

The Regulatory Response and the Current and Future Legal Status

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Abstract

The relative newness of non-fungible tokens combined with their complex nature has led to an unclear response from U.S. regulators. The incomplete regulatory scheme has left the market open to the various forms of bad actors common among financial asset classes. Within this article we evaluate the current regulatory status of the cryptocurrency markets and their applicability to NFT Markets. Regulators who are most active in the crypto space include the SEC, CFTC, CFP, and FTC. Because regulatory power is vested differently among the various regulators there exists an inability of any one regulator to adequately address the complex nature of NFTs. To address this inadequacy this article argues that the dispersed regulatory powers should all be granted to the SEC due to its express interest in regulating digital asset markets.

Keywords: non-fungible tokens, Crypto, Digital Assets, securities regulations, Securities and Exchange Commission.

A Introduction

The first non-fungible token (NFT), Quantum, was minted in 2014 with minimal public interest.¹ It was not until the lockdowns during the COVID-19 pandemic, which caused peoples' increased reliance on technology to stay connected, and the headline grabbing sale of Beeple's 'Everydays: The First 5000 Days' NFT for \$69.9 million in early 2021² that the prominence and price value of NFTs would

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1 For a summary of the history of NFTs and their rise to prominence, see Jolene Creighton, *NFT Timeline: The Beginnings and History of NFTs*, NFT NOW (15 December 2022), <https://nftnow.com/guides/nft-timeline-the-beginnings-and-history-of-nfts/#:~:text=As%20noted%2C%20the%20world's%20first,via%20Sotheby's%20for%20%241.47%20million.>

2 Mike Winkelmann, the artist behind the pseudonym 'Beeple', had collected thousands of images over 14 years into one work of digital art secured on a blockchain. The sale catapulted him into 'the top three most valuable living artists' according to Christie's, the auction house. Just a few months earlier, the most valuable art Winkelmann had ever sold were prints for around \$100. See www.theverge.com/2021/3/11/22325054/beeple-christies-nft-sale-cost-everydays-69-million.

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skyrocket.³ During the pandemic, the total market cap of all NFTs combined grew from \$85 million in December 2020 to \$20 billion in December 2021.⁴ Unfortunately, NFTs' relative newness, rapidly growing market value and the incomplete regulatory scheme has also left this increasingly profitable market open to bad financial actors.⁵ Despite the developing and ever-more restrictive regulatory response, NFTs have a promising future to be used as investment securities, in various types of contracts, repositories of health records and clinical data and as means of providing proof of ownership of real-world assets.

Because NFTs have a diverse array of possible uses, each with its own unique legal considerations, regulation by a single governmental agency may not be the best way to address all issues surrounding NFTs adequately.⁶ That being said, in the United States, granting the Securities and Exchange Commission (SEC) with powers currently dispersed among multiple regulatory agencies would create a one-stop-shop for a variety of market participants, including consumers, investors and businesses, who are seeking assistance with issues relating to NFTs. Accordingly, this article will explore what NFTs are, which agencies are or could regulate them and recommend a holistic regulatory approach consolidated under the jurisdiction of the SEC or a similarly well-endowed agency in the EU and other markets.

B What Is an NFT?

Before exploring the various legal implications surrounding NFTs, we must first define what an NFT or 'Non-Fungible Token' is. NFTs are unique digital assets that can be digital art, videos, music or digital representations – images – of physical assets such as real estate and artwork.⁷ When a new NFT is created, information is connected to the image or video file via a smart contract that assigns ownership and determines rules for transferability. The combined data is published to the blockchain through a process called 'minting'.⁸ Once an NFT is minted, it is assigned

3 See Isabelle Castro Margaroli, *Interest in NFT Market Grew Exponentially During Pandemic*, Fintech Nexus News (10 February 2022), <https://news.fintechnexus.com/interest-in-nft-market-grew-exponentially-during-pandemic/>.

4 Despite the surge in market cap during 2021, the NFT market cap has fallen to \$10 billion as of December 2022. See Zeynep Geylan, *Total NFT Market Cap Grows 11,664% in 2 Years*, Cryptoslate (29 December 2022), <https://cryptoslate.com/total-nft-market-cap-grows-11664-in-2-years/>.

5 Despite NFTs being a new type of asset class, the fraudulent activity surrounding them includes common illicit financial activity such as insider trading, rug pulling and money laundering. See Carolyn Philip, *NFTs: Fraud or the Future?*, Alloy (22 August 2022), www.alloy.com/blog/nfts-fraud.

