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# **Non-Fungible Tokens**

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**An Introduction to NFTs, NFT Marketplaces and Related Issues**

March 1, 2022

- Introduction to NFTs
  - Technology
  - Creation and Storage
  - Outlook
- NFT Marketplaces
- Risks and Downsides
- Legal Landscape

# INTRODUCTION TO NFTs

# What are NFTs and how do they work (1)

- NFT: a non-fungible token - a digital unit of data stored on a blockchain – a distributed public ledger that records transactions
- Typically stored on Ethereum, but on other blockchains as well
- In existence since 2014, but becoming increasingly popular
- Cryptographically unique – non-fungible because one NFT is not interchangeable with another NFT - its metadata cannot be duplicated or replicated
- One Bitcoin is equal to another Bitcoin but each NFT is different – “digital scarcity”



# What are NFTs and how do they work (2)

- Can be a representation of something tangible or intangible:
  - an artwork
  - photographs
  - digital images
  - videos
  - music
  - game items
  - digital collectibles
  - tweets
- or can be an original creation that exists only in digital form



# What are NFTs and how do they work (3)

- An NFT's metadata contains information about ownership and any other terms applying to its use. Once created, all subsequent sales of the NFT are tracked and recorded on the blockchain
- Cannot be divided up into smaller units, unlike cryptocurrency tokens
- Marketed through online NFT marketplaces such as OpenSea, Rarible, Nifty Gateway, Foundation, Coinbase



# What are NFTs and how do they work (4)

- NFTs are usually bought and sold using the cryptocurrency used on its blockchain
- But can be bought with credit cards on some platforms
- Sold at auction – both online auctions but also traditional auction houses:
- Sotheby's raised \$17 million in an auction of digital art by Pak
- Christie's raised \$50 million selling "EVERYDAYS: The First 5000 Days" by Mike Winkelmann (the artist known as 'Beeple')





- Participants must set up a crypto wallet to store their NFTs (and any cryptocurrency they hold)
- If buying through a marketplace, NFTs can be stored in a wallet attached to the marketplace
- Can subsequently be transferred to a separate hot or cold wallet:
  - Hot wallets: stored online and run on internet-connected devices, such as tablets, computers or phones. Convenient, but higher risk of theft.
  - Cold wallets: an external device, like a USB drive or a hard drive, not connected to the internet. However, if you lose the keycode, the NFT may be lost forever.

# What does the buyer actually get?

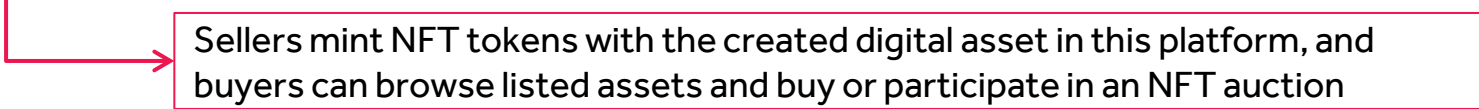
- A digital unit with built in authentication, which serves as proof of (exclusive) ownership, with some specific permitted uses of the underlying digital item, e.g.:
  - View or display for non-commercial purposes
  - Make copies for non-commercial purposes
- But not necessarily ownership of the digital item itself – creators can retain ownership of the underlying content and create additional copies
- NFT's metadata contains information on ownership, transferability, links to assets, licence fees and royalties – smart contracts

# Market view on medium/long-term outlook for NFTs

- A passing fad or a long-term alternative investment?
- Currently the hottest digital assets on the blockchain:
  - \$10 billion sales in 2021
  - 800% growth in the NFT art market in 2021
  - The Merge (also created by Pak) was sold for \$91.8 million by Nifty Gateway in December 2021
- Allows artists to monetize their work direct to the public - so likely to endure
- Value depends on whatever buyers are prepared to pay, but with some correlation with financial markets/fashion trends
- Limited or no regulation in most jurisdictions - risk of scamming

