.D.N.Y. 2019); SEC v. Telegram Grp., 448 F. Supp. 3d 352, 370 (S.D.N.Y. 2020); SEC v. Terraform Labs, 684 F. Supp. 3d 170, 196 (S.D.N.Y. 2023); Friel v. Dapper Labs, Inc., 657 F. Supp. 3d 422, 438 (S.D.N.Y. 2023).

330. *See Terraform Labs*, 684 F. Supp. 3d at 195 (citation omitted).

331. *See ATBCoin*, 380 F. Supp. 3d at 354; *Kik*, 492 F. Supp. 3d at 178; *Dapper Labs*, 657 F. Supp. 3d at 435.

enterprise, in other words, was a structural given. Militating strongly against this explanation, however, is the fact that the SEC has advocated its version of *Howey* since at least 2004, prior to the existence of cryptocurrencies, NFTs, blockchains, or any of the Digital Cases.

The second, historically deeper, and perhaps more convincing explanation is that the common enterprise prong is and always has been conceptually unstable. The common enterprise prong, as noted above, was absent from *Gopher Tire* and other blue sky case law which the *Howey* Court expressly relied in formulating its definition of an investment contract. The *Howey* Court itself provided no definition of common enterprise. It was never clear, for example, whether the enterprise had to be "common" to investors alone, or to investors and the promoter together. This prong of *Howey*, accordingly, began to fragment in the 1970s. The Second Circuit in *Revak* in 1994, which set for the circuit's horizontality standard for a common enterprise, failed to define either "pooling" or "usually combined with the pro-rata distribution of profits" and added its alternative language regarding "the success of the overall venture." In the midst of this disarray, *Howey*'s common enterprise prong has practically invited reinterpretation. If the SEC has targeted *Howey*'s common enterprise prong, and the courts in the Digital Asset Cases have largely accommodated the SEC in this effort, it is likely because the common enterprise prong has been *Howey*'s conceptually weakest, most indeterminate, and least stable component. The SEC view that a common enterprise is not a "distinct requirement" of an investment contract is not, it must be admitted, easily dismissed. Perhaps, as the SEC has argued, an investment contract under *Howey* should indeed be understood, with *Gopher Tire*, as simply "the placing of capital or laying out of money in a way intended to secure income or profit from its employment."[332] A separate additional requirement that a company use

332. *See* SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1946) (citing State v. Gopher Tire & Rubber Co., 146 Minn. 52 (1920)). Some commentators have analogized digital assets, based on the way they are marketed and sold, to the CD products determined to be securities in Gary Plastic Packaging Corp. v. Merrill Lynch, 756 F.2d 230 (2d Cir. 1985). *See, e.g.*, William Hinman, Dir., Div. of Corp. Fin., SEC, When *Howey* Met *Gary* (*Plastic*), Remarks at the Yahoo Finance All Markets Summit: Crypto (June 14, 2018), https://www.sec.gov/newsroom/speeches-statements/speech-hinman-061418 [https://perma.cc/5GC7-Q5KW]; Michael Mendelson, *From Initial Coin Offerings to Security Tokens: A U.S. Federal Securities Law Analysis*, 22 STAN. TECH. L. REV. 52,

investor funds to develop its business would not seem, frankly, to be much of a test.

More broadly, whatever its underpinnings, it seems clear that the SEC's redefined version of *Howey* would dramatically expand the range of commercial transactions that could be deemed investment contracts and, thus, securities subject to the SEC's jurisdiction. As the dissenting SEC commissioners observed in the aftermath of *Impact Theory*, the SEC's version of *Howey* could conceivably justify enforcement actions "against people that sell watches, paintings or other collectibles" or ultimately any valuable commodity, based on a "handful" of "vague promises to build the brand and thus increase the resale value of those tangible items" that "are not the kinds of promises that form an investment contract."[333] Again, it is not impossible that this was the intent of *Gopher Tire* and the "flexible rather than static principle" principle of *Howey*.[334] But however broadly we might read *Gopher Tire* or *Howey*, not even the SEC has argued that Congress intended the U.S. securities laws "to provide a broad federal remedy for all fraud."[335] Some limits on the applicability of the *Howey* test, however defined, must therefore exist.

79–80 (2019). Other commentators have suggested that the SEC in its treatment of digital assets is "slouching toward *Ralston Purina*[.]" *See* Hall, *supra* note 7, at 140–41 ("The Framework's dismissal of *Howey* prongs I and II, and expansion of prongs III and IV, suggest that the staff is moving away from the circumscribed definition of 'investment contract' in *Howey* towards a more expansive concept, reminiscent of the *Ralston Purina* approach, that labels an asset a security when it has investment appeal and is made publicly available on an undifferentiated basis").

333. *See* Peirce & Uyeda, *supra* note 8 at 2; Hall, *supra* note 7, at 141 ("Simply reading [*Howey* prongs I and II] out of the *Howey* test risks expanding the definition of 'investment contract' to encompass a wide variety of investable assets that the *Howey* Court apparently did not think Congress intended to sweep under the aegis of the federal securities laws"); *see also* Brief for Sen. Lummis as Amicus Curiae, *supra* note 7, at 4–5, 10, 14–19. *See also* Mechigian v. Art Capital Corp., 612 F. Supp. 1421, 1427–28 (S.D.N.Y. 1985) (rejecting plaintiff's argument that an artwork constituted an investment contract under *Howey* on the grounds that the plaintiff had failed to satisfy *Howey*'s common enterprise prong, and that "[i]n our mercantile economy, we should not try to turn every 'thing' which might be purchased and sold into a 'security'").

334. *See Howey*, 328 U.S. at 299.

335. *See* Gordon, *supra* note 1, at 72 (citing Ronald J. Coffey, *The Economic Realities of a "Security": Is There a More Meaningful Formula?*, 18 CASE W. RES. L. REV. 367, 373 (1967)).

The expanding definition of "investment contract" in the Digital Cases seems to raise fundamental public policy questions. As articulated by Professors Albert Choi and Adam Pritchard:

> Why do we apply securities regulations only to certain transactions? Home purchases, for example, are not covered by the securities laws, even though they are the most substantial investment that most people make. Your savings account at the local bank, another large repository of investment dollars, is not a security. How does a "security" differ from these other investments? Because securities regulation applies only to transactions in securities, the question of "what is a security" is in many ways the same as asking "should we apply securities regulation here?"[336]

Should we apply securities regulation to cryptocurrencies, NFTs and other digital assets (not to mention watches, paintings, collectibles and other valuable commodities)? If the Digital Cases are any guide, one might first wonder, particularly in this post-*Chevron* era,[337] whether the SEC, the federal courts, or Congress should make that determination.

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336. STEPHEN J. CHOI & A.C. PRITCHARD, SECURITIES REGULATION: CASES AND ANALYSIS 89 (2d ed. 2008) (emphasis omitted); *see also* Gordon, *supra* note 1, at 72.

337. *See* Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984), *rev'd*, Loper Bright Enters. v. Raimondo, 603 U.S. 369 (2024).