6 For a better understanding of the current and possible uses of NFTs, see Jeff Wilser, *15 NFT Use Cases That Could Go Mainstream*, Coindesk (14 October 2021), www.coindesk.com/business/2021/10/14/15-nft-use-cases-that-could-go-mainstream/.

7 Currently, the majority of the NFT market is focused on digital assets though there is promising potential for their increased use in representing physical assets. For a thorough explanation of what NFTs are and how they can be used to represent various assets, see Rakesh Sharma, *Non-Fungible Token (NFT): What It Means and How It Works*, Investopedia (22 June 2022), www.investopedia.com/non-fungible-tokens-nft-5115211#toc-nfts-in-the-real-and-virtual-world.

8 *Id.*

a unique identifier making it a unique item, which provides proof of ownership and authenticity.⁹ Currently, the Ethereum blockchain is the most popular NFT blockchain, and the Ethereum cryptocurrency is the most widely used form of money to purchase NFTs.¹⁰

An NFT can be purchased using Ethereum and other cryptocurrencies on the various NFT marketplaces.¹¹ It is important to note that the purchase of an NFT cannot be presumed to grant all associated intellectual property to the token.¹² For specific intellectual property rights to be granted, they must be expressly granted and included in the information in the NFT's minting. In other words, the creator of the NFT may or may not grant certain rights to copy, publicly display and use the image or video file. Unless additional rights are specifically granted, the purchase merely grants the ability to display in limited contexts or resell the token.¹³ The ability to control future use options – in ways that cannot be changed by subsequent owners or users – is one of the most exciting features of NFTs. For example, the creator of an NFT could code into the smart contract a provision that she or he will receive a certain percentage from each subsequent sale. If the NFT is first sold for \$100, the artist/creator receives the entire sum, minus the fees charged by the marketplace where the sale is happening. This relatively modest reward does not have to be the end of the story for the artist/creator, however. If the smart contract is coded in such a way that it will automatically transfer 10% of any future sale to the original artist/creator, she or he will get another \$100 if and when the NFT is sold for \$1,000. Since the commission would be paid every time the NFT is sold, the more lively the market, the better for the creator. And should the NFT value go further up over time, just like the value of many traditional pieces of art has continued to go up over decades or even centuries, the original artist/creator, respectively her estate, will always be able to partake.

- 9 The unique digital signature for each NFT makes it unique and unable to be exchanged for or equal to another NFT. Unlike cryptocurrencies where any one Bitcoin is equal to another, NFTs are not equal to each other simply because both are NFTs. See Robyn Conti, *What Is an NFT? Non-Fungible Tokens Explained*, Forbes (8 April 2022), www.forbes.com/advisor/investing/cryptocurrency/nft-non-fungible-token/. In the realm of physical art like paintings, NFTs may be comparable to art prints that were signed and numbered by the artist. Each one is unique. While there may be copies or reproductions or similar prints, no two can have the same number and digital signature.
- 10 For an in-depth overview of popular blockchains that support NFTs, in addition to the Ethereum blockchain, see Langston Thomas, *NFT Blockchains Abound. Here's a Complete Guide to the Best in Web3*, NFT Now (19 October 2022), <https://nftnow.com/guides/complete-simple-guide-to-top-nft-blockchains/>.
- 11 The purchase of NFTs requires users to open a crypto exchange account and a crypto wallet. From there, users must purchase a cryptocurrency that is useable for purchasing NFTs and connect their crypto wallet to an NFT marketplace. For a step-by-step guide on the purchase of NFTs, see Kristin Cobos, *How to Buy NFTs*, Money (28 April 2022), <https://money.com/how-to-buy-nfts/>.
- 12 Intellectual property (IP) concerns continue to be an important element in the discussion of NFTs. For a brief overview of legal issues relating to IP surrounding NFTs, see Bobby Ghaja, Marcus Peterson & Alexander Galicki, *Purchasing NFTs? Watch Out for These IP Issues*, Bloomberg Law (23 May 2022), <https://news.bloomberglaw.com/ip-law/purchasing-nfts-watch-out-for-these-ip-issues>.
- 13 *Id.*

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C The Securities and Exchange Commission

In the United States, the SEC is charged with oversight of marketplaces where ‘securities’ are traded, in particular traditional stock exchanges, as well as anyone offering securities for sale to Americans. In the realm of cryptocurrencies and digital assets, the SEC has applied an approach originally launched in the 1940s. Ever since the famous *Howey* case, the SEC is considering any sales offer to be an offering of securities, if the buyer is investing money with the expectation that the value of the asset is going to increase ‘solely from the efforts of others’, that is, without additional work or contributions by the buyer/investor.¹⁴ As a consequence of this approach, the SEC has classified most cryptocurrencies to be securities and, therefore, most sales of cryptocurrencies to require prior filings with and scrutiny by the SEC. This approach is justified by the SEC with the need to protect investors, that is, buyers of crypto, against insufficiently transparent or straight-out fraudulent offerings.

