UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF LOUISIANA

JONATHAN MANN and BRIAN L. FRYE, Plaintiffs, v. SECURITIES AND EXCHANGE COMMISSION, ERIC I. BUSTILLO, GARY GENSLER, CAROLINE A. CRENSHAW, JAIME E. LIZÁRRAGA, HESTER M. PEIRCE, and MARK T. UYEDA, in their official capacities, Defendants.	Case No. 24-CV-01881 JUDGE GUIDRY MAG. ROBY

DEFENDANTS' REPLY
IN SUPPORT OF MOTION TO DISMISS

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Defendants U.S. Securities and Exchange Commission, Chair Gensler, Commissioners Crenshaw, Lizárraga, Peirce, and Uyeda, and Regional Director Bustillo (collectively, "the SEC" or "the Commission") respectfully submit this reply brief in further support of their Motion to Dismiss, ECF No. 18. In their Memorandum of Law in Opposition to Defendants' Motion to Dismiss, ECF No. 21 ("Opp."), Plaintiffs continue to speculate they could be targeted with a "threatened [SEC] enforcement action" (Opp. at 14) without showing *any* evidence that the SEC is investigating their prospective NFT projects. Despite the absence of any action taken by the SEC as to them, Plaintiffs ask this Court to provide an advisory opinion as to how the Supreme Court's fact-based *Howey* test would apply to their inchoate prospective offerings of NFTs. Without more, Plaintiffs cannot overcome the SEC's sovereign immunity or satisfy Article III's standing and ripeness requirements.

ARGUMENT

I. Plaintiffs fail to carry their burden of showing that this Court has subject-matter jurisdiction over this suit.

The government may not be sued absent a waiver of sovereign immunity, *Alabama-Coushatta Tribe of Tex. v. United States*, 757 F.3d 484, 488 (5th Cir. 2014), and Plaintiffs have not identified a waiver that would allow this Court to exercise subject-matter jurisdiction over their claim. *See* Defs.' Mem. Supp. MTD, ECF No. 18-1 ("Memo" or "Mem.") at 10-16.

A. Plaintiffs' reliance on a First Amendment claim not alleged in the Complaint does not excuse Plaintiffs from identifying a waiver of sovereign immunity.

Plaintiffs try to defeat sovereign immunity by raising, for the first time, a First Amendment claim. Opp. at 8-10. Plaintiffs attempt to shift the focus of their lawsuit from seeking "a declaratory judgment that their proposed NFT projects do not violate U.S. securities laws" (Compl. ¶19) to asking the Court to find that the SEC is "violating the Constitution" by "[r]equiring artists such as Plaintiffs to register their art," which is allegedly an "unlawful prior restraint on artistic expression in violation of the First Amendment" (Opp. at 2, 3). Nowhere in their Complaint do Plaintiffs allege a First Amendment claim, or even mention the Constitution, and Plaintiffs cannot amend their Complaint in their opposition to a motion to dismiss. *See, e.g.*, *Mun. Emps.' Ret. Sys. of Mich. v. Pier 1 Imps., Inc.*, 935 F.3d 424, 436 (5th Cir. 2019) (internal citation omitted).

Even if Plaintiffs had asserted a First Amendment claim in the Complaint, such a claim would be barred by the SEC's sovereign immunity. *Allen v. Cooper*, 589 U.S. 248, 259 (2020) ("*Congress* must speak, and indeed speak unequivocally, to abrogate sovereign immunity."). Plaintiffs rely on *Missouri v. Biden*, 662 F. Supp. 3d 626 (W.D. La. 2023),[1] to argue that "sovereign immunity does not bar parties from seeking to enjoin federal officials from violating the Constitution" (Opp. at 8, 10), but *Missouri* does not help Plaintiffs. There, the court relied on *Larson v. Domestic & Foreign Com. Corp.*, 337 U.S. 682 (1949), and related cases to find that a First Amendment claim could proceed (662 F. Supp. 3d at 666-67), and *Larson* observed that a claim can proceed where a "statute or order conferring power upon the officer to take action in the sovereign's name is claimed to be unconstitutional" (337 U.S. at 690).[2] But Plaintiffs here make no such challenge to a statute or order of the Commission; rather, they seek an opinion as

[1] In *Murthy v. Missouri*, 603 U.S. 43, 50 & 55 n.3 (2024), the Supreme Court held that the *Missouri* plaintiffs lacked standing and, because of that holding, did not address sovereign immunity.

