NFTs Ownership and Lack of Regulations

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***Abstract*—Non-Fungible Tokens (NFTs) have recently emerged as a new way of buying and selling digital assets such as artwork, music, and even tweets. However, the lack of regulation surrounding NFTs has raised concerns about ownership and fraud. This research paper explores the issue of NFT ownership and the lack of regulations surrounding it. Specifically, the paper will examine how to protect your rights as a buyer or seller in NFT transactions, and the potential for fraudulent sales by creators, as well as disputes over ownership by buyers by exploring more on how NFT creators use technical and legal measures to exert control over their creations, even after those creations are sold to purchasers, and how the mechanisms for such control are a fundamental part of the smart contracts governing most NFTs. Consequently, purchasers often have less control over their NFTs and the related intellectual property (IP) than they may expect based on marketing claims and popular discourse. [1] and the potential for NFTs to become an integral part of the digital economy.**

I. Introduction

NFTs have gained widespread popularity recently due to their ability to tokenize digital assets, allowing creators to sell their unique pieces to collectors as one-of-a-kind items. The value of these tokens is derived from the underlying digital asset, which can be anything from a tweet to a piece of artwork. However, as the market for NFTs grows, concerns have emerged about the lack of regulations surrounding ownership and the potential for fraudulent sales.

We need clarification in the legal field as to what precisely an NFT is. One of the biggest misconceptions is that an NFT "lives" in its holder's wallet. Undefined After all, once a person purchases an NFT, it seems intuitive that this person's ownership of her newly acquired NFT should be reflected via digital custody "within" her digital wallet. The analogy feels right—a wallet in the physical world holds our valuables, so a wallet in the digital world should hold our NFTs.

II. Non-Fungible Tokens (NFTs)

NFTs, or non-fungible tokens, are digital assets representing ownership of a unique item or piece of content. NFTs have recently gained a lot of attention and popularity, particularly in the art and collectibles world, where they are being used to sell digital art, music, videos, and other forms of creative content.

One of the critical features of NFTs is that they provide a way for creators and artists to monetize their digital creations, which has traditionally been a complex and often impossible task. NFTs allow creators to sell digital items that are unique and scarce, just like physical artwork or collectibles. However, the need for regulations in the NFT market has led to some concerns around ownership and authenticity. Because NFTs are relatively new, there has yet to be an established legal framework or industry standards to regulate their creation and ownership. This means there is potential for fraud or disputes around who owns a particular NFT.

Another area for improvement is that the underlying digital content associated with an NFT can be easily duplicated or shared, which raises questions about the actual value of the NFT itself. In some cases, the creator of the original digital content may not even be aware that their work has been turned into an NFT and sold without their permission.

As the use of NFTs continues to grow and evolve, regulations will likely be implemented to address these issues and protect the rights of creators and consumers. In the meantime, buyers and sellers of NFTs need to exercise caution and due diligence to ensure they are not participating in fraudulent or unethical activities.

III. Protecting Your Rights as a Buyer or Seller

One of the main issues surrounding NFT ownership is the need for clear regulations governing the sale and transfer of ownership. While some marketplaces have established their terms and conditions, no overarching legal framework governs NFT transactions. As a result, buyers and sellers must protect their rights in any NFT transaction. [2]

A. As a Buyer

Buyers should research the creator and the marketplace before making a purchase. This includes verifying the authenticity of the creator, their work, and the marketplace's reputation. Additionally, buyers should carefully review the terms and conditions of any sale, including the transfer of ownership rights and any potential restrictions on using or displaying the NFT.

- Research the seller and the NFT - Before buying an NFT, research the seller and the item you are considering purchasing. Look for information about the seller's reputation and track record, and verify the authenticity and ownership of the NFT.
- Read the terms and conditions - Ensure you understand the terms and conditions of the NFT sale, including any

associated rights or ownership claims. If you are uncertain about any part of the agreement, seek legal advice before purchasing.
- Secure your NFT - Once you have purchased an NFT, protect your private keys to prevent unauthorized access.

B. As a Seller

Sellers should also take steps to protect their rights, such as clearly outlining the terms and conditions of the sale and ensuring that the buyer has the legal right to purchase and transfer ownership of the NFT. Additionally, sellers should consider using a reputable escrow service to ensure they receive payment before transferring ownership of the NFT.

