

NFT to protect Digital Art

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Abstract: Emergence of non-fungible tokens (NFTs) has led to considerable changes in the creative industries markets associated with the emergence of fundamentally new opportunities for the transfer and protection of intellectual property rights. The explosive growth of the NFT market has led to close attention of both regulators and market participants to the problems of legal regulation of the turnover of these digital assets. The lack of a legal definition gives rise to problems related to the delimitation of NFTs from other digital assets named in the legislation. This article examines the legal nature of NFTs, distinguishes them from securities, digital rights, digital financial assets, digital currencies and utilitarian digital rights. The author analyses the draft law on NFT and draws conclusions about the prospects for legal regulation with special emphasis on the legal problems of acquiring NFTs. Based on the study, the author concludes that it is possible to classify NFT as “other property” and that it is necessary to develop a special legal regime.

Key words: NFT, blockchain, intellectual property, digital law, digital asset, digital art.

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INTRODUCTION

NFT is a digital tool for tokenising works of art, predominantly digital art. Tokenisation in this area has become possible thanks to the appearance in 2017 of the ERC-721 standard on the Ethereum blockchain, which allows unique tokens creation. Currently, there are several standards for creating NFTs on the Ethereum blockchain, including ERC-1155, which also provides storage for multiple works in a single NFT (Ethereum 2021).

The popularity of NFTs continues to grow every day. According to Chainalysis (Bykovskij 2021), by the end of 2021, the global NFT market reached \$26.9 billion, and this figure is forecasted to double by 2030. Currently, the most expensive work on NFT, a digital painting “The First Five Thousand Days” by the artist Beeple (Mike Winkelmann), sold for \$69 million (Evseeva 2021). In 2023, the first NFT marketplace was launched in China (Kuzmicheva 2022).

In Russia, this technology also turned out to be very popular. Pokras Lampas sold his first NFT for 2.1 million rubles (RBC Style 2021), and the duo of digital artists 404.zero decided to donate the NFT work to charity, which was sold for a record 6.6 million rubles at that time (Tekdeeps 2021). In December 2021, the online gallery SAMPLE, together with an association of experts from the arts and culture, finance, technology, law and project management industries NFTMASTERTS, presented the first curated NFT collection of Russian art. Those works were sold for more than 11 million rubles.

The widespread use of NFTs requires the development of appropriate legal regulation that would eliminate the risks of legal uncertainty in the NFT market.

NFT DEFINITION

An NFT is a record in a distributed ledger (DLT) that contains unique data that cannot be tampered with or copied. Such a record can be transferred to another user of the corresponding distributed ledger, while the previous owner irretrievably loses the token after its transfer. This NFT feature makes them look like physical objects, where the transfer of the token is similar to the transfer of a physical object, unlike ordinary electronic files that can be sent to the recipient by keeping them.

Blockchain technology allows a clear-cut distinction between the original file saved in the form of an NFT and its copy, since the blockchain has records of the creation, ownership and transfer of the token. Moreover, such technology ensures that each token has only one owner. Unlike conventional electronic files, this makes a particular token unique and unique. Thus, NFT is a non-fungible token.

In common law countries, goods are considered interchangeable if they can be substituted for each other and have the same value. Stocks, currencies, commodities and other assets, for example, are fungible, which simplifies civil turnover. However, non-fungible assets are those that have unique characteristics that cannot be replaced by other assets (Frankenfield 2022).

In Russian law, instead of the terms “interchangeable” and “non-interchangeable”, the terms “individually defined” and “determined by generic characteristics” are used. However, the latter are used only in the classification of things. NFTs are not considered things due to their intangible nature, so their characteristics as “individually defined” is not entirely correct from the Russian legislation point of view.

NFT creation allows for obtaining a certificate of authenticity for a specific digital asset. This means that an NFT becomes proof of ownership of the original version of a digital object (painting, photographic, musical or other work, 3D model, etc.), regardless of who can view or download it. Just as a painting, while remaining unique, can belong to a museum or a private person, which can be viewed in an exhibition or in a catalog.

The value of the work after the creation of the NFT lies in the token. By buying a token, the buyer becomes the sole owner of the digital object associated with the token. If the owner sells the NFT, the access to the digital object is lost in the same way as when selling a regular item. Therefore, when selling digital works in NFT, the object of the transaction is a unique digital code (token) into which the work (painting, video or other digital file) is pre-converted, and not the paintings, videos or other art objects themselves.

There are three possible ways to tokenise works of art on the blockchain:

- tokenisation of an analog object (for example, the work “Morons (White)” by Banksy) (Korneev 2021)
- tokenisation of an object created in digital form (for example, Mike Winkelmann’s digital painting “The First 5000 Days”) (Tetkin 2021)
- creation of a digital object immediately on the blockchain, such as CryptoPunks Lavra Labs (<https://www.larvalabs.com/cryptopunks>).