[2] *Larson* also allowed a suit to proceed where a plaintiff claims that an officer's action is *ultra vires* their authority (337 U.S. at 689), but Plaintiffs have not alleged that an enforcement action based on a claim that an NFT was a security would be *ultra vires*. In addition, the Fifth Circuit has noted that "Congress apparently did away with the *ultra vires* doctrine and other fictions surrounding sovereign immunity when it amended the APA in 1976." *Apter v. U.S. HHS*, 80 F.4th 579, 593 (5th Cir. 2023) (cleaned up).

to the application of the securities laws to an indeterminate set of facts and argue a prior restraint without any assertion that the Commission has taken steps to investigate their products or require any action. Plaintiffs have not pointed to any authority that would allow a constitutional claim that is not challenging agency action to proceed without a waiver of sovereign immunity.

B. Plaintiffs have not shown a waiver of sovereign immunity under the APA.

As the SEC's Memo explains (Mem. at 11-16), sovereign immunity bars Plaintiffs' claims because the APA's waiver of sovereign immunity does not apply here. First, the APA's waiver of sovereign immunity does not apply because Plaintiffs are challenging matters "committed to agency discretion." 5 U.S.C. § 701(a)(2); Mem. at 12-13. Plaintiffs concede, as they must, that the SEC may in its discretion "deci[de] to open an investigation" and "'refus[e] to take requested enforcement action.'" Opp. at 14. They assert, however, that they "are challenging the SEC's incorrect interpretation of an 'investment contract' and exercise of its enforcement powers beyond its statutory mandate." *Id.* But the Commission has not engaged in any interpretation as part of an investigation or enforcement action with respect to Plaintiffs. And even if it had, Plaintiffs would be seeking to limit the SEC's discretion to enforce the securities laws as construed by the judiciary. Mem. at 12-13.

Section 702's waiver of sovereign immunity is also inapplicable because Plaintiffs (i) have not identified any agency action affecting them in a specific way and (ii) have not shown that they have suffered a legal wrong. *See* Mem. at 13-16. Plaintiffs respond that "three SEC enforcement actions and cease-and-desist orders" against other parties and the SEC's "public statements expressing its strategy of regulation via enforcement" constitute agency action. Opp. at 12; *see also* Opp. at 9 n.6 (citing a speech by Chair Gensler and an Enforcement Division press release as examples of public statements).[3] And Plaintiffs rely on *Bear Creek Bible Church v. EEOC*, 571 F. Supp. 3d 571, 599 (N.D. Tex. 2021), *aff'd in part, vacated in part, rev'd in part sub nom. Braidwood Mgmt., Inc. v. EEOC*, 70 F.4th 914 (5th Cir. 2023), in support. Opp. at 12-13, 15. But as the SEC explained (*see* Mem. at 19-20), in *Bear Creek*, the court relied on the fact that the government defendant had *issued guidance*, not a speech or press release, that "recognizes rights that have not been established by federal law and directs employers to comply with those interpretations." 571 F. Supp. 3d at 599. Plaintiffs do not point to any comparable guidance. Plaintiffs assert that a speech by a single commissioner and a press release describing an SEC enforcement action against a "crypto lending" platform has the effect of "advising the public to heed the lessons from [the SEC's] enforcement actions." Opp. at 12. But neither the speech nor the press release directed the public to take particular actions as the guidance at issue in *Bear Creek* did.[4]

Moreover, the Commission's orders in enforcement actions against other parties cannot be agency actions subject to challenge because they do not affect Plaintiffs in "a specific way" even if Plaintiffs plan to engage in similar conduct. *See Walmart*, 21 F.4th at 308, 310-11

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[3] Plaintiffs also argue in a footnote that "the future enforcement they face" is an "agency action," but they provide no support for this claim. Opp. at 12 n.8. The Fifth Circuit has explained that "action that is merely threatened"—as opposed to "concrete action[]"—is not "agency action" for purposes of the APA. *Walmart, Inc. v. DOJ*, 21 F.4th 300, 310 (5th Cir. 2021).

