The Bar Council

Bar Council response to the DCMS Select Committee Call for Evidence on Non-fungible tokens (NFTs) and the blockchain

1. This is the response of the General Council of the Bar of England and Wales (the Bar Council) to the DCMS Select Committee Call for Evidence on Non-fungible tokens (NFTs) and the blockchain (Call for Evidence).[1]

2. The Bar Council represents approximately 17,000 barristers in England and Wales. It promotes the Bar's high-quality specialist advocacy and advisory services; fair access to justice for all; the highest standards of ethics, equality, and diversity across the profession; and the development of business opportunities for barristers at home and abroad.

3. A strong and independent Bar exists to serve the public and is crucial to the administration of justice. As specialist, independent advocates, barristers enable people to uphold their legal rights and duties, often acting on behalf of the most vulnerable members of society. The Bar makes a vital contribution to the efficient operation of criminal and civil courts. It provides a pool of talented men and women from increasingly diverse backgrounds from which a significant proportion of the judiciary is drawn, on whose independence the Rule of Law and our democratic way of life depend. The Bar Council is the Approved Regulator for the Bar of England and Wales. It discharges its regulatory functions through the independent Bar Standards Board (BSB).

Summary

4. The questions are addressed in the order set out in the Call for Evidence. The UK's light-touch to NFT regulation is sufficient for current purposes, bearing in mind that NFTs form only one component in the developing digital ecosystem and any

[1] Available here: https://committees.parliament.uk/work/7038/nonfungible-tokens-nfts-and-the-blockchain/publications/

regulation will depend on the actual properties and uses of the NFT in question. However, it is important to note that as both the use cases for NFTs and Blockchains continue to evolve, the regulatory and legal landscape will have to adapt accordingly. Additional regulatory measures may need to be implemented in the future as the use of cryptoassets and blockchain becomes more widespread with the use of emerging technologies.

5. In addition to some of the risks exposed by NFTs at paragraph 16 below, a brief (non-exclusive) list of potential areas of concern to vulnerable people of NFT speculation is provided at paragraph 18, followed by the reasons why blockchains can offer security to British investors. The potential benefits to individuals and society of NFT speculation are numerous, as use cases continue to grow; but the negative impact on the environment must also be emphasised, so as not to unnecessarily mint NFTs which will not have any significant benefit.

Question 1: Is the UK's light-touch NFT regulation sufficient?

6. Non-fungible tokens (NFTs) are digital assets created using cryptography, that are unique and indivisible, whose ownership can be demonstrated and verified using distributed ledger technology (DLT). NFTs may be used to create a tokenised proof of title to a unique digital version of an underlying digital asset (such as artwork, music, videos, and other forms of media or digital content) or a physical asset (such as paintings, sculptures, branded goods, or other tangible assets). NFTs are stored on a blockchain/DLT, which is a decentralized and transparent digital ledger that allows for the secure and verifiable tracking of transactions.

7. The UK has taken a relatively light-touch approach to regulating NFTs; considering the rapid continuous evolution of uses in tokenomics (including the mixing of cryptoassets such as NFTs with stablecoins, and Decentralised Automated Organisations (DAOs) being created) this is a prudent approach that will require constant reconsideration, particularly as society transitions to incorporating Web3.0 systems and technologies. Barristers frequently deal with cutting edge technology and are at the forefront of developing the law in this area. The Bar Council welcomes the opportunity this new technology brings. English common law is sufficiently flexible to deal with these developing technologies and English Law and English courts provide an ideal forum for dealing effectively with this developing technology in comparison to various other jurisdictions.

8. The UK Jurisdiction Taskforce's Legal Statement on Cryptoassets & Smart Contracts (the Legal Statement) published in November 2019, indicated that cryptoassets have all the indica of property. It recommended that, despite cryptoassets not being classifiable as either things in possession or as things in action, "*cryptoassets are … to be treated in principle as property*". There is now a reasonable body of case law[2] established by the English Courts at an interim stage that cryptoassets are capable of being considered as property, including NFTs (*Lavinia Deborah Osbourne v Persons Unknown; Ozone Networks Inc* [2022] EWHC 1021 (Comm)). The fact that cryptoassets are principally recognised as property under English law has wide-reaching significance, in that victims of fraud or theft of their cryptoassets have recently been able to obtain proprietary orders including proprietary injunctions, freezing orders, asset preservation orders and *Bankers Trust* Orders to assist them to preserve and trace their property, and to seize it or alternatively to seek compensatory damages.