It is important to distinguish between the methods of tokenisation, as this affects the legal structuring of transactions related to the turnover of NFTs. If, for example, an analog work is tokenised for further sale of NFT on marketplace and a lawyer accompanies this transaction, it is necessary to pay special attention to legal tracking of the analog work will be in the future, who will become its copyright holder and whether the purchaser of the NFT will have any rights to this work.

DIFFERENTIATION OF NFTS FROM RELATED LEGAL CATEGORIES

The lack of special regulation of NFTs in Russian legislation required careful consideration of the possibility of extending the current rules relating to securities and digital assets to them.

Despite the intangible (incorporeal) nature of NFTs, they cannot be subject to the provisions on uncertificated securities. The peculiarity of non-fungible tokens is that they can certify not only property rights, but also other rights that have no economic value, but are of interest to their “holder”. An example of such tokens would be fan tokens, which allow football fans to participate in its life, for example by voting on the color of the players’ uniforms, are.

It is important to note that in accordance with Federal Law No. 39-FZ of April 22, 1996 “On the Securities Market”, the register of securities holders is maintained by the registrar - a professional participant in the securities market with the appropriate license. The function of the registrar when working with NFT is performed by blockchain technology, so information about this type of asset is stored in a decentralized database. It is stored on several computers at the same time, which ensures its protection from destruction and modification. In the distributed ledger, a unique code is prescribed, while the register of uncertificated securities only contains their numbers (Suvorova 2022).

The digital nature of NFTs makes it necessary to identify their relationship with the category of digital rights. In accordance with Article 141.1 of the Civil Code of the Russian Federation, only obligations and other rights named as such in the law are recognised as digital rights. Currently, these include digital financial assets (hereinafter referred to as DFAs) and utilitarian digital rights.

In accordance with the Federal Law dated 31.07.2020 No. 259-FZ “On the Digital Financial Assets, Digital Currency and on Amendments to Certain Legislative Acts of the Russian Federation” (hereinafter -

the Law on DFA), DFAs include “digital rights, including monetary claims, the possibility of exercising rights under equity securities, the right to participate in the capital of a non-public joint-stock company, the right to demand the transfer of equity securities, which are provided for by the decision on the issue of digital financial assets. DFAs are investment tokens that are recorded on the blockchain and confirm obligations to their owners.

Unlike NFTs, digital assets are of the same nature, fungible and divisible, which allows to divide the object (debt, profit) into parts. The peculiarity of digital financial assets is also that their issuance and circulation are made on the basis of Russian legislation. The Bank of Russia, in accordance with the procedure established, supervises the activities of operators of the information system in which digital financial assets are issued, and also maintains their register. At the same time, the turnover of non-fungible tokens is carried out on a decentralized basis.

NFTs cannot qualify as a digital currency either. Firstly, the main function of cryptocurrency is payment, while NFT is only confirms ownership and cannot be used as a means of payment, as it is impossible to determine the value of the object contained in the NFT. Secondly, an NFT token is non-fungible, unlike a digital currency token, which is characterised by generic characteristics. For the holder of digital currency tokens, the number of tokens plays a decisive role, while for an NFT token, its character and unique features are important. In addition, legal protection of digital currency is possible only with its preliminary declaration to the tax authorities while hile NFTs do not require such a declaration and are fully subject to judicial protection (Yankovskij 2020, 58).

The ratio of NFT and utilitarian digital rights are also of interest. According to the Federal Law dated 02.08.2019 No. 259-FZ “On Raising Investments via Investments Platforms and on the Introduction of Amendments to Certain Legislative Acts of the Russian Federation”, utilitarian digital rights circulate exclusively in the investment platform. Their content includes: the right to demand the transfer of the thing(s); the right to demand the transfer of exclusive rights to the results of intellectual activity and (or) the rights to use the results of intellectual activity; the right to demand the performance of work and (or) the provision of services. A utilitarian digital right is a token that guarantees the investors the right to receive a specific benefit from the project in which they have invested. An example would be a token that provides the right to receive a deluxe version of a music album in the recording of which the investor’s money was invested. Such tokens are issued for raising funding and fungible, unlike other tokens such as NFTs.

