F-NFTs and Securities for the Sofa Investor

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NFTs are an undoubtedly noteworthy use of blockchain technology, the digital ledger initially used to make buying a brick of cocaine untraceable, and they have major implications for intellectual property and securities litigation. NFTs or Non-Fungible Tokens are unique, individual files located on the blockchain that can be used to signify ownership to a particular image or sequence of clips held as a digital asset. They take many different forms, from NBA TopShot, a digital package of clips, artwork, and still photographs to digital houses and augmented reality sneakers. Generally regarded as a way to monetize digital art through selling whole or partial NFTs, nearly $2 billion was spent on NFTs in the first quarter of 2021. NFT's have proved to be a novel and rapidly expanding area in intellectual property as well, with a sharp increase in applications for NFT protection to the USPTO. These include everything from The Andy Warhol Foundation for the Visual Arts filing to register "ANDY WARHOL" to the band the Chainsmokers filing to register "BLOCKCHAINSMOKERS." Their classification is also a matter of contention, as they may fall under the purview of the Commodity Exchange Act, or may be treated as securities, thereby subject to registration requirements. This is the subject of ongoing litigation in the New York Supreme Court, with an owner of an NBA TopShot NFT filing a securities class action suit on behalf of owners who have incurred damages from the sale of "unregistered securities", claiming that purchasers lacked the sophistication to evaluate risks and Dapper Labs reaped the rewards.

Numerous marketplaces for buying and selling NFTs have sprung up, from the Etsy-like OpenSea, which acts as an open-air market for buying and selling, to Niftex, which specializes in selling portions of NFTs. Out of the many dangers of unregulated NFT marketplaces, including a lack of standard form contracts for transactions and guarantees against fraudulent NFTs, perhaps the greatest challenge may lie in the sale of fractional NFTs. Also known as F-NFTs or "shards," these assets present the opportunity for the less liquid investor to buy a portion of either a single NFT or a collection of NFTs. New marketplaces like Niftex have sprung up, as they always do, to facilitate the process of selling fractional NFTs. They allow owners of valuable NFTs to offer a set number of "shards" at a fixed price for an initial two-week offering, after which they are traded openly at market price.

The primary reason that these assets pose such a distinct danger from a securities perspective is that they are in some ways fungible. Each shard, despite holding a different location on a ledger, is effectively identical, and just like stock in a company, represents part of a whole. F-NFT marketplaces are a hotbed for transactions nearly identical to NBA TopShot, and this presentation will explore securities law and ongoing litigation as it pertains to shard marketplaces and what it means for investors.