While not all NFT projects will be considered a security, those that seek to extract value from investors run an increased risk of scrutiny from the SEC. To date, the SEC has not determined how to define NFTs as an asset class, though they have published documents that will be explored below, which discuss important factors to consider when creating an NFT project.¹⁵ Determining whether an NFT project is a security and the costs accompanying compliance with securities regulation could render an associated project unviable for the company involved. To address these concerns, this section aims to provide a framework for understanding which circumstances could lead an NFT to be classified as a security.

I The SEC’s Approach to Regulating NFTs

In a speech at Brooklyn Law School, SEC Commissioner Jaime Lizárraga pushed back on the assertion that the SEC has failed to provide guidance to the industry, indicating that the DAO Report, Framework for ‘Investment Contract’ Analysis of Digital Assets and multiple no-action letters were sufficient.¹⁶ Commissioner Lizárraga also conceded that not every digital token was necessarily a security offering but noted that he generally agreed with SEC Chair Gary Gensler that most digital assets offered in the market were securities.¹⁷ Accordingly, it is necessary to explore the tools the SEC uses to determine when an NFT should be classified as a security.

14 See *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). See also the analysis by Emmert in this issue.

15 See Press Release, SEC, *Framework for ‘Investment Contract’ Analysis of Digital Assets* (3 April 2019), www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets (hereinafter ‘Framework’).

16 ‘Some have suggested that the SEC has not provided guidance to the industry. The reality is that there’s an abundance of guidance, from the DAO Report, to the SEC FinHub Framework for ‘Investment Contract’ Analysis of Digital Assets, and multiple no-action letters issued by the staff of the Division of Corporation Finance.’ See Jaime Lizárraga, *Commissioner, U.S. Securities and Exchange Comm’n, Keynote Address at the Brooklyn Law School: Digital Assets: Putting Investors First* (16 November 2022), www.sec.gov/news/speech/lizarraga-brooklyn-law-school-20221116.

17 *Id.*

The SEC's efforts relating to the digital assets industry have led it to determine that most digital assets qualify as securities. The Securities Act of 1933 and the Securities Exchange Act of 1934 (together, the Acts) similarly define what constitutes a 'security', with the best example provided by Section (2)(a) of the Securities Act defining it as:

any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, *investment contract*, voting-trust certificate, certificate of deposit for a security, ... or, in general, any interest or instrument commonly known as a 'security'.¹⁸

The SEC's application of the term 'investment contract' as it relates to NFTs and their classification as securities will be further explored in Section II. However, the question as to whether an NFT is an investment contract is the threshold question the SEC asks when determining if it should be regulated as a security. The test formulated by the Supreme Court in *SEC v. W.J. Howey Co.* is used to determine what qualifies as an investment contract and is therefore subject to federal securities law.¹⁹

The requirements established in what is now commonly called the *Howey* test state that an investment contract, transaction or scheme involving (i) the investment of money, (ii) in a common enterprise, (iii) with the expectation of profits solely from the efforts of a promoter or third party. Additionally, in *Useton v. Commercial Motor Freight, Inc.*, the Tenth Circuit mentions that the investment of money required under the *Howey* test is not limited to money and can instead include goods, services, or some other exchange of value.²⁰ Furthermore, the decision in *Howey* highlighted that, under the *Howey* test, the form of a particular contract, scheme, or transaction is 'disregarded for substance and the emphasis [is] on the economic reality' and goes on to state that the term security is flexible in order to address the 'variable schemes devised by those who seek the use of the money of others on the premise of profits'.²¹ Accordingly, through the lens of the *Howey* test, the SEC has chosen to approach the regulation of the NFT market.

1 The DAO Report

On July 25, 2017, the SEC released a report on its investigation into the DAO, in which they claimed that crypto assets could be securities under the *Howey* test.²² Essentially, the DAO was an unincorporated virtual organization embodied in

18 Securities Act of 1933 § 2(a)(1) (emphasis added).

19 *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293 (1946).

20 *Useton v. Commercial Freight, Inc.* 940 F.2d 564, 574 (10th Cir. 1991).