However, as has been already mentioned above, there are NFTs that have additional utilitarian properties. For example, tokens-tickets to hockey or football matches (Brandt and Hurtado 2021), or tokens that entitle to receive a physical copy of virtual clothing or shoes, such as sneakers (Bilyk 2021). Brisov Y.V. and Pobedkin A.A. (2022) call such non-fungible tokens individually defined digital rights that are not enshrined in the current legislation. According to the authors, the rules on utilitarian digital rights can be applied by analogy to NFTs, which give their holders additional rights, taking into account that utilitarian digital rights circulate on an investment platform, and NFT turnover is carried out exclusively on the blockchain.

Thus, the current Russian legislation does not apply to NFTs. A similar situation is developing in foreign countries, forcing all parties involved to look for new approaches.

For example, the Law Commission of England and Wales proposed to separate digital assets, including crypto tokens and non-fungible tokens (NFTs), into a separate category of personal property, calling them “data objects” (Law Commission 2022). “Data objects” can become the third category of personal property, along with “things in possession” and “things in action”.

Such objects are characterised as follows:

- they consist of data presented on electronic media, including computer code, electronic, digital or analogue signals;
- they exist independently of people and legal systems, and cannot be created or terminated by legal rules or court decisions;
- they compete with each other, and the token under the control of the owner cannot be used by another person or be under the control of that person.

The judicial interpretation of the legal essence of NFT is also of interest. In May 2022, in a case brought by Lavinia Osborne against the OpenSea marketplace, the High Court of England and Wales recognised NFTs as property (Case No. CL-2022-000110). Lavinia Osborne, having discovered the loss of tokens, appealed

to the court to a circle of unidentified persons in order to seize the stolen NFTs, as well as issue an order to OpenSea not to allow transactions with these tokens on the marketplace. The High Court justified its position as follows: "... it is obvious that at some stage the question will arise as to whether non-fungible tokens are property for the purposes of applying the laws of England and Wales, but based on the plaintiff's arguments, it is assumed that there are still objective arguments in favor of treating tokens as property.

Thus, foreign law enforcers are inclined to consider NFT as a kind of property. We believe that in Russian law, NFTs can be considered as "other property" within the framework of Article 128 of the Civil Code of the Russian Federation. In the future, it may be necessary to create a separate category of digital rights for non-fungible tokens, since they are entries in the distributed ledger system that confirms the holder's rights to a particular object.

PROSPECTS FOR THE LEGAL REGULATION OF NFTs

As shown above, the lack of special legal regulation leads to problems related to determining the legal nature of NFTs, and, consequently, with their accounting and turnover. Therefore, attempts were made to regulate a new type of digital assets at the level of the law.

In May 2022, a bill was submitted to the State Duma of the Russian Federation, according to which "a non-fungible token of a unique digital asset (images, videos, other digital content or asset) is presented in the form of non-fungible data stored in a distributed ledger system" (Draft Law No. 126586-8 "On Amendments to Article 1225 of Part Four of the Civil Code of the Russian Federation")² must be recognised as an independent object of intellectual property rights. However, an NFT is only a code confirming the rights to a digital object and recorded on the blockchain, and not the work itself. Despite the fact that an art object can be "embedded" into the token, it will be necessary to distinguish between two digital objects: the work itself and the NFT (Emel'yanov and Emel'yanov 2021: 72). Therefore, NFTs cannot be recognized as an object of intellectual property rights.

It should be recognised that the author of a digital object has intellectual rights to it, but NFT here acts as a means of identifying them. Adhering to this logic, it is impossible to call the certificate of registration of a trademark an object of intellectual property, since it is a simple document certifying that a particular person has exclusive rights to a trademark, which is an object of intellectual property.

The NFT bill was also criticised in the official response from the Government of the Russian Federation No. 126586-8. It was noted that the token was defined as a "digital certificate of ownership" – a digital document confirming the rights to already existing results of intellectual activity, which contradicts the essence of the intellectual activity result, which consists in the creative nature of its creation. The draft law does not contain provisions answering the question about the relevance of the token to a certain category of intellectual property. It is hard to disagree with this argument. On electronic platforms where various digital objects, including works of art, are placed, in most cases, an NFT code is automatically generated. This excludes the creative nature of NFT creation activities.

There are several positions regarding the prospects for legal regulation of the turnover and issue of NFTs, according to one of which non-fungible tokens are an electronic asset sui generis and require special legislative regulation, since none of the existing legal structures can be applied due to the peculiarities of NFT (Brisov and Pobedkin 2022).

It is also proposed to create a legal framework for accounting for new objects of civil law, such as electronic things, in the blockchain system. Non-fungible tokens will serve as a certifying entry in the register about the rights of a particular person to a digital object. In this case, the NFT will be used as modern entries in the register and extracts from it for registration entries in the Unified State Register of Real Estate (Emel'yanov and Emel'yanov 2021: 75).