- Clearly define the terms and conditions - To avoid disputes with buyers, clearly define the terms and conditions of the NFT sale, including the ownership rights and any associated licenses or usage restrictions.
- Verify ownership - Before selling an NFT, verify that you own the underlying digital content and have the right to sell it as an NFT.
- Protect your NFT - Protect your NFT by storing it in a secure digital wallet and limiting access to your private keys.
- Seek legal advice - If you are uncertain about any part of the NFT sale or have concerns about ownership, seek legal advice before proceeding with the sale.

IV. Potential for Fraudulent Sales

One of the main concerns surrounding NFT ownership is the potential for fraudulent sales by creators. Because NFTs are digital assets, it cannot be easy to verify the authenticity of the underlying work. Additionally, because there is no legal framework governing NFT transactions, creators may be able to sell fraudulent works without fear of legal consequences.

Unfortunately, as with any emerging market, there is a risk of fraud when buying or selling NFTs. Because NFTs are a new and rapidly evolving technology, only some established industry standards or regulations govern their creation, distribution, and ownership. This can make it easier for unscrupulous individuals to create fake or fraudulent NFTs and sell them to unsuspecting buyers.

A. Here are some ways that NFTs could be sold fraudulently

- Ownership disputes - Because a digital token represents ownership of an NFT, it is possible for multiple people to claim ownership of the same NFT. This can lead to disputes over who owns the NFT and who has the right to sell it.
- Fake NFTs – Scammers can create counterfeit NFTs and sell them to unsuspecting buyers. They can use existing digital artwork, music, or other creative content to develop fake NFTs that appear original and unique.
- Unauthorised sales - In some cases, someone may sell an NFT without the original creator's or copyright holder's permission. This can result in legal disputes over ownership and the right to sell the NFT.
- To protect yourself from fraudulent NFT sales, it is essential to do your due diligence before making a purchase. This includes researching the seller and the NFT, verifying ownership and authenticity, and reading the terms and conditions of the sale carefully. If you need clarification on any part of the transaction, seek legal advice before proceeding. Additionally, make sure to use a reputable platform or marketplace when buying or selling NFTs, and be cautious of deals that seem too good to be true.

V. Disputes Over Ownership

Another issue that can arise in NFT transactions is disputes over ownership. Because NFTs are unique and one-of-a-kind, there may be questions about who has the legal right to own and transfer the NFT. This can lead to legal disputes between buyers and sellers and between creators and buyers.

To avoid disputes over ownership, it is crucial for both buyers and sellers to clearly outline the terms and conditions of the sale, including any restrictions on the transfer of ownership rights. Additionally, buyers should verify that the creator has the legal right to sell the work, and sellers should ensure that they have the legal right to transfer ownership of the NFT.

One of the main challenges with NFTs is that they represent ownership of a digital asset, which can be easily duplicated or shared. This means that multiple people can claim ownership of the same digital asset, which can result in disputes over who has the right to sell an NFT.

A. To mitigate the risk of ownership disputes, it is essential to take specific steps when buying or selling NFTs. For example:

- Verify ownership - Before buying or selling an NFT, it is crucial to verify ownership of the underlying digital asset. This may involve checking with the original creator or copyright holder to ensure that they have permitted the sale of the NFT.
- Keep accurate records - Buyers and sellers should keep correct records of NFT transactions, including the date of sale, price, and associated terms and conditions. This can help to prevent misunderstandings or disputes over ownership.
- Use reputable platforms - When buying or selling NFTs, it is important to use reputable platforms or marketplaces that have established processes for verifying ownership and ensuring the authenticity of digital assets.
- Seek legal advice - If there is any question or dispute over ownership of an NFT, it may be necessary to seek legal advice to resolve the issue.

VI. NFT creators use technical and legal measures to exert control over their creations

NFT creators use a combination of technical and legal measures to exert control over their creations and protect their intellectual property rights. Here are some examples of these measures:

A. Technical measures

Smart contracts - NFT creators can use smart contracts to specify the terms and conditions of the NFT sale, including the ownership rights and any associated licenses or usage restrictions. Smart contracts are self-executing contracts with the terms of the agreement between buyer and seller being directly written into lines of code. This provides a level of automation and transparency in the sale process and can help to reduce the risk of ownership disputes.