9. We also look forward to the Law Commission's final report to be published in 2023 on Digital Assets following their consultation. The consultation paper argues the "*law must therefore go further to acknowledge these unique features of digital assets, which in turn would provide a strong legal foundation for the digital assets industry and for users. Through these reforms, the legal system would help to create an environment that is more conducive to digital assets and their market*".

10. It is anticipated that, in due course, legislation similar to the Sale of Goods Act 1979 and the Supply of Goods and Services Act 1982 may well govern the trading and sale of cryptoassets to afford both sellers and buyers adequate protection in business-to-business transactions, or by the Consumer Rights Act 2015 (CRA 2015) if cryptoassets are acquired by a 'consumer' (although the CRA 2015 currently does not apply to a contract for a trader to supply coins or notes to a consumer for use as currency (CRA 2015, s 3(3)(a))).

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[2] As well as the *Lavinia Deborah Osbourne v Persons Unknown; Ozone Networks Inc* [2022] EWHC 1021 (Comm) on NFTs, English Court cases holding cryptoassets to be property under English law include: *AA v Persons Unknown, Re Bitcoin [2019] EWHC 3556 (Comm), [2020] 2 All ER (Comm) 704; Vorotyntseva v Money-4 Limited t/a Nebeus.com [2018] EWHC 2596 (Ch) JSC Commercial Bank Privatbank v Kolomoisky [2021] EWHC 403 (Ch).*

11. Further cases such as *Soleymani –v- Nifty Gateway LLC* [2022] EWCA Civ 1297 and *Chechetkin –v- Payward Ltd and others* [2022] EWHC 3057 (Ch) provide examples of the English Courts' ability to vindicate consumer rights even on jurisdictional issues concerning arbitration agreements.

12. Regulation and laws presently depend on:

(a) The token's characteristics and features;
(b) The activities performed in respect of such token; and
(c) The territorial scope of the particular regulatory framework.

13. Whilst NFTs are not necessarily within the scope of the UK general licensing regime, NFTs are in scope of the UK anti-money laundering regime. The Joint Chiefs of Global Tax Enforcement[3] (J5), issued a statement in April 2022 about the growing risks of money laundering and fraud associated with NFTs providing a non-exclusive list of best practices as 'Marketplace Red Flag Indicators'. NFTs, like other cryptoassets as defined under the Money Laundering Regulations 2017 as "*a cryptographically secured digital representation of value or contractual rights that uses a form of DLT and can be transferred, stored or traded electronically*" sets out activities that when performed in respect of cryptoassets, trigger a registration requirement. This includes compliance with regulations related to anti-money laundering and counter-terrorism financing, which require companies that deal with NFTs to comply with certain requirements to prevent the use of these assets for illegal activities.

14. There are also some specific regulatory considerations related to NFTs, such as consumer protection and data protection. For example, the UK's Advertising Standards Authority has issued guidance on how NFTs should be advertised, including requirements to clearly disclose any risks or limitations associated with the asset. Additionally, the UK's data protection agency, the Information Commissioner's Office, has issued guidance on the use of personal data in NFTs, including requirements to obtain consent from individuals before using their data in this way.

[3] The J5 is comprised of Australian Taxation Office (ATO), the Canada Revenue Agency (CRA), the Fiscale Inlichtingen- en Opsporingsdienst (FIOD), **HM Revenue & Customs (HMRC),** and Internal Revenue Service Criminal Investigation (IRS-CI). For more information, please see the Joint Chiefs of Global Tax Enforcement Successes

15. Another regulatory consideration related to NFTs is tax. In the UK, NFTs may be subject to capital gains tax if they are sold for a profit, and VAT may be applicable to certain NFT transactions. It is important for individuals and businesses dealing with NFTs to understand their tax obligations and ensure that they are in compliance with relevant laws and regulations.