PROBLEMS OF NFT TURNOVER IN THE FACE OF LEGAL UNCERTAINTY

NFT is a record in the blockchain that certifies the rights to digital assets. However, according to Russian law, such a record in itself has no legal force. Consequently, a person who acquires non-fungible tokens receives only the right to own a registry entry in a distributed ledger, but not the exclusive right to the results of intellectual activity. Under Russian law, the buyer also does not receive personal non-property rights

(they are not alienable) and does not automatically become the owner of the exclusive right to the result of intellectual activity (hereinafter referred to as RIA). Thus, an NFT includes a “right of enjoyment” – this right confirms the ownership of the original version of the digital art object (and not a copy) for personal purposes only, as well as the right to resell the NFT.

The transfer of exclusive rights to use the intellectual property must be agreed upon additionally when the NFT is transferred to the buyer. Therefore, in such a situation, it is necessary to conclude an agreement on the alienation of the exclusive right or a license agreement in parallel.

The most efficient way to obtain the exclusive right to intellectual property in the form of NFT is to alienate this right under a contract. At the same time, the purchaser of the NFT receives the full right to use the RIA. It is important to note that the purchaser of the NFT independently protects his exclusive right and does not depend on the copyright holder. This is especially important when the NFT is resold several times, as the binding of the right to use the intellectual property in the form of NFT by a license agreement with the copyright holder significantly reduces the value of the NFT.

License agreement, according to Article 1235 of the Civil Code of the Russian Federation, states under the license agreement, the owner of the exclusive right to the intellectual property (licensor) grants or undertakes to grant the other party (licensee) the right to use such a result or such a means within the limits provided for by the contract. If it is necessary to dispose of the exclusive right to intellectual property in the form of NFT only for certain methods of use, for example, to grant the right to demonstrate to a counterparty, then such an order is possible only using the license agreement model.

The transfer or granting of the exclusive right can also be provided for in the smart contract through which the NFT is alienated or the ways of using the RID in the metadata of a particular token can also be prescribed (Buzko 2021).

Another important issue is the re-tokenisation of original works, both digital and analog. If the copyright holder wants to prevent the creation of other NFTs related to the original work, the parties must provide for an appropriate prohibition when acquiring the NFT. Although a contractual ban cannot prevent the creation of other tokens, it will provide legal grounds for making demands on the creators of “illegal” tokens. To understand the specifics of handling non-fungible tokens, it is advisable to consider the rules for using popular services on which NFT transactions are made.

NBA Top Shot is a platform designed to collect, buy and sell and display exclusive video clips of basketball games, photos of players of the National Basketball Association (NBA Top Shot 2023). In accordance with clause 4 of the rules of the service, the user receives a non-exclusive, non-transferable and royalty-free license to use, copy and display drawings only for the purchased moments for the purposes specified in these rules.

SuperRare is a digital art trading platform. The terms of use of the platform set forth in the “Ownership” section, indicate that the acquirer receives the rights to the cryptographic token, but not to the result of creative activity itself. The owner of the token does not have the right of ownership, exclusive rights to the results of intellectual activity and means of individualisation. The author of the work retains all rights to it, including, but not limited to, the right to reproduce, display, perform and distribute the work (SuperRare 2023).

A similar mechanism is used to regulate the turnover of non-fungible tokens on the Nifty Gateway online digital art auction site: all intellectual property objects are “located” outside the NFT turnover and cannot be copied, reproduced or used without the appropriate permission of the copyright holder (Nifty Gateway 2022).

The experience of working with NFTs in Russia also deserves attention. BIZAR, being a marketplace of contemporary art, helps the works of artists to find their owners. In this marketplace, the format of the simultaneous sale of physical work and its token is implemented (in this case, the token is a digitised work uploaded to one of the NFT marketplaces). The painting token represents the added value to the physical work. Thus, the issue of exclusive rights to the work, which are transferred to a potential copyright holder, is resolved. Subsequently, the copyright holder himself decides the legal fate of these rights. Thus, when buying an NFT, the future owner should take into account the terms of the transaction and the rules of the NFT sale sites for the disposal of the exclusive rights of the intellectual property, since by default these rights will remain with the current copyright holder.

CONCLUSION

The study showed that there is currently no special legislation on the regulation of relations related to NFTs. Non-fungible tokens, being a record on the blockchain certifying the rights to a digital asset, cannot be attributed either to things due to their intangible nature, or to protected results of intellectual activity and equated means of individualisation, since they are not separately valuable to their holder, but only confirm the rights to a digital object. In our opinion, NFT should currently be classified as “other property” in accordance with Article 128 of the Civil Code of the Russian Federation. At the same time, it is necessary to recognise non-fungible tokens as an independent category of digital rights and develop a special legal regime for them.

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