

NFTs: How Nonfungible Tokens Fit into Preexisting Regulatory Policies Globally Analysis of the Legal Implications

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Nonfungible tokens (NFTs) represent the latest and perhaps most controversial form of cryptocurrency. Due to their unique nature and ability to implicate multiple legal rights, it is unclear how NFTs should or can be regulated. The lack of regulatory guidance globally has caused some investors to avoid them at all costs and issuers, advisers, and purchasers of NFTS at risk of litigation. But creating a new regulatory framework for this new form of crypto could take years. As such, countries should mold NFTs into existing cryptocurrency framework.

I. Introduction

The latest form of cryptocurrency, nonfungible tokens (NFTs), have taken the world by storm and left issuers, advisers, and purchasers of NFTs uncertain and at risk of litigation with no current regulatory framework to follow. Governments are slow to regulate cryptocurrency, in general, but NFTs come with a whole new set of complications.² Fungible tokens implicate all different kinds of legal rights and liabilities like security, currency, and utility, making them difficult to regulate.³ But NFTs go even further because they can implicate multiple rights at once such as both security

are noninterchangeable or replaceable with one another.¹⁰ They are comprised of distinct and separate units, known as tokens, with a software code attaching them to underlying assets.¹¹ Tokens affect an NFTs valuation through things like differences in appearance, scarcity, and utility among other things.¹² For example, a pair of shoes worn by an Olympic athlete when they won a gold medal has more value than the same pair of shoes worn by a random person, despite the shoe being the same model.¹³

2. *How NFTs are being used in today's digital world.*

Because of their uniqueness, NFTs have helped solve the issue of original ownership in digital markets.²⁷ In the context of digital content, many creators and consumers struggled with how to trade original content before the rise of NFTs.²⁸ Because an indefinite number of identical copies of a piece of content like a photograph can exist, original and exclusive ownership was difficult to regulate.²⁹ Thus, clear ownership rights are critical for content creators and consumers for effective and secured trade.³⁰

Three attributes make NFTs effective in solving the problem of original content ownership in the digital world.³¹ First, as previously explained, NFTs are unique and thus, noninterchangeable.³²

³³ Second, NFTs are immutable, meaning they cannot be altered or forged because each one is recorded on the blockchain.³⁴ This recording process is called minting.³⁵ When a person mints an NFT it creates a unique data file of the digital version of the work using blockchain.³⁶ After this process,

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thus ensuring each NFT is authentic, making it valuable for both the seller and buyer.³⁸ Finally, NFTs are transparent because they are recorded on the blockchain and can be verified, and specify the ownership properties so that both buyer and seller are aware of what is being traded.³⁹ NFTs

the authenticity of one-of-a-kind pieces and catch counterfeit goods using NFTs.⁴⁵ The events and ticketing industry is also capitalizing on NFTs inherent certificate of authenticity to address ticket fraud.⁴⁶ Further, some companies are releasing NFT packages which include brand licenses.⁴⁷ For example, musicians can use NFTs to license their trademarks by releasing exclusive digital content for fans to purchase.⁴⁸

B. What are the rights associated with NFTs?

While the rights attaching to NFTs are still unclear, commentators have analyzed NFTs under property, copyright, and trademark laws.

2. *How NFTs fit into property law*

The property rights underlying the assets of NFTs can be misleading. Although NFT promoters advertise that the token can be used to ownership of the token conveys ownership of the underlying asset, no such law exists currently to give an NFT owner that right.⁴⁹ whether tangible or intangible ⁵⁰ NFTs do not embody property rights in a reference thing, like for instance, a deed does.⁵¹ Because a deed has a legal connection to the land it describes, ownership of the deed conveys ownership of the land.⁵² There is no current law Beca

⁶⁰ Thus, the artist keeps the copyright even if the original art or a copy is sold through NFTs, unless the copyright is granted in the smart contract.⁶¹ Practically speaking, even though the buyer now owns the NFT, they do not have the right to sell copies of the artwork or digital asset associated with the NFT or to display images of the artwork on merchandise for example.⁶² Thus NFTs rarely transfer intellectual property ownership rights.⁶³ But it is common for NFT sellers to license intellectual property rights to buyers for specific limited purposes.⁶⁴