[4] Plaintiffs' other cited cases (Opp. at 11-13) are also distinguishable. *See Clarke v. CFTC*, 74 F.4th 627, 633-34, 636 (5th Cir. 2023) (agency division's rescission of no-action letter it had issued nearly eight years previously to operator of "marketplace" in which appellants participated was agency action); *Apter*, 80 F.4th at 583, 590-91 (agency's online posts "direct[ing] consumers to take specific actions in keeping with the generally applicable principle that [agency] had settled on and announced" was agency action in doctors' suit alleging that posts interfered with their medical practices); *Lewis v. United States*, 2019 WL 4738791, at *3, *23-24 (M.D. La. Sept. 27, 2019) (government's cease-and-desist order to plaintiffs was final agency action).

(holding that an express threat of future enforcement action does not qualify as agency action); *Alabama-Coushatta*, 757 F.3d at 491 (agency action must be "factually developed 'by some concrete action applying the regulation to the claimant's situation in a fashion that harms or threatens to harm him'") (cleaned up). The orders in other actions do not require Plaintiffs to take or refrain from taking any action, and they are not binding on anyone other than the parties to those actions. And, given the fact-bound nature of the *Howey* test, those orders do not indicate any determination as to the application of that analysis to the Prospective Offerings.

Plaintiffs also deny the need to show final agency action (*see* Mem. at 11, 15), stating that they are not "assert[ing] claims under the general provisions of the APA" (Opp. at 13). Instead, they assert for the first time that "the relevant cause of action underlying Plaintiffs' DJA suit is a claim under Section 5 of the Securities Act," which they admit is an "anticipated claim" that would be brought by the SEC in a theoretical enforcement suit. *Id*. Plaintiffs' assertion, however, only serves to highlight that they are not challenging agency action; rather, they are contesting a theoretical future investigation or enforcement action.

Nor have Plaintiffs shown that they have "'suffered legal wrong because of the challenged agency action, or [are] adversely affected or aggrieved by that action within the meaning of a relevant statute.'" *Alabama-Coushatta*, 757 F.3d at 489. Effectively conceding that the "SEC's prior actions against" other entities have not caused them "legal wrong," Plaintiffs offer only a short, unsupported argument that they are "adversely affect[ed]" by those actions because their fear of enforcement "impact[s] their careers, reputations, and livelihoods." Opp. at 15. Such fears about the possibility of an SEC investigation cannot suffice, and they are belied by the fact that at least one of those Plaintiffs continues to sell NFTs despite those supposed fears. *See* Mem. at 19.

II. Plaintiffs lack standing.

Even if sovereign immunity did not bar this action, Plaintiffs would need to show that they have presented a justiciable case or controversy. They have not done so. Plaintiffs have not pled an actual or imminent injury in fact. *See* Mem. at 16-20. Plaintiffs seek to overcome the absence of any cognizable injury by contending that all they must plead is "an intent to engage in arguably proscribed conduct and a 'credible fear' of enforcement." Opp. at 16 (citing *Braidwood Mgmt., Inc. v. EEOC*, 70 F.4th 914, 924 (5th Cir. 2023)). *Braidwood*, however, allows standing based on a threat of an enforcement action "only if [a plaintiff] establishes that (1) it has 'an intention to engage in a course of conduct arguably *affected with a constitutional interest*, but proscribed by a statute,' and (2) 'there exists a credible threat of prosecution thereunder.'" *Braidwood*, 70 F.4th at 925 (quoting *Susan B. Anthony List v. Driehaus*, 573 U.S. 149, 159 (2014)) (emphasis added). Plaintiffs omit the critical precondition to a pre-enforcement challenge—constitutionally protected conduct. While Plaintiffs belatedly invoke the First Amendment, the Complaint does not plead any constitutional interest or challenge the constitutionality of the securities laws.[5] *See* Opp. at 3 ("Plaintiffs freely acknowledge that there is no First Amendment right to violate securities laws.").

Indeed, Plaintiffs' true dispute is not constitutional at all, but is a transparent attempt to exempt digital assets and NFTs from the Supreme Court's 75-year-old construction of the term "investment contract" in *Howey*. *Cf. SEC v. Payward, Inc.*, 2024 WL 4511499, at *8-10 (N.D.

