Article Information

Authors: Steven Pettigrove, Luke Higgins, Emma Assaf
Service: Banking & Finance, Blockchain, Corporate & Commercial, FinTech
Sector: Financial Services

Blockchain Bites: Howey bout that? California judge says Bored Ape NFTs are not securities; Soundwaves and stablecoins: AUDD wins trade mark dispute; America embraces markets innovation

Steven Pettigrove, Luke Higgins, Tahlia Kelly and Emma Assaf of the Piper Alderman Blockchain Group bring you the latest legal, regulatory and project updates in Blockchain and Digital Law.

Howey bout that? California judge says Bored Ape NFTs are not securities

A US Court in the Central District of California has granted a motion to dismiss on a class action lawsuit against Yuga Labs, the creator of the Bored Ape Yacht Club non-fungible tokens (**NFTs**), after finding that the plaintiffs failed to adequately establish that the NFTs are securities. This kind of motion is difficult for a defendant to win, as the court must assume, for the purposes of the exercise, that all the allegations of fact in the plaintiff's complaint are true.

The court cited *SEC v. W.J. Howey Co* (1946) (**Howey**) noting that

although the Securities Acts do not define 'investment contracts,' courts … have taken the term 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

The court considered each prong of the *Howey* test, being:

(1) an investment of money,

(2) in a common enterprise,

(3) with an expectation of profits produced by the efforts of others.

(1) Investment of money

The first prong of the *Howey* test requires investors to commit assets to an enterprise in a way that exposes them to financial loss. The plaintiffs alleged that their investment of fiat currencies and digital currencies into the NFTs was sufficient to satisfy the first limb.

However, the court found that the NFTs were not marketed for investment purposes but rather for consumptive uses, such as offering membership in a digital club and access to related perks. Bored Ape Yacht Club was renown for hosting lavish parties for holders during the NFT boom. These features were not presented as opportunities for financial gain. While the plaintiffs argued that buyers were motivated by profit, the court said that subjective intention only has 'some bearing' on the analysis. The first prong of the *Howey* test was therefore not met.

(2) Common enterprise

The court, for completeness, needed to consider the balance of the test, and found that the plaintiffs did not adequately allege a 'common enterprise' by showing either horizontal or vertical commonality.

In the Dapper Labs case, horizontal commonality was found because the NFTs relied on a private blockchain. That blockchain was essential to the value of the NFTs. In contrast, the NFTs in this case were recorded to the Ethereum

blockchain, which was not controlled by the defendants and does not depend on the NFTs for its survival.

The court also looked at the DraftKings case where horizontal commonality was found because the NFTs were sold in a proprietary marketplace controlled by the defendant. If that marketplace shut down, the 'value of the NFTs would plausibly drop to zero'. In this case, however, the plaintiffs purchased their NFTs on independent platforms such as OpenSea and Coinbase.

The plaintiffs also argued that because both the purchasers and defendants owned ApeCoin, the utility coin airdropped to Bored Ape NFT holders, that the fortunes of the two were 'linked'. However, the fact that Yuga Labs earned a fee each time an NFT was transferred (irrespective of whether its value increased, decreased or stayed the same) suggested a de-coupling of fortunes. This analysis contradicts arguments previously advanced by the SEC that such fees indicate asset *is* a security.

The court concluded that the:

plaintiffs have not alleged the type of "interplay" between the alleged securities and proprietary "ecosystem" that underpinned the logic of Dapper Labs and DraftKings, and therefore have not adequately alleged horizontal commonality.

(3) Expectation of profits produced by the efforts of others

The plaintiffs referred to Yuga Labs' statements about the long-term and intrinsic value of the NFTs as well as their prices and trading volumes. However, the court found these were not enough on their own to establish an expectation of profit. The court compared this to the Dapper Labs case where the use of rocket ship, stock chart and money bag emojis clearly suggested an expectation to profit.

