

## DraftKings NFTs Class Action – An Attempted Dapper Labs Sequel?

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On March 9, 2023, a putative class action was filed against DraftKings Inc. for alleged violations of federal securities laws in the US District Court for the District of Massachusetts. The class, if certified, will include those who purchased or otherwise acquired DraftKings NFTs between August 11, 2021, and present.

As emphasized in our recently published [Dapper Labs alert](#), whether NFTs are securities is a fact-specific inquiry, so companies should exercise caution when developing new platforms and collections.

### ***SEC v. W.J. Howey*, 328 U.S. 293 (1946)**

Under the *Howey* test, which is utilized by courts when assessing whether a financial instrument qualifies as an “investment contract” and thus a security under the Securities Act of 1933, courts evaluate the following elements in ascertaining whether a scheme is a security: (1) an investment of money, (2) in a common enterprise, (3) with the expectation of profit from the essential entrepreneurial or managerial efforts of others. The *Howey* test applies to any contract, scheme, or transaction, regardless of whether it has any of characteristics of typical securities. The focus of the *Howey* analysis is not only on the form and terms of the instrument itself (in this case, the digital asset) but also on the circumstances surrounding the digital asset and the manner in which it is offered, sold, or resold (which includes secondary market sales). Thus, the *Howey* test embodies a flexible approach adaptable to various schemes under which alleged investment contracts may arise and takes into account the “totality of circumstances.”

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## ***DraftKings Inc. Class Action Complaint***

In their complaint, which closely aligns with the reasoning behind the court's order denying a motion to dismiss in *Dapper Labs*,<sup>[1]</sup> the plaintiff class asserts that DraftKings NFTs constitute investment contracts under the *Howey* test.

While the allegations against DraftKings mirror those at issue in the *Dapper Labs* case, there is at least one notable difference between the NFT collections. Whereas the Dapper Labs NFTs are minted on Dapper Labs' private blockchain, Flow, the DraftKings' NFTs are minted on Polygon, a public, Ethereum-based blockchain. The use of a private blockchain was a significant, though not the only, factor in the court's conclusion that Dapper Labs and consumers were engaged in a "common enterprise" under the *Howey* test. Whether the same reasoning will extend to NFTs minted on a public blockchain remains to be seen.

The plaintiff class also alleges that the third *Howey* test prong is met because DraftKings NFT purchasers rely on the significant managerial efforts of DraftKings to make and maintain profits. In support, the complaint alleges that DraftKings NFTs and the DraftKings Marketplace satisfy a number of factors identified by the US Securities and Exchange Commission (SEC) as indicative of an expectation of profits from the efforts of others.

### ***Next Steps***

As in all litigation, DraftKings will evaluate a strategy to respond to the complaint, which could include a motion to dismiss. Our team will be monitoring this case as well as *Dapper Labs* as both unfold.

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### **FOOTNOTES**

<sup>[1]</sup> *Friel v. Dapper Labs*, 21 Civ. 5837, 2023 WL 2162747 (S.D.N.Y. Feb. 22, 2023).

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