

Alerts & Publications



Non-Fungible Tokens (NFTs): When Collecting Meets Crypto, Legal Challenges Abound

March 25, 2021

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[Non-Fungible Tokens](#), or NFTs, are big news these days. After an NFT for a piece of digital art by the artist Beeple (Mike Winkelmann) sold for \$69 million in March 2021—making it [the third-most expensive artwork by a living artist](#)—businesses and their lawyers have been scrambling to understand the legal issues surrounding NFTs, not to mention the meaning and value proposition of this novel class of digital assets for online marketplaces and digital content developers.

An NFT is a unique digital asset. For example, NFTs can be associated with a blog post, a sports highlight, or in the case of Beeple's "Everydays: The First 5000 Days," a digital collage of images. Unlike cryptocurrencies, where one Bitcoin has the same value as another (*i.e.*, they *are* fungible), each NFT is unique. In a way, the only value of an NFT is the fact of owning it, though it can also be related to a real-world asset, like a parcel of land. In its simplest form, you might think of this as similar to what happens if you donate money to your school to build an athletic stadium, and they add your name to a plaque of donors. You don't own the stadium, or the plaque. You only own a place on the list.

Coming years will undoubtedly raise a sea of legal issues about NFTs, just as for cryptocurrency during the late 2010s.

[Artists, Vendors, and Online Marketplaces Must Clearly Describe to Purchasers the Rights Associated with an NFT to Avoid Transaction Disputes](#)

Copyright

Owning an NFT and owning the right to exploit a copy of a digital work—which is mainly covered by copyright—are distinct. Digital works can be infinitely reproduced with no diminution of quality, and therefore are not scarce by definition. Artists and media companies create scarcity for digital assets via technical means (like DRM for digital music) and via copyright law (which controls the right to make copies).

Because NFTs are so new, IP rights associated with a sale may be unclear unless carefully set by contract. There has long been a presumption in copyright law that fine art is always tangible, and NFTs challenge that presumption. The sale of physical artworks historically has not come with any intellectual property rights, though, by implication, a buyer probably has a right

of public display of the physical copy purchased. Older artworks, of course, no longer enjoy copyright protection. Museums have long relied on these principles for accessioning. But buyers of digital art will probably also expect some right to display or use the artwork, and the law to support this expectation has not yet been settled. Any artist, online marketplace, or other vendor selling or reselling rights to NFTs should clarify those rights in a written agreement or terms of service. Otherwise, buyers may misunderstand the rights that an NFT confers and dispute the transaction as a result.

Moral Rights

In the US, moral rights are limited to visual “fine art” under the [Visual Artist Rights Act](#). Particularly in the EU, moral rights (droit moral) are much broader. VARA enacted the moral rights required in the Berne Convention on copyright, but the US interpretation of this requirement was much narrower than in Europe. Rights under VARA include rights of attribution (right to claim authorship) and integrity (right to prevent mutilation or destruction, or to disclaim authorship as a result). California also has a parallel law, the California Art Preservation Act (California Civil Code §987). Droit moral in the EU also confers other kinds of moral rights. Moral rights in the UK may be unclear currently due to Brexit.

Because purely digital works are relatively new to the fine art world, the extent to which moral rights applies to them is also unclear. For example, VARA only protects works of “recognized stature” and NFTs have not yet been tested against this standard. An artist might, for example, insist on the ability to claim or disclaim authorship, or prevent destruction of the work—and with an NFT it is unclear what that might mean. Under the VARA, moral rights for works created today have the same duration as copyright, which is quite long (author’s life + 70 years). This duration will likely long survive current assumptions about technology used to deploy NFTs.

Trademarks and Publicity Rights

While the main coverage of digital works will be copyright, issues of trademark or publicity rights—which are similar for individual fine artists—also may arise. These will interact with VARA rights of attribution and integrity. How these legal regimes will interact is not clear, but an artist seeking redress will likely claim the protection of all of them.