21 *Howey*, 328 U.S. at 298-299.

22 Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, SEC, '34 Act Release No. 81207 (25 July 2017), www.sec.gov/litigation/investreport/34-81207.pdf [<https://perma.cc/F862-YS5V>] (hereinafter DAO Report).

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computer code and executed on a blockchain.²³ The DAO was created by Slock.it UG, a German corporation, which intended to create and hold assets via the sale of ‘DAO Tokens’ to investors, which would then be used to fund projects.²⁴ The raising of capital through the sale of the DAO Tokens prompted the SEC to investigate whether the sale amounted to an unregistered security offering.²⁵ However, prior to the release of the DAO Report, the DAO was exploited by a hacker leading the DAO Tokens to be delisted on most cryptocurrency exchanges, ultimately culminating in the organization returning money to investors.²⁶ However, while the SEC chose not to pursue an enforcement action, the defunct status of the DAO did not stop them from determining that the issuance of DAO Tokens to raise capital qualified as a security under the *Howey* test.²⁷

The SEC concluded that the DAO Tokens amounted to investment contracts under the *Howey* test for the following reasons. First, there was an investment of money because the exchange of Ethereum for DAO Tokens qualified as a contribution of value that can create an investment contract.²⁸ Additionally, investors were determined to have a reasonable expectation of profit because of the promotional materials distributed by Slock.it stated that the DAO was a for-profit entity, that DAO Token holders could vote on the projects embarked on by the DAO and DAO Token holders stood to share in the potential profits from the contract.²⁹ Lastly, the profits were determined to be derived from the managerial efforts of Slock.it and the DAO’s curators because investors expected them to use their expertise to monitor the DAO’s operation, safeguard funds and determine if proposed contracts or projects would be put to a vote.³⁰

II Investment Contract Analysis

The next significant development in the approach taken by the SEC to regulate crypto assets occurred through its publication of the Framework for ‘Investment

23 While the DAO Report focused on a specific nonregistered organization (the DAO), a ‘DAO’ usually stands for a decentralized autonomous organization, a new form or unincorporated company or association, which is structured to lack a governing body, instead opting to utilize a bottom-up management approach. In essence, buyers of the governing token become members of the DAO and co-decision-makers in the governance of the organization in proportion to their ownership share. For an in-depth explanation of what DAOs are and how they work, see Nathan Reiff & Erika Rasure, *Decentralized Autonomous Organization (DAO): Definition, Purpose, and Example*, Investopedia (23 September 2022), www.investopedia.com/tech/what-dao/.

24 Investors who purchased DAO Tokens expected to share in the earnings as a return for their investment. See *DAO Report*, *supra* note 22, at 1.

25 *Id.*, at 10.

26 For an analysis covering the beginning and end of the DAO, see Samuel Falkon, *The Story of the DAO – Its History and Consequences*, Medium (24 December 2017), <https://medium.com/swlh/the-story-of-the-dao-its-history-and-consequences-71e6a8a551ee>.

27 See *DAO Report*, *supra* note 22, at 11-12.

28 *Id.*, at 11.

29 *Id.*, at 11-12.

30 In addition to investors’ expectations that Slock.it and its curators would provide their expertise following the launch of the DAO, the voting rights help by investors were limited and did not provide them with meaningful control over the enterprise. As a result, in spite of some involvement of the investor, any profit expectations were still based on the efforts of others. See *Id.*, at 13-15.

Contract' Analysis of Digital Assets, which provides insight into when federal securities law applies to digital assets.³¹ In the Framework, the SEC describes how regulators will apply the *Howey* test to digital assets. While the Framework does not explicitly mention NFTs, the SEC beginning to probe NFT creators and exchanges to determine whether those assets qualify as unregistered securities indicates that they will likely utilize the Framework when making that determination.³²

The Framework provides a baseline understanding of how the SEC intends to apply the *Howey* test to crypto assets. The Framework begins its analysis by asserting that the first two prongs of the *Howey* test – the investment of money and common enterprise – are present in most crypto sales.³³ The reasonable expectation of profits based on the effort of others is the primary focus of the Framework's analysis.³⁴ In a contribution to the Westlaw Journal Computer and Internet, Jules Carter thoroughly explores how the considerations discussed in the Framework would apply in the context of NFTs.³⁵ Carter explains that the following should be considered when determining if NFT purchasers have a reasonable expectation of profit as defined in the Framework:

- Is the NFT *offered broadly to potential purchasers*, rather than being targeted solely to expected users of the goods or services that token holders may gain access to, or to those who have a need for the functionality of the network?
- Is the network on which the NFT is intended to function *operational at the time the NFT is offered for sale*?
- Does the NFT give holders *the right to share* in the income, profits, or capital gains of the underlying enterprise?
- Can the NFT be *traded on a secondary market or platform*?