# NFT MARKETPLACES

## Path to digital assets, collectibles, and art investments

- 1 — NFT marketplace – platform that connects content creators with NFT buyers with NFT sellers  


Sellers mint NFT tokens with the created digital asset in this platform, and buyers can browse listed assets and buy or participate in an NFT auction
- 2 — There are primary and secondary sales of NFTs in the marketplace with differing transaction costs depending on how the marketplace operates and who facilitates the sale
- 3 — Dozens of NFT marketplaces are in existence
- 4 — Most NFT marketplaces use Ethereum (has high gas and carbon fees)
- 5 — There are NFT marketplaces opting for the cheaper gas fees and better carbon footprint offered by newer blockchains (e.g., Polygon, Flow, Tezos, Solana)

1. Most NFT marketplaces require to create a crypto wallet to mint and trade NFTs (MetaMask, Coinbase)

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2. NFT tokens are often sold in the form of an auction

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3. NFT tokens sales triggers commission payment (it can be payable at the time of the sale, or after purchase, or the author has to pay the commission)

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4. Verification processes for creators and NFT listings aren't consistent across platforms — some are more stringent than others

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5. OpenSea and Rarible do not require owner verification for NFT listings

# Selecting NFT marketplace

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What kind of digital asset do you want to buy, sell or create?

2

What tokens does the NFT marketplace support?

3

What kind of security the NFT marketplace has in force, and if it has had any issues in the past?

4

What are the commissions, gas fees and other transaction costs associated with validating transactions and processing payments?

## Documents for consideration

- 1. Code of conduct**

Most NFTs, given the predominance of user-generated content and transactions in NFT marketplaces, include an extra layer of legal restrictions in the form of codes of conduct to govern interactions on the platform

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- 2. Platform Terms of Service**

NFT marketplaces must have essential documents such as Terms of Service, which govern the relationship between the NFT marketplace operator and customers, and between the buyers and sellers of the NFTs featured on the platform

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- 3. Terms of Sale**

Sellers or creators listing their NFTs on an NFT marketplace may wish to impose additional terms of sale on purchasers of their NFT, especially if the platform's terms of service do not sufficiently address risks to the seller or creator)



## Typical Terms of Service

Accessing the service

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Ownership

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License to Access and Use Our Service and Content

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Third-Party Content and Services

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User conduct

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Intellectual property rights

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Communication preferences

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Apps terms

Indemnification

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Disclaimers

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Assumption of risk

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Limitation of liability

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Privacy policy

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Dispute resolution

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Governing law

# Selected NFT Marketplaces

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OpenSea.io

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Nifty Gateway

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Rarible

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Foundation

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TopShot

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SuperRare

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Binance NFT

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MakersPlace

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KnownOrigin

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Zora

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Mintable

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# Selected NFT Marketplaces



OpenSea.io

Amazon of NFT marketplaces

<https://opensea.io/>

one of the oldest, the  
broadest and most  
established NFT marketplace

NFT type:

Art, music, photography, collectibles, sports, virtual worlds, and more

Blockchain:

Ethereum, Polygon, Klatyn

easy-to-use, an account can be set for free, minting, selling and browsing can be started in minutes

boasts over 80 million NFTs

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offers a huge support by accepting over 150 different payment tokens, though Ethereum (ETH) remains the main one

# Selected NFT Marketplaces



## **RARIBLE** NFT Marketplace

The NFT marketplace for rare media and sports collections

Designed to sell both single pieces of art and collections

User-friendly interface, which is used to create NFT art

NFT type: Art, photography, games

Blockchain: Ethereum, Flow, Tezos  
is community-owned and promotes decentralisation

Own token: RARI token (required for carrying transactions)

Partnered with a number of leading brands that have launched their NFTs in this marketplace (e.g., Taco Bell and Cloud software giant Adobe, who teamed up with Rarible to protect the works of NFT artists and creators)

# Selected NFT Marketplaces

## Nifty Gateway



Most eye-catching big-money NFT sales

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NFT type: Digital art, verified and curated drops

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Blockchain: Ethereum

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Managed by the parent company and crypto exchange, Gemini

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Two of the most expensive NFTs were sold: Beeple's CROSSROAD and Pak's The Merge, which sold for US\$91.8 million in December 2021

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Mission is "to make NFTs accessible to everyone."

