Securities Regulation Daily Wrap Up, ENFORCEMENT—Company charged with unregistered NFT offering in first-of-its-kind action, (Aug 29, 2023)

By Rodney F. Tonkovic, J.D.

Peirce and Uyeda dissented in part, saying there are larger questions that the Commission should tackle before bringing more NFT cases.

In its first enforcement action involving non-fungible tokens, the SEC concluded that the NFTs at issue were sold in an unregistered offering. A media company raised almost $30 million by selling the NFTs to hundreds of investors, promising they would deliver "tremendous value." The Commission found that the NFTs were offered and sold as investment contracts and that the company thus engaged in the unregistered offer and sale of securities. In addition to a series of undertakings, the company will pay $6.1 million in disgorgement and penalties. Commissioners Peirce and Uyeda dissented, raising a series of questions that would allow the Commission to tackle NFTs "sensibly" (*In the Matter of Impact Theory, LLC*, Release No. 33-11226, August 28, 2023).

Impact's offering. Los Angeles-based Impact Theory, LLC is a media and entertainment company. Between October 13, 2021 and December 6, 2021, Impact Theory offered and sold crypto asset securities called Founder's Keys to the public in the form of purported NFTs. The KeyNFTs were sold in three tiers, "Legendary," "Heroic," and "Relentless," with the Legendary tier priced the highest per token.

Impact Theory hosted several live events and participated in social and news media interviews promoting the KeyNFTs. Potential investors were urged to view the purchase as an investment in the business: Impact Theory said it was trying to "build the next Disney," an effort which, if successful, would deliver "tremendous value" to purchasers. For example, Impact Theory said:

- “If you’re paying 1.5 [ETH], you’re going to get some massive amount more than that. So, no one is going to walk away saying, ‘Oh man, I don’t think I got value here.’ I’m freakishly bullish on that. I will do whatever it takes to make sure that that is true.”
- “Now as we’re building out this IP, imagine that you could’ve gotten in on Disney when they were doing Steamboat Willie, and that’s how we think of the Legendary tier. That’s how we think of this whole first drop quite frankly.”

Impact Theory emphasized that this value would be the result of the company's efforts, and that the proceeds would be used for development and creating more projects. The company also stated that the fortunes of KeyNFT purchasers, Impact Theory, and Impact Theory's founders were all linked together.

As a result, the order says, KeyNFT purchasers said that they believed that Impact Theory's development of its projects could translate to appreciation of the KeyNFTs' value over time. Impact Theory sold 13,921 KeyNFTs to at least hundreds of investors, raising $29,896,237.16 worth of ether ("ETH"). The KeyNFTs also traded on various secondary market crypto asset trading platforms, and Impact Theory programmed the smart contract for the KeyNFTs so that it received a 10 percent royalty on each secondary market sale, generating approximately $978,000 worth of ETH.

Unregistered offering. The Commission found that Impact Theory's offer and sale of the KeyNFT's was not registered and that there was no applicable exemption. As a result, the company violated Sections 5(a) and (c) of the Securities Act. "Absent a valid exemption, offerings of securities, in whatever form, must be registered," said Antonia Apps, Director of the SEC’s New York Regional Office. "Without registration, investors of all types are deprived of the protections afforded them by the robust disclosures and other safeguards long provided by our securities laws."

To settle the charges, Impact Theory agreed to a cease-and-desist order and to pay disgorgement of $5,120,718.27, prejudgment interest of $483,195.90, and a civil money penalty of $500,000. The Commission took into account the fact that the company instituted repurchase programs in December 2021 and August 2022 through which it repurchased 2,936 KeyNFTs, returning approximately $7.7 million worth of ETH to investors. Impact Theory also agreed to undertakings including destroying all KeyNFTs in its possession and eliminating any royalty payments.

Dissent. Commissioners Peirce and Uyeda dissented in part from the Commission's order due to their disagreement with the application of the *Howey* analysis, but that analysis was not the focus of the statement. Peirce and Uyeda acknowledged the legitimate concern over "hype" causing people to spend over $30 million with no clear idea of how they would use, enjoy, or profit from the NFTs. This legitimate concern, however, "is not a sufficient basis to pull the matter into our jurisdiction."

The commissioners said that the handful of statements cited in the order are not the kinds of promises that form an investment contract. Even if they were, they questioned whether this set of facts warranted an enforcement action. A registration violation is typically cured by rescission which the company made in their repurchase program, they said.

The statement ends with a series of nine questions that Peirce and Uyeda feel the Commission should have grappled with long ago. They feel that a discussion about NFTs now could help the Commission approach the topic "sensibly."

The release is No. 33-11226.

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