31 See Framework, *supra* note 15.

32 For more details regarding the details of the SEC probe into NFT creators and the exchanges on which they trade, see Matt Robinson, *SEC Scrutinizes NFT Market Over Illegal Crypto Token Offerings*, Bloomberg Law (3 March 2022), www.bloomberglaw.com/product/blaw/bloomberglawnews/bloomberg-law-news/XA7L0SLC000000?bc=W1siU2VhcmNoICYgQnJvd3NlIiwiaHR0cHM6Ly93d3cuYmxbv21iZlZlJnbfGF3LmNvbS9wcm9kdWN0L2JsYXcv2VhcmNoL3Jlc3VsdHMvYTAxOTNiN2I1ZTUzOWI1NGJhODBINTViZTMzOTRiOTMiXV0--9b27b03d9a30ec18ab8ed1c1022124cbfb8d76c9&bna_news_filter=bloomberg-law-news&criteria_id=a0193b7b5e539b54ba80e55be3394b93&search32=Hhckm82bjqkX8Em7yGndKQ%3D%3DwY5BoJAb4WAp0F6cAB4UILKtrXhEQQMVTA2tnuZcLebYE7S8RM0h4rcZgmgBp_EwyBcx-Dtr5_dPXGzgf3mn_TEwkDpBXkPqKftPtRFZ7Rirshgl08sZYLVgifdPE15yr0gajpRzB9E8LFij_Yhh7bWJO9NVHG04l5k1Tyy9CnPGLlI_p9BRorXrneLxeRC5vM3tk7FZXE2iGT5c7lgZ56b4L2hpV6lmI_GrRh9OxH94rFC_8KjAWA3rK5uO95tOEQc65U-LFXWfc8M7C0Uew%3D%3D.

33 See Framework, *supra* note 15.

34 *Id.*

35 The author provides detailed analysis how the Framework can apply to NFT assets. See Jules Carter, Esq., *Everything You've Ever Wanted to Know About NFTs and Securities Regulation (and a Few Things You Didn't)*, Westlaw Journal Computer & Internet (1 September 2022), [www.westlaw.com/Document/Id4256d16257411ed9f24ec7b211d8087/View/FullText.html?transitionType=Default&contextData=\(sc.Default\)&VR=3.0&RS=cblt1.0](https://www.westlaw.com/Document/Id4256d16257411ed9f24ec7b211d8087/View/FullText.html?transitionType=Default&contextData=(sc.Default)&VR=3.0&RS=cblt1.0).

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- Is the NFT marketed by *emphasizing the future functionality* of the network or the digital asset, the potential profitability of the operations of the network, or the potential appreciation of the value of the digital asset?³⁶

Additionally, Carter lists the below factors to be considered under the Framework to determine if the generation of profits was based on the efforts of others (Active Participants):

- Is the NFT marketed by *emphasizing the expertise of the Active Participants*, or the Active Participants' *ability to grow the value of the network or digital asset*?
- Is an Active Participant *responsible for the development, enhancement, operation, or promotion* of the network?
- Are essential tasks or responsibilities necessary to achieve the intended purpose of the network *performed by an Active Participant*, or are they *performed by a decentralized network of users*?
- Is an Active Participant *primarily responsible for creating or supporting the market* for an NFT, performing functions such as creating or issuing of the NFTs, or regulating supply through activities like buybacks or "burning" tokens?
- Does an Active Participant *play a central role in decision-making* with respect to governance matters, such as transaction validation, network security, participant compensation, asset distributions, and secondary market liquidity?
- Can an Active Participant *benefit from its efforts by holding the same class of digital asset* as those offered for sale to the general public?³⁷

It is important to note that the SEC does not view any single element listed above to be determinative when evaluating whether a digital asset qualifies as a security.³⁸ Accordingly, in practice, the more of the above factors that can be answered yes, the more likely the SEC is to classify a digital asset as a security.³⁹

The SEC has been the most enthusiastic Federal agency attempting to regulate the emerging digital asset market. Chairman Gary Gensler described the SEC as the 'cop on the beat', stating an urgency to ensure that 'investor protections come standard in the crypto market'.⁴⁰ However, the SEC's ability to deliver prompt remedies to victims of fraud in digital asset markets faces problems similar to those of the Federal Trade Commission (FTC) discussed below. Under the current legal framework, the SEC cannot order a wrongdoer to disgorge any fraudulently obtained gains until it has brought a successful enforcement action.⁴¹ Accordingly, actors in digital asset markets would be better protected and informed if the SEC

36 *Id* (emphasis added).