Watermarking and encryption - Some NFT creators may use digital watermarking or encryption to embed unique identifiers or signatures in the NFT or the underlying digital asset. This can help to prevent the unauthorised use or distribution of digital assets and provide a way to track ownership and provenance.

B. Legal measures

Copyright registration - NFT creators can register their digital content with copyright offices in their respective jurisdictions to establish their works' ownership and copyright protection.

Licensing agreements - NFT creators can use licensing agreements to specify how their works can be used and distributed, including any associated royalties or usage fees.

Non-disclosure agreements - NFT creators can use non-disclosure agreements to prevent the unauthorised use or disclosure of their digital content and to protect their trade secrets.

VII. How the mechanisms for such control are a fundamental part of the smart contracts governing most NFTs

The mechanisms for control NFT creators use to protect their creations are often a fundamental part of the smart contracts governing most NFTs. Smart contracts are self-executing contracts with the terms of the agreement between buyer and seller being directly written into lines of code. Smart contracts are powered by blockchain technology, which provides a secure and transparent way to enforce the terms of the contract.

The smart contract is a key part of the NFT sale process and can include a range of mechanisms to help NFT creators exert control over their creations. These mechanisms may include

A. Ownership and transfer rights

The smart contract can specify who owns the NFT and how it can be transferred between owners. This can help to prevent unauthorized use or distribution of the NFT and ensure that the original creator maintains control over their creation.

B. Usage Restrictions

The smart contract can specify how the NFT can be used and distributed, including any associated royalties or usage fees. This can help to ensure that the NFT creator receives compensation for their work and can maintain control over how it is used.

C. Provenance tracking

The smart contract can include mechanisms to track the provenance of the NFT and the underlying digital asset. This can help to prevent fraud and ensure that the NFT has a transparent and verifiable history.

D. Automatic enforcement

Because smart contracts are self-executing, they can automatically enforce the terms of the agreement between buyer and seller. This can help to reduce the risk of disputes and ensure that the sale process is transparent and efficient.

VIII. Conversation with Daniel M. Barabander, Associate at Cravath.

A. What is the new trend in the NFT world?

The new trends in the NFT world are divided into two components. First is what we call the legal components, meaning what legal rights you are getting when you are purchasing an NFT(that's what the paper NFTs, Incentives and Control: Technical Mechanisms and Intellectual Property Rights is about) [2] it's kind of what legal rights are you actually getting to use, the asset associated with the NFT, that is the right legal question and in terms of where I think that is going, I actually think is interesting there has been an increased rise lately in some of the really popular NFT projects with something called The Creative Commons Zero (CC0) license.

Which effectually means that you are the person who created the art in the NFT. They basically said you could use it for whatever you want is basically unrestricted IP licensed. Those are getting more popular because people are starting to pay more and more attention to this discrepancy between owning the NFT and the IP rights being limited, so I think that he will be more of that kind of CCO zero license. In the context of non-fungible tokens (NFTs), a CC0 NFT license would mean that the creator of the NFT is waiving their copyright and related rights in the underlying work associated with the NFT. This would allow anyone to use, modify, or distribute the work, even for commercial purposes, without asking for permission or providing attribution.

I want to be clear, NFTs can be used for much more than art and profile pictures, etc. I think a lot more of what we talk about NFT in the future will not necessarily be IP rights but also, for example, imagine you have an NFT. It represents a house that you buy the legal right there presumably would default to, however, would you like, as property law, so I think much more in the future, as people get more comfortable with NFTs, we going to stop talking about the fact of NFTs, we don't talk about when you buy a house today, and you buy digitally we don't talk about how is represented digitally. We don't care. And we say on property law, and I think in the future there will be much more of this obsession with what is and NFT, which is very interesting, but we will be more focused on the underlying finger represents. If you buy an NFT for a physical house, we will be talking about real state law; we will not talk about IP law. It's crazy that it sounds like it goes there. Kind of a lot right now.

B. Can you talk about an actual case related to NFT regulations?

There are three cases, but this one is interesting to the previous point. In this case, it's called on StockX, Nike and StockX; [5] StockX is a popular online marketplace for buying and selling sneakers, streetwear, electronics, and other products. They are known for their rigorous authentication process, ensuring that products sold on their platform are genuine. And Nike, a global sportswear and footwear brand.

