Fountain Court CHAMBERS

Quarterly Commercial Crime Newsletter:

COMMENTARY

Money Laundering through Non Fungible Tokens

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Introduction

With the paradigm-shifting sale at Christies of Beeple's digital artwork 'Everyday: The First 5000 days' for $69.3 million plus fees, Non-Fungible Tokens, or 'NFT,' have burst into the mainstream consciousness.

An NFT is an intangible asset which records, and constitutes, ownership to property (typically, but not necessarily, another digital asset), on a distributed ledger, or 'blockchain'. The blockchain is, in very short terms, a record of every transaction that has been made using the relevant protocol, a copy of which is held by every computer (or 'node') operating the software (space preludes a more detailed analysis of smart contracts; an excellent introduction can be found in Green and Sanitt, 'Smart Contracts', in Davies and Raczynska (eds.), The Contents of Commercial Contracts: Terms Affecting Freedoms (Hart, 2020)). Each token is unique (that is, 'non-fungible') and any transaction in the token is verified and immutable on the ledger. There is no inherent connection between NFTs and digital art, which was created and traded long before the advent of blockchain. However, NFTs have been crucial to the recent meteoric rise in the value of some digital art.

Although a digital image, a YouTube video, or a tweet, may be publicly available, only the holder of the NFT owns the 'original' version of that work. That uniqueness brings value, and the valuable right is transferable. In many ways this is nothing new: in

general terms, the value of an NFT in a digital artwork is analogous to the value of a photograph; whilst the original may command a high price, an ostensibly identical reproduction will be very much less valuable. The principal difference between owning a photograph and an NFT is that the NFT is not the work itself, but merely the smart contract conferring rights in that work.

NFT as a money-laundering tool

The money laundering risk presented by NFTs is twofold:

- First, both sellers and buyers are usually functionally anonymous, the transfer of NFT for cryptocurrency taking place on a blockchain (most commonly Ethereum.) At present, a number of high-profile NFT platforms will allow prospective buyers and sellers of NFTs to register without performing any AML checks. This anonymity also brings collateral disadvantages for enforcement authorities, such as the difficulty of establishing jurisdiction. In Ion Science Ltd v Persons Unknown (unreported, 21 December 2020), Butcher J considered (to the standard of a serious issue to be tried) that the situs of a cryptoasset is the place where its owner is domiciled.

- Secondly, the high and fluctuating value of many NFTs allows for the introduction of significant capital into the system, and for the onward sales at markedly different prices, usually a 'red flag' for money laundering.

Given these features, the artist David Hockney appeared to speak for many in the art world when he described the NFTs as being a market for *"crooks and swindlers"*.

Relevant Money Laundering Offences

The money laundering offences are set out in Part 7 of the Proceeds of Crime Act 2002. That Part includes two sets of offences: those which apply to all persons, and those which apply only to regulated sectors.

General offences

The offences of general applicability are: (i) concealing, disguising, converting, transferring, or removing from the jurisdiction criminal property (section 327); (ii) entering into or becoming concerned in an arrangement which facilitates the acquisition, retention, use or control of criminal property (section 328); and (iii) acquiring, using or possessing criminal property (section 329). In each case, it is a defence for the defendant to make an authorised disclosure and obtained consent from the relevant authority to pursue the act(s). The inchoate forms of these offences are themselves money laundering offences (section 340(11)).

"Criminal property" is defined in section 340(3) as property, (i) which constitutes a person's benefit from criminal conduct or represents such a benefit whether directly or indirectly, if (ii) the defendant knows or suspects the same. In this context, *"suspects"* means *"the Defendant must think that there is a possibility, which is more than fanciful, that the relevant facts exist"* (*R v Da Silva* [2006] EWCA Crim 1654).

Section 340(9) makes clear that property includes money, real property and tangible and intangible personal property, and choses in action. Sections 340(5)-(6) define the concept of *"benefit"* to include any property or pecuniary advantage obtained as a result of or in connection with the relevant conduct. A

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pecuniary advantage includes the avoidance of payable taxes (*R v Rowbotham* [2006] EWCA Crim 747; *R v K*(I) [2007] EWCA Crim 491).

If the relevant act(s) were committed within the jurisdiction, it is no defence that the underlying criminal conduct which generated the benefit took place outside the jurisdiction (unless the defendant knew the act(s) to be lawful under the law of the jurisdiction in which the act(s) occurred), and no defence that the criminal property was obtained outside the jurisdiction.