37 *Id*. (emphasis added)

38 See Framework, *supra* note 15.

39 See *Re: TurnKey Jet, Inc.*, SEC, www.sec.gov/divisions/corpfin/cf-noaction/2019/turnkey-jet-040219-2a1.htm.

40 Gary Gensler, *The SEC Treats Crypto Like the Rest of the Capital Markets*, Wall Street Journal (22 August 2022), www.wsj.com/articles/the-sec-treats-crypto-like-the-rest-of-the-capital-markets-disclosure-compliance-security-investment-mutual-fund-protections-blockfi-bankruptcy-bitcoin-11660937246.

41 *Investor Bulletin: How Victims of Securities Law Violations May Recover Money*, SEC, www.sec.gov/oiea/investor-alerts-bulletins/ib-recovermoney.

was granted the regulatory powers currently distributed among multiple Federal agencies.

D The Commodities Future Trading Commission

The Commodities Future Trading Commission (CFTC), whose mission is to ‘promote the integrity, resilience and vibrancy of the U.S. derivatives markets through sound regulation’, has already asserted its jurisdiction over virtual currencies.⁴² For the CFTC to have proper jurisdiction over NFTs, they would have to qualify as ‘commodities’ under the Commodities Exchange Act (CEA).⁴³ The three main categories used to classify commodities under the CEA are most agricultural commodities, certain other goods and articles and all services rights and interests ‘in which contracts for future delivery are presently or in the future dealt’.⁴⁴ In other words, almost anything can be a commodity if it is traded via contracts for future rather than immediate delivery. The CFTC does not regulate excluded commodities, which are limited to certain financial instruments under the CEA.⁴⁵ Lastly, an exempt commodity is an exchange-traded commodity that enjoys exemptions from most rules under the CEA but is subject to fraud and price manipulation rules.⁴⁶

The CFTC has defined virtual currencies as a ‘digital representation of value that functions as a *medium of exchange, unit of account, and/or store of value*’, and stated in 2017 in its ‘Primer on Virtual Currencies’ that it has jurisdiction over virtual currencies if they are used in a derivatives contract or are involved in fraud or manipulation when traded in interstate commerce.⁴⁷ Additionally, the CFTC has asserted its jurisdiction over instances of fraud or manipulation in ‘spot or cash market exchanges and transactions involving *virtual currencies* that do not *utilize margin, leverage, or financing*’.⁴⁸ These requirements suggest that because the non-fungible nature of NFTs makes them distinct from cryptocurrencies and that they are not usually used in futures or derivatives contracts, they would not fall under the jurisdiction of the CFTC. However, in the context of fractionalized NFTs – for example for fractional ownership rights in blue-chip art⁴⁹ – it is conceivable that the CFTC could determine them to fall under its definition of virtual currencies and thus be subject to CFTC regulation.

42 About the CFTC, www.cftc.gov/About/AboutTheCommission.

43 7 U.S.C. § 1.

44 For a complete list of agricultural products that qualify as commodities, see 7 U.S.C. § 1a(9).

45 See 7 U.S.C. § 1a(19).

46 See 7 U.S.C. § 1a(20).

47 LabCFTC, *A CFTC Primer on Virtual Currency*, CFTC 4, 11 (17 October 2017), www.cftc.gov/sites/default/files/idc/groups/public/documents/file/labcftc_primercurrencies100417.pdf. (emphasis added).

48 *Id.* (emphasis added).

49 For an example, see www.masterworks.com/.

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E The Consumer Financial Protection Bureau

The Consumer Financial Protection Bureau (CFPB) is probably in the best position to provide prompt remedies to defrauded consumers. The CFPB's goal is to 'make consumer financial markets work for *consumers*, responsible providers, and the economy as a whole'.⁵⁰ Additionally, the CFPB aims to protect consumers from deceptive practices, provide the tools they need to make intelligent financial decisions and monitor financial markets for *new risks*.⁵¹ However, what makes the CFPB appealing as an NFT regulator is the array of relief it is statutorily authorized to grant consumers concerning proceedings in which a violation of Federal consumer financial law has occurred.⁵² The CFPB can grant fraud victims relief, including, without limitation, rescission or reformation of contracts, refunds, restitution, disgorgement of profits or compensation for unjust enrichment and potentially other remedies.⁵³

