TECHNOLOGY PROBATE

NFT Scams—Buyer Beware

Technology—Probate provides information on current technology and microcomputer software of interest in the probate area. The editors of *Probate & Property* welcome information and suggestions from readers.

The year 2022 has been a rough year for digital assets. First, after reaching all-time highs in late 2021, Bitcoin, Ethereum, and many other popular cryptocurrencies lost more than 70 percent of their market value earlier this year, erasing trillions of investment dollars. Second, multiple crypto exchanges either declared bankruptcy or limited withdrawals from their customers' accounts to avoid a run on assets. Third, the Securities and Exchange Commission (SEC) charged several crypto exchange employees with insider trading which resulted in increased demand for Congressional regulation over digital assets and their markets. Among digital assets, this article focuses on a specific type of digital asset that is experiencing remarkable volatility—non-fungible tokens (NFTs).

Like other digital assets, NFTs have faced their fair share of problems in the last year. Sales of NFTs have significantly dropped in both volume and value. According to Non-Fungible.com's market tracker tool, NFT sales peaked in late 2021 and as of late summer 2022 stood at about 25 percent of their highest values. Admittedly, even after excluding the current market turmoil, I have some doubts about the functionality and value of a majority of existing NFTs. I believe the purported fundamentals of many NFTs are questionable at best. Furthermore, the NFT environment and various markets are ideal for scams and other fraudulent activity (more on that below). That being said, underlying NFT smart-contract technology appears to be useful in some capacities and will likely continue to appear in different formats and platforms for years or decades to come. In other words, I believe we are still in the very early stages of NFT development, and just as the internet of the late 90s barely resembles the ubiquitous digital resource we so heavily rely upon today, NFT naysayers should not immediately dismiss NFTs as merely a passing fad.

Technology-Probate Editor: Ross E. Bruch, Brown Brothers Harriman & Co., One Logan Square, 14th Floor, Philadelphia, PA 19103-6996, ross.bruch@bbh.com.

What is an NFT?

By now, most readers have heard of NFTs so I won't belabor the point with an in-depth explanation, but I suggest that uninitiated readers return to the September/October 2021 issue of *Probate and Property* magazine and read Joshua Caswell and Leigh E. Furtado's excellent article titled *NFTs for Estate Planners: Not Just a Token Concern*. Essentially, an NFT is a form of digital data on a blockchain with unique identification codes and metadata that distinguish them from each other. They can be entirely digital creations, or they can be digital representations of real-world items like artwork and real estate. NFTs cannot be replicated or replaced. A very common NFT form is digital artwork, but NFTs can be a wide range of items including GIFS, tweets, items in video games, songs or albums, tickets, etc. NFT ownership and sales are recorded through the blockchain and therefore, in theory, are intended to be more secure and less susceptible to fraud.

NFT's blockchain-based ownership can also serve as the foundation of smart contract-enabled NFTs such as automated legal or financial operations. For example, some NFT license agreements include provisions that grant a royalty to the original NFT artist or issuer every time an NFT is resold. I believe one of the greatest benefits an attorney can provide to an NFT investor is to help them read the token's license agreement and alert them to the potential pitfalls of these agreements. Many attorneys may be surprised to learn (i) how poorly written many of these agreements are, (ii) that many of these agreements are extremely vague and fail to address several basic contractual questions for all parties involved, and (iii) how easy it is for an NFT owner to run afoul of the requirements embedded within these agreements, thereby jeopardizing the agreement and forfeiting their rights and access to the NFT.

Returning to the above-referenced article, Caswell and Furtado also make suggestions about how to structure an estate plan that contains NFTs. I believe all of the authors' suggestions are useful, including asking questions about digital assets and NFTs in client intake forms, considering holding NFTs within LLCs for easier management and transfer, employing strategic gifting strategies, updating estate planning documents to ensure they are compliant with the Revised Uniform Fiduciary Access to Digital Assets Act (RUFADAA), and structuring ownership to provide secured access to owners.

What Could Go Wrong?

Beyond NFT basics and license agreements, there is another consideration estate planning attorneys should be aware of to educate, advise, and protect their clients: the proliferation of scams plaguing the sale and ownership of all digital assets, but in particular NFTs. It should come as no surprise that fraud and grift are not uncommon in NFT marketplaces, because many new NFT buyers are not well versed in the mechanics of NFT ownership but are nevertheless drawn to the asset class because they have observed the rapid growth of the industry (which until recently, rarely decreased in value), and either assumed NFTs will continue to appreciate at a rapid level for years to come, or simply feared that if they didn't act quickly they will miss out on their opportunity to participate in "the next big thing." This is a dangerous combination leading to opportunities for nefarious individuals to initiate scams on a susceptible population. To be clear, I am not saying that all NFTs are scams (despite the questionable valuation of some), but given the dynamics of the current NFT environment, attorneys need to educate their clients on potential mishaps NFT buyers may face. As with any investment, buyers must be aware of what they are purchasing and do their due diligence about the underlying asset and the company or individual from which the asset is being purchased. To further this point, I will briefly summarize some of the most popular NFT-related scams that are being deployed in 2022. It may be helpful to educate your clients on these potential investment traps both to steer them clear of such dangers as well as to demonstrate the potential risks of investing in NFTs on a broader scale.

