

Securities

Bored Ape NFTs Ruling Finds a Line Between Art and Investment

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Summary by Bloomberg AI

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- A federal judge in California rejected unregistered securities claims from people who bought cartoon images of “bored” apes in the form of non-fungible tokens, or NFTs, because they were marketed for “consumption.”
- The judge's ruling focused on how the company’s Bored Apes Yacht Club tokens were promoted and sold, with allegations that they provided membership in a digital club, “access to a collaborative art experience,” and fun.
- The ruling could provide a path out of litigation for token issuers, as they can now argue that their NFTs were sold for personal use and enjoyment, rather than as investments, by avoiding language about profits or related concepts.

Issuers and promoters of blockchain-based collectibles sued under securities laws can now argue those were sold for personal use and enjoyment as a path to avoid liability, based on a recent ruling.

A federal judge in California recently rejected unregistered securities claims from people who bought cartoon images of “bored” apes—some wearing sunglasses—in the form of non-fungible tokens, or NFTs, because they were marketed for “consumption.” Now those token purchasers have refiled their class action complaint, trying to resurrect their original premise.

While the law governing cryptocurrency trading remains in flux, NFTs stand apart because each item is unique. Judge Fernando M. Olguin’s ruling in favor of Yuga Labs Inc. and its promoters focused on how the company’s Bored Apes Yacht Club tokens were promoted and sold.

Though NFT sales have declined, their promoters still face significant liability stemming from their heyday. NBA great-turned-businessman Shaquille O'Neal settled a suit over his Astrals and Galaxy NFTs for \$11 million earlier this year. Yuga Labs' tokens were touted by Madonna, Paris Hilton, Justin Bieber, and other celebrities.

The recent decision pointed to allegations that Yuga Labs and its promoters said NFTs like Bored Ape Yacht Club provided membership in a digital club, "access to a collaborative art experience," and, significantly, fun.

"None of these alleged promotional statements can be read to tout the NFTs as investments," Olguin said. His ruling and reasoning, if it survives and propagates, could provide a path out of litigation for token issuers.

Buying Art

Lee Reiners, a Duke Financial Economics Center fellow who's testified about crypto before Congress, said he doesn't recall a judge ruling that digital assets weren't securities because the purchasers' money didn't constitute an investment.

Olguin effectively said, "No, you're buying digital art," Reiners said. "I don't think he necessarily got that wrong."

Margot Hoppin of Hoppin Grinsell said it's the first decision she's aware of that grants a dismissal motion for failure to adequately show an NFT collection is an investment contract and therefore a security.

Under Olguin's logic, "NFT promoters could potentially escape securities regulations simply by avoiding using language about profits" or related concepts, she said.

"This case comes down to whether these are 'consumption goods,' or are they securities?" said Adam Moskowitz, who represents plaintiffs in litigation over the collapse of crypto exchange FTX and other cases. "These were mainly marketed as consumption goods."

"So it's a different world from the rest of crypto," where there are "interest accounts and tokens sold for profit," he said.

Repleading Investment

The NFT holders repleaded their allegations. Before, they spent four paragraphs discussing whether they invested money. In the new complaint, the issue takes up about 13 pages.

The defendants' marketing "contained specific crypto industry terms that marketed the Yuga Financial Products to Plaintiffs and Class members as investments with the prospect of financial gain," they now allege. Remarks about "aping in," rocket and moon emojis, the NFTs' value, and Yuga's promised development of a "metaverse," or virtual world, all relate to future profit, they say.

If Olguin rejects the securities claims again, the Bored Ape token holders will still have consumer protection claims to fall back on.

‘Efforts of Others’

Congress will likely step in to decide which digital assets can be considered securities, and in what circumstances. But for now, courts are using a 1946 US Supreme Court decision, *SEC v. W. J. Howey Co.* to assess those questions. To show an asset is a security, a party must show an investment of money in a common enterprise, with an expectation of profits produced by the efforts of others.

Olguin’s look at the “efforts of others” prong provided some surprises, attorneys said.

Blockchain lawyer Lewis Cohen of Cahill Gordon & Reindel LLP says Olguin suggested in a footnote that the “efforts of others” aspect can be satisfied through sales on the secondary market, rather than sales direct from the issuer.

That view “runs exactly contrary” to the findings of Judge Analisa Torres of the Southern District of New York in *SEC v. Ripple Labs Inc.*, he said. Torres had said exchange-based sales of Ripple’s token to the public, often made by trading algorithms, didn’t satisfy *Howey*—while sales to institutional investors did.

But *Ripple Labs* also differed from another 2023 ruling in the same district that rejected the distinction between public and institutional sales. Olguin cited that case, *SEC v. Terraform Labs Pte*, along with Bored Ape social media statements, in rejecting a defense argument.

To Hoppin, whose firm represents both plaintiffs and defendants in crypto cases, the blockchain “ecosystem” has played a key role in the “efforts of others” determination.

The use of a privately controlled blockchain counts toward “efforts” by the token issuer, as in a case involving Dapper Labs, and it also counts if the promoters control the NFT marketplace, as in a DraftKings case, she said.

“But what happens when the ecosystem is more like a virtual world or an interactive platform or a universe creation based on a media property or artistic property, or comic book series?” she said. “This case suggests that that’s not enough, and that’s a surprising result,” she said.

Other Worlds

Many NFT collections are “promoted in tandem with a corresponding universe,” she said. And for many NFT purchasers, “the value of the NFTs they’re holding are really directly linked to a promise of future preservation and access rights to those spaces, to those virtual worlds.”

Hoppin said there’s a tendency for courts to be “dismissive of newer, non traditional, virtual-world-based, or meme- or hype-driven assets.”

“Holding a really new and nontraditional type of finance up to the metrics and terms and ways of thinking about traditional financial products, they will tend to fail those metrics and not speak in that language,” she said. But the markets exist. “It shouldn’t mean there’s less protection, legally.”

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