The CFPB made clear that it believes fraudulent activity surrounding digital assets falls within the scope of its authority via the publication of a 'Complaint Bulletin' analysing consumer complaints relating to crypto assets.⁵⁴ Luckily for consumers, the authority of the CFPB can be invoked when a defrauded person files a complaint using the streamlined process available on the agency's website.⁵⁵ Currently, the CFPB has yet to state any intent to regulate fraud relating to NFTs similar to other digital assets, but given their stance on digital assets, it is a distinct possibility. However, while a plethora of remedies are available to consumers via the CFPB, they only address a fragment of the regulatory issues surrounding NFTs.

F Federal Trade Commission

The FTC is another agency tasked with protecting consumers from fraud that could throw its hat into the ring of NFT regulation.⁵⁶ The FTC can use laws governing unfair or deceptive acts or practices in or affecting commerce.⁵⁷ However, the ability of the FTC to deliver prompt remedies to defrauded consumers is more limited than that of the CFPB due to the requirement that relief can only be granted following the completion of the administrative process and issuance of a final cease and desist order.⁵⁸ Considering the inability to deliver prompt relief to defrauded

50 See *About Us*, CFPB, www.consumerfinance.gov/about-us/the-bureau/ (emphasis added).

51 *Id.* (emphasis added).

52 12 U.S.C. § 5565(a)(2).

53 *Id.*

54 See *Complaint Bulletin: An Analysis of Consumer Complaints Related to Crypto-Assets*, CFPB, https://files.consumerfinance.gov/f/documents/cfpb_complaint-bulletin_crypto-assets_2022-11.pdf.

55 *Learn How the Complaint Process Works*, CFPB, www.consumerfinance.gov/complaint/process/.

56 To gain an understating of the FTC's mission and its benefits to consumers, see *About the FTC*, www.ftc.gov/about-ftc.

57 15 U.S.C. § 45(a)(1).

58 The FTC can seek civil penalties and relief that a district court deems sufficient, though the relief can only be granted following the completion of the administrative process and issuance of a final cease and desist order. See 15 U.S.C. § 45(l).

consumers and the FTC's limited action to date, it would likely not be the most effective regulator to protect consumers from fraud relating to NFTs. However, its ability to act on unfair and deceptive acts or practices and pursue civil penalties in the sale of NFTs would be an important addition to a consolidated regulatory approach under the SEC.

G Other Notable NFT Legal Considerations

Criminal acts occurring in the NFT space are pursued by the Department of Justice (DOJ), working in tandem with the other agencies mentioned above. Because NFTs are often used for financial purposes, they also fall victim to the various financial crimes that plague other asset classes. To address these issues, the DOJ has taken various actions, including charges against a product manager at OpenSea (an NFT marketplace) for insider trading, investigations into money laundering groups utilizing NFTs and, most notably, charges against FTX CEO Sam Bankman-Fried.⁵⁹ In a marketplace currently rife with fraudulent activity, the DOJ will continue to play a crucial role in reducing criminal activity in the NFT space. It is hard not to imagine how NFTs can be used for criminal purposes, including money laundering, subtly bribing politicians or run-of-the-mill phishing scams. Accordingly, if the regulation of NFTs were to be consolidated under the SEC, as suggested in this article, the DOJ would only have to work with one other federal agency instead of the variety it currently is required to coordinate when addressing crimes relating to digital assets.

Another important consideration relating to NFTs is their impact on intellectual property law. While not a primary topic addressed in this article, it is important to note that NFTs do not conveniently fit into the traditional framework of U.S. copyright law.⁶⁰ However, to clarify IP rights associated with the sale of an NFT, parties should expressly state them in a written agreement or terms of service.⁶¹ Further, to ensure rights are transferred, creators with copyright protections must take affirmative steps to transfer any rights associated with the sale of an NFT.⁶² Currently, the legal implications of NFTs' interactions with existing IP law are somewhat unclear though buyers and sellers can work to limit the ambiguity by use of written and signed agreements.

59 The cryptocurrency regulatory tracker provides a detailed history of actions taken by several Federal agencies on crypto and other digital assets. See *Cryptocurrency and Virtual Currency Regulatory Tracker*, Westlaw, <https://1.next.westlaw.com/Document/I1c0f2858505011e89bf199c0ee06c731/View/FullText.html?ppcid=817ea1081629499e993f61a95a571354&originationContext=knowHow&transitionType=KnowHowItem&contextData=%28sc.Default%29>.