[Artists, Vendors, and Online Marketplaces Must Understand that Financial Regulations May Apply and Exceptions to Regulation are Limited and Fact Specific](#)

Securities Regulation

Some commentators have begun to draw parallels between NFTs and initial coin offerings (ICOs). The Securities and Exchange Commission has been scrutinizing ICOs and token offerings for years now. Depending on the specific characteristics of the NFT and offers and sales, certain NFTs could also be classified as securities, triggering regulatory and filing requirements and potential liabilities. Like most other digital assets, the primary test relevant to whether an NFT would be a security is the [Howey Test](#), under which a transaction is deemed an investment contract if “a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.” *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). The non-fungible nature of many NFTs and association with assets not commonly understood to be securities like art or digital collectibles often may clearly distinguish NFTs from securities, but depending on the specific design of the NFT and associated bundle of rights, as well as how it sold and promoted and other factors, there is the potential for it to be deemed a security.

Anti-Money Laundering and Sanctions

Any transaction conducted by cryptocurrency or token exchange raises potential compliance issues under AML regulations such as the Bank Secrecy Act (BSA) and sanctions administered by the Office of Foreign Asset Control (OFAC). While OFAC sanctions will undoubtedly apply to NFT transfers, the application of AML regulations will be fact-specific and primarily impact vendors, payment processors, and online marketplaces.

Since 2013, FinCEN has considered persons that administered, exchanged, or transferred cryptocurrencies to be money transmitters required to comply with the BSA. FinCEN limited the application of money transmission to “convertible virtual currency” that FinCEN determined has an equivalent value in real currency and functions similar to real currency. Being unique digital tokens, NFTs would fall outside of the definition of “convertible virtual currency.” However, vendors, payment processors, and online marketplaces that facilitate sales of NFTs by accepting currency or convertible virtual currency from a buyer and transferring it to a seller may fall within the purview of the BSA. Regulatory exceptions exist for businesses that facilitate transfers that are necessary and integral to separate products or services. Businesses trading in NFTs may need to conduct compliance analyses to determine whether they meet this “integral exception.” Additionally, to the extent an NFT aims to include a smart contract that may facilitate or execute a payment, further analysis of compliance requirements will be required. NFT transactions that do constitute regulated activity under the BSA will have significant AML program requirements and expectations.

Finally, the Anti-Money Laundering Act of 2020 amended the definition of “financial institutions” to include transactions in the antiquities market and required FinCEN and the FBI to study the need to consider dealers in art as financial institutions. Further regulation to apply BSA requirements to the art market seems inevitable.

Artists, Vendors, and Online Marketplaces Must Understand the Underlying Technology Issues to Mitigate the Risk of Theft or Loss

Cybersecurity

It's easy to conflate NFTs and the technology that authenticates them—which is a blockchain. Most NFTs today are created on the Ethereum blockchain, which is widely considered both reliable and broadly accessible enough to create a robust market for the assets.

All digital assets today can be vulnerable to cyberattacks. Blockchain authentication is designed to keep NFT rights secure and unambiguous. Cyberattacks on blockchain are difficult, but can include 51% attacks. Most companies today purchase cybersecurity insurance, if only to address day-to-day ransomware events. Any company trading in NFTs should review its insurance policies to be sure they will also cover NFT hacking. There is [currently no equivalent for NFTs to the registry of stolen artworks](#) maintained by the US Federal Bureau of Investigations, Interpol, and the Art Loss Register.

Technology Lifespan

The technology and IP underlying the authentication of NFTs is still developing, but at this point, NFTs are all implemented on blockchains. While blockchains like Ethereum are currently very robust, new technologies are likely to eclipse them in the timespan covered by the relevant IP rights. For example, current blockchain technologies have been [criticized for their effect on climate change](#)—due to the computing power necessary for zero-knowledge proof verification—and new and preferable technologies may be developed.

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