Yuga Labs' efforts also needed to be 'undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise'. The court found that Yuga was responsible for developing and implementing the roadmap that would shape the future value of the NFTs. The court rejected the argument that buying NFTs on the secondary market prevented the plaintiffs from relying on Yuga's efforts.

Despite this particular finding in the plaintiffs' favour, the other prongs of the Howey test were not satisfied. The court held that the NFTs were not securities and granted the defendant's motion to dismiss.

Remarkably, despite the motion to dismiss being granted, the Court allowed the Plaintiffs to replead their case for the third time.

An investment is in the eye of the beholder

This decision draws an important line between NFTs marketed as investments and those designed for cultural or community use. In this case, the fact that Yuga Labs relied on decentralised infrastructure and did not squarely market the NFTs as an investment were influential in their not being classified as securities. The ruling also clarified that general statements about future plans or value do not automatically create an expectation of profit.

After the Dapper Labs and Draft Kings rulings, this judgment will give some comfort to US NFT projects seeking to build around art, culture or community, and which are not promoted as an investment scheme. While the judgment has limited application beyond US shores, the Howey test bears some similarities to other collective and managed investment scheme tests under British and Australian law. The Australian Courts are yet to rule on whether an NFT could be a financial product or managed investment scheme, however, this judgment is a hopeful sign that artists and creatives may not require a financial services licensure in order to find new audiences in the digital economy.

Written by Steven Pettigrove and Emma Assaf

Soundwaves and stablecoins: AUDD wins trade mark dispute

A recent decision of the Australian Trade Marks Office has sided with an Australian crypto firm, upholding its opposition to a US company's trade mark application. The decision demonstrates the increasing integration of software into financial and other services and accordingly the potentially broad scope for confusion in the offering of different types of software.

On 4 May 2024, **AudD LLC**, the developer of a music recognition API, applied to register the trade mark "AudD". The application covered services in Class 9 and 42 such as "encoding of digital music", "software as a service featuring software for machine learning", and "deep learning and deep neural networks". It also covered goods including "application software", "downloadable software applications", and "computer interface software".

This move ruffled the feathers of **AUDC Pty Ltd**, the fintech company behind the Australian backed stablecoin AUDD, who filed a notice of intention to oppose AudD's application on 4 December 2024.

CEO of **AUDC**, Effie Dimitropolous, supported the firm's opposition by declaring that the AudD trademark was *"substantially identical, or deceptively similar, to a trade mark registered by the Opponent in respect of closely related services".*

AUDC had already registered the trade mark "AUDD" on 12 September 2022, which covered services under Class 36 including "financial exchange in crypto assets", "financial exchange services", "currency exchange services", and "brokerage of currency".

The Law

Section 44(2) of the *Trade Marks Act 1995* (Cth) provides that a trade mark application in respect of services must be rejected if it is substantially identical, or deceptively similar to a trade mark registered by another person in respect of **similar services or closely related goods**.

The Decision

Delegate of the Registrar of Trade Marks, Debrett Lyons, determined that the marks "AudD" and "AUDD" were *"substantially identical"* despite the difference in upper and lower case letters.

This left the issue of whether **AUDC's** registered trademark covered services which were similar to the services and/or closely related to the goods covered by **AudD's** application. The Delegate found the finance/currency exchange services covered by **AUDC's** registered trademark were not the same as the music recognition/software services outlined in **AUdD's** application. However, the Delegate determined that the services covered by **AUDC's** trade mark *were* closely related to the goods covered by **AudD's** application. The Delegate stated that:

*Application software and a host of other nominated services are necessary adjuncts to virtually all of the services covered by AUDC's registered trademark. Some, **such as trading in currencies, will in this age absolutely depend on application software**…*

In other words, the Delegate found that trading in currencies and crypto assets will necessarily depend on application software, and consequently rejected the application in its entirety. That is, the decision did not turn on the actual use of the software (e.g., music vs crypto trading), but rather on the broader category of "application software" and its functional proximity to service delivery in general. On one view, this proximity is particularly close in the context of stablecoins as opposed to traditional financial services as stablecoins inherently involve a type of software service.