Regulated sector offences

The offences applicable to the regulated sector include: (i) failure, without reasonable excuse, to disclose information gained in the course of a business in the regulated sector, as a result of which the defendant knows or suspects (or has reasonable grounds for knowing or suspecting) that another person is engaged in money laundering, and which information includes either the identity of such persons or the whereabouts of laundered property; and (ii) 'tipping off', by disclosing the fact of an investigation or authorised disclosure concerning potential money laundering, where such information came to the defendant in the course of business in the regulated sector, and the disclosure is likely to prejudice any investigation.

The *"regulated sector"* is defined in Schedule 9. It includes (in broad terms) financial institutions and insurers, and, relevantly: (i) a firm or sole practitioner trading (including as intermediary) in the sale of purchase of works or art where the transaction value exceeds €10,000, or which operates a freeport storing works of art of that value (para 1(1)(u)); and (ii) cryptoasset exchange provisions and custodian wallet providers (para 1(1)(v)).

For these purposes, a *"cryptoasset exchange provider"* is a firm or sole practitioner who (whether or not it created or issued the cryptoasset) exchanges or arranges the exchange of cryptoasset for money (or vice versa) or for another cryptoasset. A *"cryptoasset"* is *"a cryptographically secured digital representation of value or contractual rights that uses a form of distributed ledger technology and can be transferred, stored or traded electronically"*.

These definitions were inserted into POCA by the Money Laundering and Terrorist Financing (Amendment) Regulations 2019, which (alongside other regulations) give effect to the EU's Fifth Money Laundering Directive. Although the definition of *"cryptoasset"* was predominantly intended to cover cryptocurrencies such as bitcoin and ether, that definition is broadly worded. It is at least arguable that it includes NFTs themselves.

HM Treasury issued guidance in May 2021 to the effect that (traditional) artists are not *"art market participants"* for the purposes of 5MLD, and do not *"trade in the sale or purchase of works of art"* within the meaning of POCA. However, it remains possible that a digital artist dealing in his or her own works may be a *"cryptoasset exchange provider"* within the meaning of POCA.

Some examples

There are various ways in which art market participants dealing in NFTs may engage the

above provisions. For example:

- Art Dealer facilitates the sale of an NFT to Buyer in ether. Buyer is the spouse of a PEP accused of fraudulently misappropriating money from his or her state's central bank. Art Dealer thinks that there is a (non-fanciful) chance that Buyer's bitcoin represent the traceable proceeds of that fraud, but fails to make an authorised disclosure. This is a straightforward case; Art Dealer is guilty of an offence under (at least) section 328.

- Art Adviser's client, Consignor, has consigned an NFT to auction. Art Adviser learns that Auction House has informed the National Crime Agency of its concerns that Consignor is engaged in money laundering. Art Advisor advises Consignor to withdraw the work from auction to prevent any negative publicity. Art Advisor is probably guilty of the 'tipping off' offence under section 333A.

- NFT Platform is approached by Buyer for assistance in purchasing high-value NFTs at their asking price, and immediately selling them on to third-party entities at a significant reduction. NFT Platform has reasonable grounds for suspecting that Buyer is engaging in money laundering. If NFT Platform fails to make an authorised disclosure, it is probably guilty of the 'failure to disclose' offence under section 330.

Asset tracing

Whilst NFTs present some clear opportunities for would-be money launderers, one countervailing factor is that most blockchains – including Ethereum - are publicly accessible. This may make assets more easily traceable than traditional transactions, including through the use of disclosure powers under Part 8 of POCA against NFT platforms, crypto-wallet custodians, or the parties to NFT transactions. The immutability of the ledger may therefore work to the authorities' advantage, providing an up-to-date record of the path taken by the proceeds of crime in and out of NFTs.

Looking to the future

The art market is yet to decide whether the prices that some NFTs have commanded in recent months represent a bubble or a trend. Whichever it is, there can be no doubt that blockchain-based assets and cryptocurrencies are here to stay. That new and uncertain landscape presents both opportunities and challenges for at market participants, not least because it comes at the same moment that the market is coming to terms with the money laundering regulations which apply to it as a consequence of 5MLD. Whilst the potential rewards from digital art may be great, the potential downside of failing properly to engage with money laundering risk could be greater still.

ABOUT THE AUTHORS

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