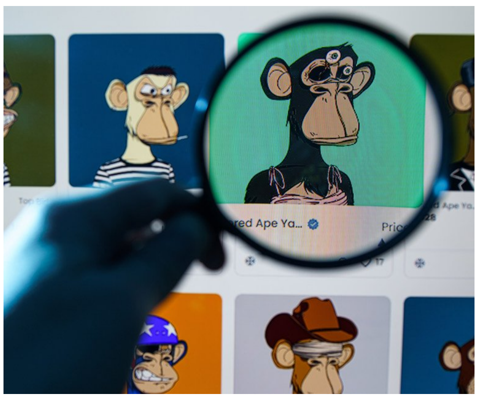

NFTs are digital assets that represents ownership of real-world items like art, video clips and music. Credit: Rokas Tenys/Shutterstock.com

ANALYSIS

What GCs Exploring NFT, Web3 Opportunities Need to Know

"Businesses that fail to evolve will cease to be competitive," Louis Lehot, a partner with Foley & Lardner.

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5 minute read

Technology Media and Telecom

Hugo Guzman

What You Need to Know

- Big money is flowing into NFT business opportunities.
- That's despite a plunge in NFT transactions since last year.
- Firms entering the space need to navigate a fast-evolving regulatory landscape.

Companies across every industry are jumping into non-fungible tokens (NFTs), seeking to seize what they perceive as huge business opportunities.

Attorneys working in the space see myriad reasons to be bullish, despite a recent plunge in NFT sales and a host of tricky legal and regulatory issues companies entering the field must navigate.

NFTs are digital certificates registered on a blockchain, a ledger spread across decentralized computer networks. NFTs can be everything from digital art and collectibles to a plot of land in the virtual world known as the metaverse. The digital certificates are a key cog in Web3, a new iteration of the internet built on blockchains.

Missing opportunities in this emerging field could be catastrophic, said Louis Lehot, a partner with Foley & Lardner in California.

“Businesses that fail to evolve will cease to be competitive,” he said.

Some companies already are unleashing bold moves. Earlier this month, video game publisher Square Enix sold off many of its major video game properties, such as Tomb Raider, to fund its entry into the NFT space.

Those making such moves are undeterred by a nearly 92% drop in NFT sales in the first week of May, compared with the all-time high last September, according to data from market tracker NonFungible.

Meanwhile, NFT startups raised $2.4 billion in the first quarter, representing 25% of all blockchain funding. Lehot said that shows the market is going strong, and has barely slowed despite the transaction drop.

LAW FIRMS MENTIONED

Kilpatrick Townsend & Stockton LLP

Foley & Lardner

"The flow of capital into new transactions is still at a breakneck pace," Lehot said. "We've got deals as if nothing happened in the public markets."

Early Movers

Rob Potter, a partner with Kilpatrick Townsend & Stockton in New York City, said established brands will have varying degrees of success selling NFTs to mainstream, less technically savvy fans.

Potter is well-versed on how companies can interact with NFTs and Web3. He authored a piece for the Association of Corporate Counsel late last year offering advice to GCs on the subject.

He said tying NFTs into more traditional marketing opportunities and promotional benefits, like customer loyalty programs or exclusive products, is a safer bet.

For example, Clinique leveraged its loyalty program earlier this year by offering members an opportunity to win exclusive NFTs tied to products to be released each year for the next decade.

In March, rock band Kings of Leon cut out music publishers by releasing its latest album as an NFT. It deleted all unsold NFTs after two weeks of sales, with no more being made.

These examples are simply the tip of the iceberg, Lehot said. For example, mobile developers can use Web3 to distribute apps directly to customers without going through app stores. He added that going through Big Tech costs developers 25-30% of gross revenue and can be unreliable at times.

Those developers could even choose to cut out payment systems, by transacting with self-issued tokens or NFTs.

General counsel should consider which parts of their businesses are digital and require transactions through Big Tech entities, attorneys say. If blockchains and Web3 can cut out those middlemen, that business might be well-suited to experiment with NFTs.

Navigating Risks

Max Dilendorf, a New York City attorney specializing in cryptocurrencies and Web3, said venturing into NFTs and other blockchain technologies brings big opportunities but also big risks.

He said general counsel must make sure their businesses are in compliance with money laundering regulations, such as the Currency and Foreign Transactions Reporting Act of 1970— commonly called the Bank Secrecy Act.

While that might sound surprising to the uninitiated, Dilendorf said NFTs carry a money-laundering risk, since decentralized technology makes their transactions untraceable.

Once legal teams have covered that territory, Dilendorf said they should brush up on the regulatory landscape, which is in flux.

Securities and Exchange Commission Chairman Gary Gensler last month announced plans to step up regulation of blockchain technologies and to nearly double the size of the agency's Crypto Assets and Cyber Unit.

Potter said that working with experienced partners, including outside counsel, can help GCs navigate the regulations.

"That's who you want to start with to get the benefit of that perspective, because it's moving rapidly," Potter said.

Companies also should get comfortable with the idea of selling an extremely risky asset, Dilendorf said, referencing the recent drop in NFT prices.

The average price of an NFT was about $1,400 in April, according to NonFungible, down from $4,000 in February.

He said buyers should be given disclosures and made to understand their investment can drop to zero at any time.

"This way, you protect yourself against future claims," Dilendorf said, emphasizing. "[This way,] your buyer cannot come to you and say 'I've lost $5,000, and I want my money back.'"

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