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NFTs are stored in the user's Nifty account instead of their digital wallet

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Partners with global names like artist Michael Kagan and is one platform that allows transactions in fiat currency USD

# Selected NFT Marketplaces



An artist-run NFT marketplace with rare and exclusive projects

NFT art: Fine art, digital art, photography, 3D artBlockchain: Ethereum

“platform that aims to build a new creative economy—a world where creators can use the Ethereum blockchain to value their work in entirely new ways and build stronger connections with their supporters.”

Allows creators to list their artworks and auction them to collectors who can bid on them in ETH

Enables the platform to enlist all kinds of NFTs that are supported by Ethereum

Exclusive and cost of entry—artists must also purchase “gas” to mint NFTs

Boast higher-caliber artwork

# Selected NFT Marketplaces



The NFT App for digital collectibles of NBA basketball achievements and viral highlights

NFT type: so called "Moments", i.e. digital packs of NBA photographs, videos, sets of statistics

Blockchain: Ethereum, Bitcoin, Bitcoin Cash, DAI, USDC

Every Moment falls into its own tier of scarcity: Common – with over 50,000 NFTs – to Fandom, Rare and Legendary, the most exclusive, with fewer than 99 NFTs

The most expensive NFT: The A LeBron James reverse windmill dunk was sold for \$210,000 in March 2021

NBA Top Shot generated over \$700 million in gross sales over 10 million transactions

Nearly four dozen NBA players have Top Shot accounts, including All-Stars like Rudy Gobert

## SOME RISKS AND DOWNSIDES

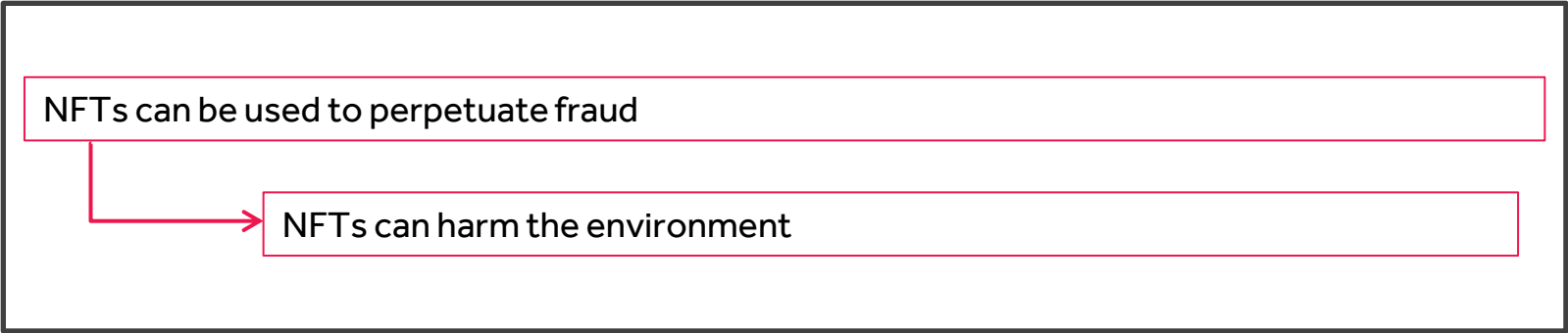


# NFT's Risks and Downsides (1)

- 1 — A new industry and is highly speculative
  - Some NFTs may rocket higher in value, but there's no guarantee
  
- 2 — Liquidity concern (how readily an asset can be exchanged for cash)
  