16. NFTs can nevertheless pose certain risks and additional regulatory measures may be required to mitigate those risks as their uses expand. Some risks posed by NFTs include:

- Financial risks: The value of NFTs is highly volatile and can fluctuate dramatically over short periods of time. This means that people who invest in NFTs may be at risk of losing money if the value of their assets decreases.

- Exclusion: The high costs associated with buying and selling NFTs may exclude some people from participating in the market. This could lead to a further concentration of wealth and power among a small group of individuals, rather than benefiting a wider range of people.

- Environmental impact: The process of minting and dropping (including transferring) NFTs requires significant amounts of energy, which can contribute to carbon emissions and other forms of environmental harm. This may create legal challenges involving climate action.

- Digital divide: The high costs and technical requirements associated with NFTs may exclude people who do not have access to the necessary resources, such as a reliable internet connection or a computer with sufficient processing power. This could lead to further inequality and exclusion, as people who are able to participate in the NFT market may benefit financially while those who are unable to do so are left out.

- Cybersecurity risks: NFTs are stored on the blockchain, which is still vulnerable to hacking and other forms of cyber-attacks. People who invest in NFTs may be at risk of losing their assets if their accounts are compromised or their NFTs are stolen.

- Privacy concerns: The use of NFTs can raise privacy concerns, as they are often associated with personal information, such as the name of the owner or the location of the physical item being represented. This information may be accessible to anyone who has access to the blockchain, which could pose risks to people who value their privacy or who may be at risk of harm if their personal information is disclosed.

- Market manipulation: The NFT market is relatively small and illiquid, which makes it more susceptible to market manipulation. People who invest in NFTs may be at risk of being affected by manipulative behaviour, such as price manipulation or insider trading.

17. At present, the Bar Council considers that the UK's current regulatory approach to NFTs is broadly sufficient to ensure that these assets are used in a responsible and transparent manner. However, it is important to note that the regulatory landscape for NFTs is still evolving, and it is possible that additional regulatory measures may need to be implemented in the future as the use of these cryptoassets becomes more widespread. It is also worth noting that different countries may have different approaches to regulating NFTs, and individuals and businesses should be aware of the specific regulatory environment in which they operate and/or are relevant.

Question 2: What are the potential harms to vulnerable people of NFT speculation?

18. While NFTs have the potential to provide new opportunities for artists, musicians, creators, businesses, and organisations to build communities, promote their brands and/or monetize their work, they also present risks for vulnerable people. Some potential harms of NFT speculation include:

- Lack of understanding: Some people may not fully understand the risks and complexities of NFTs, and may be more vulnerable to being scammed or taken advantage of by unscrupulous actors. Further the lack of understanding and often, the absence of legal rights attached to the purchase of their NFTs, (for example that an owner of a NFT does not have intellectual property rights particularly copyright assigned to them for use).

- Predatory behaviour: Some people may be targeted by predatory individuals or groups who seek to exploit their lack of knowledge or resources for financial gain. For example, a person with a large social media following may be approached by someone offering to sell them an NFT at an inflated price, based on the assumption that the person will be able to resell the NFT for a profit.

- Scams and fraud: NFTs make it easier for scammers and fraudsters to take advantage of unsuspecting investors in this relatively new area of transactions. There have been instances of people being duped into buying fake NFTs, or NFTs that have been copied from other sources without permission or been misled in disclosing their private key on their DTL allowing fraudsters to steal the NFTs.

- Exploitation: Some people may be targeted based on their identity or circumstances, and may be more vulnerable to exploitation as a result. For example, an artist who is struggling financially may be more likely to accept a low price for their work when approached by someone offering to buy their NFT, even if the price is significantly below market value.

19. In the UK, there are several measures in place to protect investors in financial products which might already be said to apply to NFTs, but problems arise where technology evolves. Technologically neutral approaches are therefore required. It is not always clear, for example, how various provisions in the Regulated Activities Order under the Financial Services and Markets Act 2000 (FSMA) apply to 'debt' instruments which do not involve debts, or 'current accounts' which do not involve actual deposits (or even money). Where measures do not apply, some existing protections could either be extended to regulate NFTs or similar measures could be developed specifically for NFTs. Measures protecting investors in financial products include:

- The Financial Conduct Authority (FCA): Among other things, the FCA sets out rules and guidance on how firms should treat vulnerable customers, including those who may be elderly, have a disability, or may have difficulty understanding financial products or services.