3. *How NFTs fit into trademark law*

legal risks by infringing on minted NFTs. Trademarks are another form of intellectual property rights which protect words, phrases, symbols, or designs that identify goods and services.⁶⁵ With the growth of NFTs, so have lawsuits as brands grapple with unsteady laws. NFTs that are linked to expressive content like images, videos, and words, can unintentionally infringe on an existing trademark by incorporating the trademark into the underlying asset linked to the NFT leading to lawsuits.⁶⁶

For example, in an ongoing lawsuit, [NIKE, INC. v. StockX LLC](#), Nike sued StockX, a company which operates an online resale platform for various brands, claiming it infringed on its trademark

⁷² Both parties filed cross-motions for summary judgment, but the Judge denied both, making several key findings of fact, including that jurors

or, rather, from an

⁷³ On February 8, 2023,

consumer products, which are bound by trademark laws, than art protected by the First
⁷⁴ The jury awarded Hermes \$133,000 in total damages for trademark infringement and cybersquatting, cybersquatting.⁷⁵

Yuga Labs, Inc. v.

*Ripps.*⁷⁶

Bored Ape Yacht Club (BAYC).⁷⁷ Only 10,000 of those NFTs exist, which upped the value of the BAYC NFTs, causing them to resell for millions of dollars.⁷⁸ The defendant, Ripps, created their own NFT collection called Ryder Ripps Bored Ape Yacht Club (RR/BAYC) and copied every

but used a unique entry on the Ethereum blockchain.⁷⁹ Ripp argues that even though he has copied the trademarks and trade dress of the BAYC digital art, since he listed them in a new NFT listing

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III. How NFTs Can and Do Fit into the Current Regulatory Framework

A. Countries that have regulatory frameworks conducive to NFTs

1. European Union Regulatory Framework

NFTs are not regulated under current EU regime, but could fall under a number of existing regulations.⁹⁶ For example, the European Commission published the Markets in Crypto-assets Regulation (MiCA) on September 24, 2020.⁹⁷ The European Parliament is expected to vote on the bill in early 2023, then after formal approval by the Council of the EU, MiCA will be published in

- Lead to a lack of crypto-

security.¹²⁹ Further, fractionalized NFTs can be regarded as securities where NFT platforms are facilitating the sale and secondary trade of assets, and will need to register with the SEC.¹³⁰

Second, although The Financial Crimes Enforcement Network (FinCEN) has yet to issue guidance on NFTs, they could implicate anti-money laundering laws.¹³¹ FinCEN regulates money services business models involving digital currency.

Additionally, U.S. federal sanctions laws may be implicated as NFT transactions occur across multiple jurisdictions between U.S. and non-U.S. persons, which could implicate compliance with the U.S. Office of Foreign Assets Control (OFAC) regulations.¹⁴⁸ Although OFAC has not yet issued any NFT guidelines, they have noted that the sanctions apply to digital transactions.¹⁴⁹ Moreover, the OFAC has enforced sanctions regarding blockchain-based transactions, which could mean they are likely to enforce sanctions on NFT transactions.¹⁵⁰ Going further, the OFAC could do more than just impose sanctions, but also initiate an action if persons penalized by them

and thus, a financial instrument under the German Banking Act.¹⁶¹ But another interpretation reads Act.¹⁶² If an NFT is considered a financial instrument, it would likely be subject to a licensing requirement.¹⁶³

Moreover, the law in Germany pertaining to NFTs, and the rights and obligations that apply,

¹⁶⁴ Notably, German property law only applies to tangible objects, so the digital works underlying an NFT will not fall under the scope of property law in Germany.¹⁶⁵ But NFTs could fall under rights of use, -licensed and

¹⁶⁶ These can be supplemented by additional types of use and it is expected that the NFT

laundering and terrorist financing, known as the AML/CFT Law, provides definitions that could implicate NFTs: virtual assets and virtual currencies.¹⁷⁷

representation of value that can be digitally traded, or transferred, and can be used for payment or

¹⁷⁸ This broad definition could encompass NFTs and leave it open to obligations under different aspects of Luxembourg law.¹⁷⁹