60 For a thorough explanation as to how NFTs are impacted by intellectual property law, see James Grimmelman, Yan Ji, and Tyler Kell, *Copyright Vulnerabilities in NFTs*, Medium (21 March 2022), <https://medium.com/initc3org/copyright-vulnerabilities-in-nfts-317e02d8ae26>.

61 See Heather J. Meeker, Laurel Loomis Rimón, Eric Sibbitt and Braddock Stevenson, *O'Melveny & Myers Discusses the Legal Challenges of NFTs*, The CLS Blue Sky Blog (14 April 2021), <https://clsbluesky.law.columbia.edu/2021/04/14/omelveny-myers-discusses-the-legal-challenges-of-nfts/>.

62 Cam Thompson, *NFTs and Intellectual Property: What Do You Actually Own?* Coindesk (14 October 2022), www.coindesk.com/learn/nfts-and-intellectual-property-what-do-you-actually-own/.

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H Conclusion

The SEC, being the most active regulator in the digital asset market, is best positioned to take on their regulation. It also has the largest staff and resources dedicated to the subject, compared to all of the other agencies currently involved. Considering the time it would take to pass legislation and create a new agency to regulate digital assets, doing so is not a viable option at this stage in the asset class's development. The better option would be to pass legislation officially and clearly granting the SEC the regulatory powers currently spread among the agencies discussed above in the limited context of digital assets. Doing so would allow the SEC to become a one-stop shop for all blockchain-related issues. It would also allow the SEC to realize its goal of protecting main street investors, ensuring everyone is treated fairly and has access to specific facts about investments and those who sell them more holistically.⁶³ In exchange for getting the additional powers, the legislation should require that the SEC simplify its filing and registration procedures for small-scale digital assets issues and offerings and provide better guidance on the matter. The current procedures require retention of highly specialized and expensive attorneys and, therefore, are frequently beyond the resources of innovative start-ups.

Additionally, the authority of the SEC is currently limited to issues involving securities, which would force fraud victims in cases that fall outside of this scope to seek aid from an agency with less experience in the digital asset market. By subjecting all blockchain and digital asset-related cases to SEC oversight, the somewhat unpredictable classification of digital assets as 'securities' would no longer be an issue. Furthermore, while the SEC can grant relief to defrauded consumers, that relief is more limited than the CFPB. As it stands, the SEC cannot easily provide for restitution of moneys paid and/or disgorgement of profits. These powers should be clarified and added via legislation.

In conclusion, it is the view of the present author that the SEC should be granted the exclusive authority to regulate NFTs and other digital assets even if they fall outside of being classified as a security. This would include the ability to regulate digital assets that are considered commodities, thus supplanting the CFTC in that context. Additionally, in instances of consumer fraud relating to digital assets, which would typically fall under the CFPB's jurisdiction, the SEC should be given exclusive responsibility for anything that goes beyond individual consumer cases. In this context, the SEC should be able to provide the remedies currently available to the CFPB to all cases of digital asset fraud, not those only relating to consumer issues. Lastly, the protections currently managed by the FTC and the DOJ protecting investors and consumers from unfair and deceptive acts involving commerce should be brought within the scope of the SEC's regulatory authority. The SEC is already taking false advertising actions like the FTC with its recent enforcement action against National Basketball Association (NBA) Hall of Famer

63 *What We Do*, SEC, www.sec.gov/about/what-we-do.

Paul Pierce for making misleading statements about a crypto security.⁶⁴ Consolidating the regulatory responsibility for digital assets under the SEC would provide the most effective and expedient method of managing the government's response to the emerging asset class. It could also limit the number of interdepartmental communications to essentially the SEC and the DOJ, with the latter focusing on enforcement.

While regulatory specialization makes sense in many cases, the involvement of too many actors with an unclear division or overlap of responsibilities has become a problem for operators in the digital asset markets. Because the SEC is already heavily invested in the management of digital assets and is well funded, it is in the best position to deliver the highest quality regulatory response for most investors, creators and consumers of this asset class. A similar approach should be considered in other jurisdictions, in particular in the EU.

64 The SEC has charged Paul Pierce for failure to disclose the payment he received for the promotion of the EMAX Token and for making false and misleading promotional statements relating to the asset. See *SEC Charges NBA Hall of Famer Paul Pierce for Unlawfully Touting and Making Misleading Statements about Crypto Security*, SEC, www.sec.gov/news/press-release/2023-34.