- The Financial Services Compensation Scheme (FSCS): The FSCS covers a wide range of investment products, including stocks and shares, insurance, and savings products.

- The Financial Ombudsman Service: This is an independent service that helps resolve disputes between financial firms and their customers.

- The FCA's rules on treating customers fairly: Financial firms are required to treat their customers fairly, including vulnerable customers. This means that firms must take steps to understand the needs and circumstances of their customers, and ensure that the products and services they offer are suitable for those customers.

- The FCA's rules on pension scams: The FCA has introduced a number of measures to protect people from pension scams, including a ban on cold calling about pensions, and rules requiring firms to check that customers understand the risks of transferring their pension to a new scheme.

20. It is important to note that these protections are not absolute, and vulnerable investors in NFTs will still need to carefully consider their financial situation and goals; and seek professional financial advice if they are unsure about any investment decisions.

Question 3: Do blockchains offer security to British investors?

21. Blockchain technology has gained significant attention in recent years for its ability to provide a secure and transparent platform for recording and verifying transactions. Blockchain is so versatile that, besides its initial uses in the finance sector, it has expanded to many other fields including healthcare, sports and continues to evolve. Blockchain, being versatile, has expanded to many other fields.

22. One example of how blockchains can provide security for British investors is in the case of digital asset ownership. If a British investor holds a digital asset, which is connected to another physical asset or has selective rights (asset), on a blockchain, they can have the added security of knowing that their asset is protected by the decentralized network and cryptographic hash functions of the blockchain. This can provide an added level of confidence for the investor that their asset is secure or authentic and has an added level of security.

23. Another application of blockchains that may offer security for British investors is through the use of smart contracts. Smart contracts are self-executing contracts with the terms of the agreement between buyer and seller being directly written into lines of code. They can provide a secure and transparent way for investors to enter into and enforce contracts, such as in the case of property transactions.

24. Blockchain is predicated on the concepts of consensus, decentralisation, and cryptography to confirm dealings trust; and are designed to be resistant to tampering and modification due to the use cryptographic techniques in its system to secure the integrity of the data recorded. However, there are potential vulnerabilities that can be exploited in any system, including in blockchains. Although it is generally considered to be very difficult to hack a blockchain it is still susceptible to security issues. Blockchain security issues include:

- Sybil attacks[4], and 51% attacks[5]. It is also possible for a malicious actor to attempt to manipulate the consensus process that is used to validate transactions on a blockchain. However, this type of attack would typically require a significant number of resources and would be very difficult to execute successfully.

- End-point vulnerabilities wherever users act with the blockchain on electronic devices like computers, tablets, and mobile phones. Hackers will observe user behaviour and target devices to steal the user's private key. Additionally, attacks may occur if a user's device is not properly configured or if it is not adequately secured.

- Phishing attacks and weak private keys: individual users of a blockchain may be vulnerable to phishing attacks or other forms of cybercrime if they do not take steps to protect their own security and their private keys.

- Routing attacks: A blockchain network and application rely on the real-time movement of massive amounts of knowledge. Hackers can use an account's anonymity to intercept data because it's being transmitted to internet service

[4] Sybil attack is where hackers generate fake networks nodes; using those nodes, the hackers then deceptively acquire majority consensus and disrupt the chain's transaction.
[5] A 51% attack occurs when one individual or organization (malicious hackers) collects quite 1/2 the hash rate and seizes control of the whole system, which might be disastrous. Hackers can modify the order of transactions and forestall them from being confirmed. they'll even reverse previously completed transactions, leading to double spending.

providers. In the case of a routing attack, blockchain users may unknowingly expose confidential data or extract assets without the user's knowledge.