For example, under Luxembourg law, a person who provides specific services listed by law that are related to virtual assets, thus possibly implicating NFTs, on behalf of clients, must comply with regulations such as applying for a Virtual Asset Service Provider authorization before the

A digital representation of value, which has not been issued or backed by a central bank or a public authority and which is not necessarily pegged to a legal tender, but which is used as a means of exchange for the purpose of goods or services or for investment purposes, and may be transferred, stored or negotiated electronically.²⁰⁶

including the definition was to capture the wider possible range of digital assets to prevent them from being used for money-laundering and to facilitate te²⁰⁷

7. *Singapore's Regulatory Framework*

Singapore has taken a slightly different regulatory approach.²⁰⁸

announced that it would not regulate NFTs because it is an emerging market and it

beyond a²⁰⁹ Thus, the approach is to look
²¹⁰ If the characteristics fall within an existing regulatory framework, the NFT will be subject to regulation under that existing framework.²¹¹ Under this approach, there are generally three types of digital tokens: security tokens, payment tokens, and utility tokens.²¹² For example, if an NFT had the characteristics of a capital markets product under the Securities and Futures Act, it would be subject to those regulatory requirements.²¹³ Furthermore, if an NFT had the characteristics of a digital payment token under the Payment Services Act, restrictions and obligations on the seller of that NFT would be imposed.²¹⁴

NFTs as capital markets products subjecting it to regulations under the Securities and Futures Act of 2001, it is unclear what characteristics an NFT would have to have to qualify as a capital markets product.²¹⁹

A. Countries that actively regulate NFTs

1. People's Republic of China (PRC) Regulatory Framework

Alternatively, cryptocurrencies and cryptoassets are strictly regulated in the PRC even in the absence of a regulatory framework.²³⁴ The Circular on Preventing Risks related to Initial Coin

6. Not to invest in NFTs directly or indirectly, and not to provide financing support for NFTs investments.²⁴⁴

above, the PRC will likely come out with heavy regulation on NFTs.²⁴⁵

V.

The United Arab Emirates is one of the leading countries in regulatory efforts with regard to crypto currencies.²⁴⁶ The ESCA, or Securities and Commodities Authority in the UAE, issued a regulatory decision in 2020 concerning the Crypto Assets Activities Regulation, noting that the

ts in the state
²⁴⁷ While it was unclear under this decision whether NFTs were included, other regulations in the UAE seem to make clear that NFTs are meant to be included in the definition of cryptocurrency, which the UAE is attempting to regulate.²⁴⁸

For example, on March 9, 2022, Dubai established a new regulator for cryptocurrency called the Virtual Asset Regulatory Authority, or VARA.²⁴⁹ includes NFTs.²⁵⁰ Additionally, the UAE government issued a cabinet resolution regulating Virtual Assets and Service Providers on December 12, 2022, which went into effect February 14, 2023.²⁵¹ The law requires people or entities engaged in virtual asset-related activities to obtain approval and license from the Financial Regulator.²⁵²

by the law.²⁵³

regulations.²⁵⁴

²⁵⁵ The paper further discusses that NFTs may trigger anti-money laundering regulations and sanctions, and depending on the nature of the underlying asset, could be subject to Crypto Asset Regulations.²⁵⁶

VI. Recommendations & Conclusion

they are unique and thus, different than other types of cryptocurrencies.²⁵⁷ Further, a regulatory body has trouble distinguishing between the different types of cryptocurrencies.²⁵⁸ With a rapidly growing NFT market, it could take years before countries caught up and made specific legislation in regard to NFTs.²⁵⁹ Although not a perfect fit, if regulators clarify the definitions of NFTs and include them in pre-existing regulations, it will make it easier for issuers, advisers, purchasers, and regulators to make sure they are following the law and avoid litigation.

Scholars argue governments could assume a wait-and-see approach to regulation.²⁶⁰ Some argue that NFTs are just a fad that will die down in the next few years and affect less and less investors.²⁶¹ For example, one expert noted:

Governments could just assume a wait-and-see approach to regulation. If NFTs are here in a couple of years and are affecting a significant portion of retail investors,

to put out statements offering guidance on how NFTs will be construed and fall under existing regulations.