Rug-Pull Scams: In this scenario, a scammer will promote an NFT project or collection on social media and promise investors guaranteed returns as well as other intangible benefits to NFT ownership (e.g., in-game giveaways or VIP access to events). Purchasers buy into the idea that this is a "can't lose" opportunity, but, after enough NFTs are purchased, the scammer shuts down the entire project and often vanishes with the funds in hand (something far easier to do in the digital world than it is in the real world), leaving buyers with nothing but worthless NFTs.

Pump and Dump Scams: This type of market manipulation involves an individual or group that artificially inflates NFT prices by buying large amounts of digital assets to drive up prices. Similar to rug-pull scams, the process may also involve sellers spreading misleading information about the value or function of the NFTs. The group then sells the asset in bulk to cash in on the gains before the price drops. This type of scam is not unique to NFTs or digital assets, but whereas pump and dump attempts of publicly traded securities are under the purview of the SEC, NFTs do not (yet) have the benefit of similar regulatory oversight.

Bidding Scams: This scam often occurs in secondary market places where an individual places an NFT for sale or auction; a winning offer or bid is accepted at an agreed price, paid in cryptocurrency. Immediately before the transfer, however, the scammer changes the type of cryptocurrency he will pay with to a far less valuable coin. If the seller does not catch the last-second switch, the sale will occur at a fraction of the originally agreed-to value.

Plagiarism: NFTs are supposed to be unique digital tokens as with all high-value assets. Unfortunately, plagiarism is extremely common on many NFT platforms. Recently, the largest NFT marketplace, OpenSea, reported that over 80 percent of NFTs created for free on its platform were fake. OpenSea has taken steps to minimize this issue, but the problem still exists in many different NFTs marketplaces. Just as a replica of a high-priced tangible object has very little value compared to its original counterpart, fake NFTs are nearly worthless.

Artificial Inflation: In this type of scam, one party will create an NFT and "sell" it to a second party, who is also in on the scam, for a high price. The second party will then turn to the open marketplace and sell the same NFT, at a "discount" while demonstrating the original purchase price he paid. An unrelated third-party buyer will see the discount and purchase the NFT believing that it is a bargain. The creator and the first buyer will then split the profit from the resale.

Airdrop Scams: Also known as NFT giveaway scams, this scam occurs when fraudsters ask innocent targets to undertake some activity such as creating an account on the fraudster's website or helping promote an NFT project in exchange for a "free" NFT. Once that is done, they send their targets a link requiring them to enter their digital wallet information to receive the prize. The scammers then copy the account details and use them to access and steal the targets' NFT collections.

How to Avoid

The scams listed above are far from an exhaustive list, and assuming NFT ownership remains popular, this list will surely evolve and change in the coming years. It is noteworthy that most of these scams existed in non-digital forms before the invention of digital assets but have simply been updated using modern technology. How can attorneys best help their clients avoid these potential investment mistakes? It is important to remember the age-old advice that if it seems too good to be true, it probably is. It is easy to understand why the hype around a particular NFT project makes some potential buyers believe it is a "can't miss" opportunity, but an attorney should advise clients to thoroughly research any large investment they intend to make, which includes a thorough investigation of the individual or group promoting the NFT project. If this is the first time they're publicly promoting an NFT, it carries a significantly larger amount of risk than if they have a proven record of successful NFT launches. Learning to be skeptical in a market that appears to have unlimited upside is a difficult but important lesson to convey to clients.

Furthermore, buyers often assume that they will be able to spot pumps and dumps ahead of time and that they are smart enough to predict when to exit an investment, but unfortunately in real-life market situations, people are rarely as nimble as they predict they will be. Though it may be difficult to convince clients that these scams work because most people are susceptible to them, it is nevertheless important to try. Attorneys should also remind investors to use extreme vigilance leading up to a sale. Although no marketplace can guarantee that every transaction is secure, it is preferable to use well-established third-party exchanges that properly vet their patrons. Unfortunately, the only truly fool-proof way to invest in NFTs is to not invest in them at all—undoubtedly, that is an unacceptable solution for many NFT investors who remain extremely interested in the sector despite its recent downturn. Nevertheless, there are ways to minimize the risks involved as we wait for the industry to establish greater stability and consumer protection, either through innovation or future regulation. ■