25. The other important factor that investors are likely to take into consideration is the environmental impact both in connection with climate action commitments as well as compliance with any relevant ESG corporate governance concerns in line with the UK's route to carbon net zero in and the use of blockchains and their energy consumption. So, for example, investors committed to aligning their investments portfolio with their stance on climate change are likely to consider investing in NFTs generated using renewable energy and/or using the proof-of-stake blockchain[6]. Differentiating sustainable and unsustainable blockchains are likely to be of significant importance to investors and society.

26. While blockchains are generally considered to be secure, it is important for users to take steps to protect their own security and to be aware of the potential vulnerabilities of any system. Overall, the use of blockchain technology has the potential to increase the level of technological security for British investors.

Question 4: What are the potential benefits to individuals and society of NFT speculation?

27. The Bar Council is aware of various proposed potential benefits, including:

- Investment opportunities: NFTs can be bought and sold like traditional assets, and their value can fluctuate based on demand. For example, an individual who buys an NFT of a piece of artwork for $100 may be able to sell it for $500 a year later if the artist becomes more popular or the artwork gains more recognition, but obviously the markets can be extremely volatile.

- Supporting artists, musicians, brands, and creators of their Intellectual Property Rights (IPR) and brand management: NFTs can provide a new source of revenue for artists, musicians and creators by allowing them to monetise on their creativity and IPR and obtain fair reward for the use of their works and proper exploitation and enforcement of their IPR. NFTs are being used to

[6] "Blockchain, climate damage, and death: Policy interventions to reduce the carbon emissions, mortality, and net-zero implications of non-fungible tokens and Bitcoin" by Jon Truby , Rafael Dean Brown, Andrew Dahdal, Imad Ibrahim, on Energy Research and Social Science 88, (2022) 102499

authenticate the IPR of their products (both physical and virtual goods) by brands.

- Build communities and loyalty with their target consumers: NFTs are being used by enterprises from large consumer brands to sporting associations and charities to build, maintain and create communities with a more connected experience with the issuing of a variety of NFTs.

- Increased access to art and culture: NFTs can make it easier for people to access and own digital versions of art and other cultural works, even if they are not physically able to visit a museum or gallery. For example, someone who lives in a remote location may not have the opportunity to see a famous artwork in person, but they may be able to attend a virtual NFTs gallery, view it digitally and purchase an NFT of that artwork.

- Preservation of digital works: NFTs can provide a way to preserve digital works, as they can be used to verify the authenticity and ownership of a digital asset. This can help to prevent the loss or degradation of important digital works over time. For example, an NFT of a rare digital recording may be able to be preserved and passed down through generations as a valuable heirloom.

- Improved liquidity: NFTs can improve the liquidity of digital assets by providing a way to easily buy and sell them on various online platforms. This can make it easier for individuals to realize a return on their investment in these assets. For example, someone who buys an NFT of a piece of music may be able to sell it quickly and easily on a marketplace if they decide they no longer want it.

- Potential economic impact: NFT speculation and trading can generate economic activity and potentially contribute to the growth of the broader economy. For example, the sale of an NFT for a high price may generate income for the artist, the platform hosting the sale, and potentially other related businesses.

- Enhanced security: The use of blockchain technology for storing and tracking NFTs can provide enhanced security and reduce the risk of fraud or counterfeiting. For example, the blockchain can be used to verify the authenticity of an NFT and ensure that it has not been copied or altered.

- Conservation: NFTs can also assist in conservation and ecological causes: The TreeDAO[7] is such an example where Tree Tokens are used to raise funds to purchase woodlands. The investors who become NFT owners, do not own the actual woodland purchased but are provided with limited voting rights on certain conservation projects connected to their particular NFT as well and the ability to trade their NFTs. Other uses of NFTs are being deployed to assist in climate action such as tokenising carbon credits[8]. However, organisations will need to be vigilant not to be greenwashing.

28. Overall, the potential benefits of NFT speculation include the opportunity for investment, support for artists and creators, increased access to art and culture, preservation of digital works, improved liquidity, potential economic impact, and enhanced security, but the potential downsides of volatility and impact of regulation need to be considered.

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[7] http://treedao.org

[8] For example, Moss Earth's MCO2 Tokens https://agfundernews.com/nfts-crypto-carbon-credits-moss-earth-is-using-to-fight-climate-change

[9] Prepared by the Information and Technology Panel