StockX is a sticker marketplace for fancy sneakers, and its uses NFTs. What happened was that in their NFTs, they show pictures of the Air Jordans sneaker because it's like you are literally buying a sneaker and here is the picture of what you are buying, and Nike suit them for trademark, and this is exactly what I'm talking about when I say, what I hope in the future move more in what is the underline thing like Nike is basically the argument is to listen - this is not a shoe this is that you're trying to sell a collectible an image using our branding while StockX said, what are you talking about? if I go and open the footlocker right now and I saw your shoe I don't have to go and worry about the trademark analysis on that due on the way trademark works. Stock X is a really good example of how not clear which law is to apply if we're going to use the trademark regular rights or if we're going to be applying the actual IP of the NFTs. This is an excellent example of the first question that's like legal rights, as I call it.

C. What is the second component in the new trend in the NFT world?

There is a second bucket which is the regulatory question. And by regulatory I mean like how is the government trying to enforce and protect people against whatever harms NFTs can be used to facilitate the one you can't have a conversation about without mentioning crypto and The Securities and Exchange Commission (SEC) [6] (The Securities and Exchange Commission (SEC) or the Commission is the national government regulatory agency charged with supervision over the corporate sector, the capital market participants, and the securities and investment instruments market, and the protection of the investing public.)

Right now, there is an entirely existential debate on whether NFTs and other crypto assets are securities, and the test specifically, this is what the Dapper Labs/ NBA Top Shots [7] lawsuit is about, so that's a lawsuit by people who purchase these tops shots NFTs. facial NFTs are video highlights from NBA basketball games, and this is a class action where these people are alleging they purchase these moments (that is the name of the NFT projects – Moments). They are alleging listen they purchased the security, and because this is security, they didn't receive adequate disclosure, etc. that you suppose to get under SEC regulation so that's the other huge elephant in the room are NFTs securities in what contacts are on, or are they, not security? and the Dapper Labs case is what really is trying to unpack that because it's not a security, thinks as security literally stocks and bounds. If it is not a security, they can't bring this class action under security law, so is a relational question that's being iron down right now.

It's just not clear, and as a lawyer, it's very, very complicated and frustrating sometimes because there are no clear lines ever when something is a security. We now all agree that when you buy a stock on the NY stock exchange as security, no one is confused about it, and that's what we were contemplating when the law was written in 1933-1934. The law wasn't thinking about NFTs. There is a real intersection between those two, there are really good arguments that they are, and they are not, and it's not really clear, and that's a big thing in this industry right now. And it is not only the SCE, it is all the regulator, is it anti-money laundering regulation, of all very confused right now.

IX. Conversation with David J. Kappos, Partner and Co-Chair of the IP Practice at Cravath.

A. How do you see the future of NFTs ownership and emerging regulations?

NFTs are very much in a wild west state right now, with lots of claims being made about them and statements being made about who owns what rights and how they work and what they can represent and what they can't represent. I think what's going to happen is, gradually, the public will become more knowledgeable and astute About how NFTs work. Double more transparency and more disclosure about what rights could be within an NFT because lots of rights are very few rights could be conveyed in the fact that you own an NFT doesn't necessarily mean that you're getting very much in the way right, but it made me that you're getting a lot of rights to be more transparency. There will be some regulatory activity, and you've seen statements here in the US by our SEC—another regulatory body about looking very seriously into NFTs. I do think NFTs are a super valuable way to render digital, if you will, render tradable and inconvertible really any asset, physical, personal, or digital, and provide a powerful new tool, but there's a lot of evolution still to come for them.

Conclusion

NFTs can revolutionize how we buy and sell digital assets. However, the lack of regulations surrounding NFT ownership has raised concerns about fraud and disputes over ownership. To protect your rights as a buyer or seller in NFT transactions, it is essential to take steps to verify the authenticity of the underlying work and the creator's reputation.

These ongoing transformations in NFT ownership models showcase the potential for NFTs to become an integral part of the digital economy. As the technology continues to mature and more use cases are discovered, we can expect further innovation and growth in the NFT space.

References

[1] David J. Kappos et al., Fuzzy Tokens: Thinking Carefully About Technical Classification Versus Legal Classification of crypto assets (paper forthcoming).

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[3] 1-1 conversation with Daniel M. Barabander at Cravath.

[4] 1-1 conversation with David J. Kappos, Partner and Co-Chair of the IP Practice at Cravath.

[5] Nike is suing StockX for allegedly selling counterfeit shoes. What happens next? by Mark Wilson.

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