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[5] As discussed *supra*, the Court should disregard Plaintiffs' First Amendment argument (Opp. at 18) as improper because it was not pled. In *Braidwood*, in contrast, the plaintiffs were challenging the constitutionality of Title VII which aligned with the EEOC's guidance in the wake of *Bostock v. Clayton County, GA*, 590 U.S. 644 (2020). *See Braidwood*, 70 F.4th at 919, 925.

Cal. Aug. 23, 2024) (surveying case law and rejecting argument that *Howey* should be read to require "post-sale obligations"). Not only have courts universally rejected this approach by applying *Howey*'s case-specific analysis to the offer and sale of a variety of asset types, but courts have expressly found *Howey* applicable to the offer and sale of certain NFTs in private actions pre-dating any SEC action involving NFTs. *Friel v. Dapper Labs, Inc.*, 657 F. Supp. 3d 422, 432-50 (S.D.N.Y. 2023) (applying *Howey* to NFTs); *Dufoe v. DraftKings Inc.*, 2024 WL 3278637, at *4-10 (D. Mass. July 2, 2024) (finding plaintiff sufficiently pled NFTs were offered and sold as securities under *Howey*); *Harper v. O'Neal*, -- F. Supp. 3d --, 2024 WL 3845444, at *8-10 (S.D. Fla. Aug. 16, 2024) (same).[6] Plaintiffs' disagreement with these courts and desire to rewrite *Howey* does not grant them standing to preemptively sue the SEC and seek an advisory opinion on how the law may apply to their contemplated future NFT offerings.

In addition, with or without a constitutional issue at play, Plaintiffs need to establish that a credible threat of enforcement exists, which they have failed to do. A sufficient "injury must be actual or *imminent*, not speculative—meaning that the injury must have already occurred or be likely to occur *soon*." *FDA v. All. for Hippocratic Med.*, 602 U.S. 367, 381 (2024) (emphasis added). "The threat of future injury must be '*certainly* impending'; mere allegations of possible future injury will not suffice." *James v. Hegar*, 86 F.4th 1076, 1081 (5th Cir. 2023) (quoting *Clapper v. Amnesty Int'l USA*, 568 U.S. 398, 409 (2013)). Similarly, it is well-established that "'to meet the Article III standing requirement when a plaintiff is seeking injunctive or

[6] Prior to the SEC bringing its first case involving NFTs, private plaintiffs had brought actions against NFT issuers for selling unregistered securities, such that some deterrent effect on Plaintiffs' planned course of conduct already existed. As a result, "it is difficult to see how the plaintiffs' [alleged] self-censorship can be traced to" the SEC. *Murthy*, 603 U.S. at 73 (cleaned up).

declaratory relief, a plaintiff must allege facts from which it appears there is a *substantial likelihood* that he will suffer injury in the future.'" *Id.* at 1080 (emphasis added). "Substantial likelihood" means "'considerably more likely' than not." *See, e.g.*, *Texas Voters All. v. Dallas Cnty.*, 495 F. Supp. 3d 441, 457-58 (E.D. Tex. 2020).

Plaintiffs have not pled facts showing a "substantial likelihood" of an impending SEC enforcement action to commence "soon." Plaintiffs do not allege an investigation into their prior NFT offerings or any substantive communication from the SEC and do not plead any facts that indicate an enforcement action is planned or likely against their Prospective Offerings. Plaintiffs plead that NFTs comprise part of the multi-*trillion* dollar digital asset industry and imply that there are innumerable artists creating and selling NFTs. Compl. ¶¶42-43, 121. In addition, by arguing that their past and current NFT offerings are so "distinct" from their Prospective Offerings that their current offering brings no fear of enforcement (Opp. at 20),[7] Plaintiffs concede that each NFT offering must be evaluated separately under *Howey* on its individualized facts. Plaintiffs fail to any plead facts that make it likely that, amongst the great multitude of NFT offerings and other activity in the world's largest and busiest capital markets, the SEC would choose to initiate an investigation into their offerings, conclude they constituted the offering of a security under *Howey*, and exercise its discretion to bring its fourth case ever involving NFTs against either Plaintiff. *See generally Texas State LULAC v. Elfant*, 52 F.4th 248, 257 (5th Cir. 2022) (finding credible threat of enforcement does not exist when prosecution depends upon "a 'highly attenuated chain of possibilities,'" including the prosecutor's own

[7] Plaintiffs concede that the material distinction amongst the offerings is not derived from the NFTs themselves which, for Mann, will merely be a remix of an NFT he previously sold. *See* Opp. at 20. The true distinction arises from the representations Mann will make to purchasers during the offering, which are currently unknown.

discretion). Under Plaintiffs' theory of standing there is no limit to when a curious entrepreneur seeking legal advice could, rather than consult counsel, file a declaratory action to determine whether their planned conduct would violate the securities laws.