- 3 — NFTs do not offer their owners any income potential

# NFT's Risks and Downsides (2)

■ — 4 —



■ — 5 —

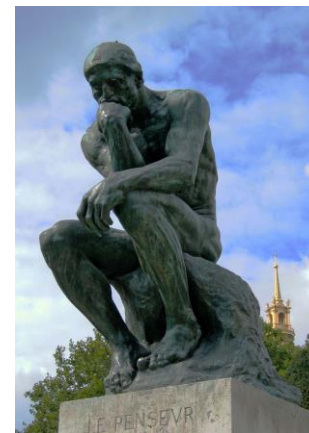
Cybersecurity Risks

# LEGAL LANDSCAPE

- Securities and Commodities Laws
- AML/Sanctions (Bank Secrecy Act)
- Consumer Protection Laws
- Intellectual Property
  - Copyright
  - Trademarks
  - Right of Publicity
  - Patents
  - Licensing Considerations



**CONSUMER RIGHTS**



- Current NFTs unlikely to be treated as securities (in the absence of legislative action)
  - But it is conceivable...e.g., fractionalized interest in a whole
- NFTs could potentially be viewed as commodities
  - Lack of current guidance from the CFTC
  - Regulatory oversight would nevertheless be limited in the context of typical minting and trading of NFTs

- NFTs probably not currently covered by many current AML regulations
- Revised FATF guidance on virtual currencies (published in 2021) recommends that member countries apply AML and similar rules with respect to NFTs that are used for payment purposes
- Local sanctions compliance requirements can still apply



- Purpose of consumer protection laws
  - Safeguard buyers of goods and services, and the public, against unfair practices
- Particularly relevant to NFT marketplaces
  - Does the consumer understand what is being purchased, and what fees and rights will accompany ownership of the NFT
  - Considerations:
    - » Accuracy and usefulness of a site's Terms of Use
    - » Adequate employee training

- Distinctions between Ownership of Physical Assets and NFTs
  - Owning an NFT is typically not the same as owning the underlying digital asset
  - Owner may have ownership of a unique representation of an asset, but often not the asset itself
    - » Examples:
      - Limited Edition Artwork
      - Celebrity Tweets





- Copyright

- Resides initially with the creator of an asset that is fixed in a tangible medium of expression

- Just some examples:

- » Artwork



- » Books



- » Movies



- » Music



- Includes rights to copy, distribute, perform, prepare derivative works, display

- NFT referencing a digital asset based on a copyrightable work does not automatically carry with it these rights

- Trademarks
  - A word, phrase, symbol, design or combination of the foregoing that identifies and is used in commerce in connection with particular goods (trademarks) or services (servicemarks)
  - In NFT context:
    - » Potential infringement if a trademark is used in creating a NFT, or marketing an NFT on the relevant marketplace
    - » Examples:
      - Sports team logos
      - Use of a celebrity's image, voice, etc.

- Right of Publicity
  - Concerned with the unauthorized use of a person's name, likeness or other aspects of one's persona for commercial use
  - In NFT context:
    - » Potential infringement where image or artwork includes a recognizable likeness of a person on an unauthorized basis
    - » Balance against “free speech” rights of the artist or creator, where applicable



- Patents
  - Grant of a property right to an inventor for a particular invention
  - Generally includes the right to exclude others from making, using, offering for sale, or selling the invention in a covered territory
  - In NFT context:
    - » Potentially relevant to NFT marketplaces (e.g., minting methods, storage methods, etc.)
    - » Possibility has also been proposed of using NFTs to represent patent ownership

- Licensing
  - Common approach: IP owners and NFT seller license certain IP rights to the purchaser of the NFT for specified purposes
    - » “Basket of Rights”
  - Can incorporate a royalty concept (e.g., X% of proceeds from subsequent sales are delivered to the NFT seller and/or the IP owner)
    - » Built into Smart Contract
  - Examples:
    - » NBA TopShots
    - » CryptoKitties





# Questions



Byungkwon (Ben) Lim  
blim@debevoise.com



Gary E. Murphy  
gemurphy@debevoise.com



Philip Orange  
porange@debevoise.com