Implications for Australian Fintech Firms

The decision highlights a potentially expansive interpretation of the relationship between software goods and service-based trademarks under section 44(2). Tech companies looking to protect their brand can take this into account when assessing whether to oppose a trade mark application which they regard as the same or deceptively similar to their own registered trade marks.

Fintech firms looking to register a trade mark should be aware that including broad descriptions of software related goods could increase the risk of overlap with existing trade marks. As the boundaries between software and services continue to blur, industry participants should be prepared for broader interpretations of what constitutes a "closely related" good or service.

Written by Steven Pettigrove, Luke Higgins and Nick Rae

America embraces markets innovation

The annual Fordham Blockchain Regulatory Symposium was convened at Fordham Law School in New York this week with the leading crypto lawyers in attendance. It has been a whirlwind 12 months for the crypto industry, particularly in the USA, as regulation by enforcement has given way to innovation supporting reform which promises to drive US financial markets forward.

The SEC Chairman, Paul Atkins, was in attendance and joined the convenor Donna Redel for a fireside chat. Earlier this year, the Chairman announced Project Crypto as the agency's North Star to enable America's financial markets to move on chain. Chairman Atkins' keynote covered a wide range of initiatives that the SEC has embraced which promise to reset the

way capital markets operate in the United States for generations. While Fordham is held under a strict 'Chatham House rules' basis, for Chairman Atkin's talk, those rules were lifted and all comments were 'on the record'. The Chairman was frank at the US falling behind, saying:

I view the US as a decade, or perhaps 5 years, behind in trying to address distributed technology so we have to do double time marching to catch up.

Chairman Atkins has cast his plans to upgrade American financial markets as part of a broader digital evolution stretching back decades. A key priority for the SEC is to provide a pathway for entrepreneurs and software developers to develop ideas in the USA and use its capital markets to raise capital, rather than chasing them offshore.

We want to try and make people feel safe to do things in the US, in the past this wasn't the case and we chased people offshore, they should be able to do things in the US and access our capital markets.

According to Chairman Atkins, the SEC's important initiatives include:

1. Using ample existing authority to rule make to allow people to build and innovate in the United States;
2. Provide technical assistance to Congress as it progresses statutory reforms that will lay an enduring foundation to future proof policy reforms;
3. Seek harmonisation with the Commodity Futures Trade Commission (CFTC) by deploying joint rule making powers and closer collaboration with other agencies such as the IRS;
4. Reset the SEC's approach to what it regards as an "Investment contract" based on what people are buying (a point reinforced this week by a decision of a California Court which found that Bored Ape NFTs are not securities, but more akin to art or collectibles);
5. Lay the regulatory foundations to allow SuperApps combining banking, securities, and commodities trading by the encouraging closer collaboration between regulators;
6. Make IPOs great again by making it more attractive to be a public company by tackling class action risk, revisiting disclosure exemptions and curbing the weaponisation of corporate governance;
7. Providing rules for an "Innovation exemption" to allow testing of innovative products which the SEC expects to share further details of by the end of the year; and
8. Regulatory guidance for tokenised securities to embrace the benefits of faster settlement and on chain compliance.

We're not going to have the Wild West of course but we want to encourage experimentation.

While some in the financial services and crypto industries have clamoured for principles based rule making, Chairman Atkins believes detailed rules will be necessary:

Everyone wants principles based rules, but in the litigious environment of the United States, market participants want certainty.... In principle I like principles-based rules and we should strive for that in the crypto world.

Taken in combination, these policy reforms represent a broad reset of US financial markets policy to embrace innovation without leaving investor protection behind.

While the longevity of these reforms will depend fundamentally on legislative reforms from Congress, and continuing technological changes, the current SEC Chairman has outlined an agenda which could fundamentally change the infrastructure which underpins how Americans consume financial services with impacts far beyond its shores.

Written by Steven Pettigrove