III. Plaintiffs' claim is not ripe.

Plaintiffs' claim is also not justiciable because it is not ripe. *See* Mem. at 21-25. To "be ripe," a case must not depend on "contingent future events that may not occur as anticipated, or indeed may not occur at all." *Trump v. New York*, 592 U.S. 125, 131 (2020) (cleaned up). Plaintiffs' attempt to paint the issues before the Court as purely legal ones highlights their fundamental misunderstanding of *Howey* and, ironically, NFTs. Plaintiffs claim that no additional facts are necessary for the Court to decide "whether the SEC has the authority to regulate NFT art sales." Opp. at 24. But all NFT art sales are not at issue here and the application of *Howey* is, by its terms, fact-specific. The application of *Howey* turns on the specific statements, promises, or representations that Plaintiffs will make and the full economic reality of the transactions. *See, e.g.*, *Dapper Labs*, 657 F. Supp. 3d at 432-33, 450 ("Not all NFTs offered or sold by any company will constitute a security, and each scheme must be assessed on a case-by-case basis."). Any determination by this Court would be limited to the particular facts of Plaintiffs' Prospective Offerings, and those facts are not known at this time. Plaintiffs have not pled what they will say in the future to prospective purchasers, and Plaintiffs did not attach to the Complaint any prospectuses, offering memoranda, marketing materials, or public statements they would use with prospective purchasers. Plaintiffs' future representations are merely conjectural.

Moreover, it is undisputed that the SEC has taken "no action" with respect to their past or future offerings. As a result, there is no SEC decision-making, much less final decision-making, and how the SEC would apply *Howey* to the Prospective Offerings is an open question. *See Pakdel v. City & Cnty. of San Francisco, CA*, 594 U.S. 474, 478-79 (2021) (finality requirement for ripeness in takings case ensures that plaintiff has actually been injured by government action and "is not prematurely suing over a hypothetical harm"). Only once the SEC has committed to a position can the dispute be ripe for judicial resolution. *Id.* at 479.[8]

Lastly, Plaintiffs' claims of economic harm from withholding a decision (Opp. at 24) are overblown and untethered from the real world. Plaintiffs cannot manufacture standing or ripeness by inflicting harm on themselves by refraining from selling their art. Plaintiffs claim that artists have been selling art for the last 75 years without running afoul of *Howey* and the securities laws. The digitization of art does not impede artists from continuing to sell art in a manner outside the scope of *Howey* and the federal securities laws.

CONCLUSION

For the foregoing reasons, and the reasons in the SEC's Memo, the SEC respectfully requests that the Court grant the SEC's motion to dismiss.[9]

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[8] Elsewhere, Plaintiffs try to import significance to the fact that the SEC's Memo "does not dispute that Plaintiffs' NFT projects (when released) would run afoul of the SEC's interpretation of the federal securities laws." Opp. at 17. The lack of any position is significant only in that it shows that Plaintiffs' claims are not ripe. Plaintiffs' initiation of a declaratory action does not require an agency to engage in hypothetical analyses. As set forth by Congress, the five-member Commission would need to vote on whether to bring an enforcement action after evaluating the facts and applicable law. *See* 15 U.S.C. §§ 78d(a), 78d-1, 78u(d). The Commission does not vote on future hypothetical conduct. *Cf. Trump*, 592 U.S. at 134 ("Letting the Executive Branch's decisionmaking process run its course not only brings more manageable proportions to the scope of the parties' dispute, but also ensures that we act as judges, and do not engage in policymaking properly left to elected representatives.") (cleaned up). And even after such vote, a collateral attack by a defendant would likely fail to satisfy the twofold inquiry for ripeness.

[9] Notably, Plaintiffs have not requested leave to amend their Complaint. This Court should not give them such an opportunity because amendment would be futile.

Dated: January 8, 2025

Respectfully submitted,

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