EMERGENCE OF NON-FUNGIBLE TOKENS AND THE CORRESPONDING RISE IN INTELLECTUAL PROPERTY CONCERNS

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Abstract

With Metaverse becoming a potential possibility in the near future, owning digital assets and making digital investments is on the rise. Metaverse may very well become a platform that holds the most valuable data for the consumers in the virtual business world. Since ownership and trade in digital assets will increase significantly once the idea of metaverse becomes a reality, understanding these digital assets as in the form of non-fungible tokens (NFTs) and the potential regulatory and intellectual property issues that may arise from them is of utmost importance. With metaverse looking to alter the Internet of Things to integrate the digital world onto the real world, the future may hold such that the investors would prefer to invest in these digital assets as is already happening. As such there is a need to regulate their trade and investments while addressing the challenges they may pose in the various ventures. The paper primarily focuses on NFTs and their legal concerns especially relating to the intellectual property concerns. With the world advancing to regulate cryptocurrency and blockchain technology, the Intellectual property rights violation has become a matter of great concern. In particular, the copyright violations relating to NFTs pertaining to what is included in the array of rights provided to the NFT buyer/ user requires immediate attention. Also, another important concern would be to deal with what exactly amounts to the infringement, which is what this paper seeks to analyze.

KEY WORDS: non-fungible tokens – digital assets – blockchain – intellectual property rights ownership – unauthorized use/ misuse

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INTRODUCTION

Digital assets are those assets that are stored and transferred electronically. These do have right of ownership, possession and usage associated with them. When dealing with digital assets, cryptocurrency and such, the most often heard/used jargon is the blockchain technology. While blockchain indicates a huge database that has enormous amount of information stored electronically, the term 'Token' indicates a digital asset stored within a blockchain.

Token as such does not mean to represent the digital asset, rather it is more of a location or a code of that particular digital asset within the blockchain. Every token has a unique digital authenticity certificate that is linked to the underlying asset that it represents showing its genuineness and that the person selling the same has the right to do so.

The digitalized, tokenized forms are gaining such popularity that they have found their way even into the Energy sector, especially the crude oil sector which is using those tokens to calculate and adjust their prices based on the carbon intensity. The individual crude oil cargoes simply own these digital tokens that represent the ownership of the cargo and the associated attributes of carbon credits.

The token may be fungible or non-fungible based on the ability to be replaced with an identical token or to be interchanged with another. Let us consider an example of government issued currency notes, a note of denomination of Rs.20 can be interchanged with two notes of denomination of Rs.10. This interchangeable ability based on their value makes it a fungible token. The non-fungible tokens (NFTs) are those that cannot be replaced owing to their unique nature as the value of an identical/ similar asset will still be different due to its uniqueness. It is also to be noted that both the fungible and the non-fungible tokens are linked to assets in digital form but that underlying asset can be either tangible or intangible.

NFTs AND WHAT THE BUZZ IS ALL ABOUT

NFTs are basically metadata of the underlying asset they are linked to. The NFTs are blockchain based units of value or tokens that have a unique ID linked with a particular underlying asset and are created by a process called 'minting' by the minters. The NFT ideally consists of a code that is used to identify the underlying asset or is encoded with a virtual copy of the underlying asset. Once minting creates a unique digital authenticity certificate for the identification of the linked asset, it can then be stored or transferred and any replica or misuse can be prevented as a consequence of the uniqueness of the authenticity certificate because a copy of the NFT will not have the same certificate and thus being recognized as a counterfeit. This uniqueness helps the original creator to benefit monetarily from the purchasers of the NFT in a process called 'tokenization'. The most commonly used blockchain technology for NFTs is Ethereum but other blockchains are also used.

Though NFTs have been around for about a decade, it became the buzz starting 2017 with the sale of NFTs linked to some cute digital cat cartoons called the CryptoKitties by a company called Dapper Labs. After that, the prices for the NFTs have gone through the roof starting with the auction of an NFT of his first ever tweet by the Twitter CEO Jack Dorsey which sold for over USD2.9 million. The inherent scarcity of these NFTs can be understood compared to that of a limited edition item and consequentially understanding the craze over them.

To understand this hype, a few characteristics of NFTs are to be acquainted with. Firstly, every NFT created is stored on the ledger of the blockchain system. It is unique, cannot be replaced and lives on the blockchain . NFTs get recorded in the blockchain ledger each time they are transferred and since the blockchain system has open access, it is pretty much transparent. The fact that the NFTs are trackable means it is capable of proving ownership and this provenance is not even offered in the real world with the help of all the available documents. That said, the NFTs themselves don't carry any value rather they are as valuable as the underlying asset/ creation. This literally avoids the million dollar sale at auctions of some forged pieces of creation.

This is exactly why despite the possibility of owning a screenshot or a gif or a free copy of the original work, people spend huge amounts to purchase NFTs as the original copy that is linked to the original creator/ artist is owned by the individual who purchases it. So yes, the stats for January 2022 released by the Block research does indicate a three-fold jump in the volume of NFT trade in a month to about USD6.86 billion.

One of the recent hype in such NFT transactions may be that of the Bored Ape NFT which sold with the highest four-digit ETH (cryptocurrency ether powered by Ethereum) sale for the price of a single one. It is owned by top celebrities like Serena Williams, Justin Bieber, Eminem, Neymar Jr., and Stephen Curry among others. With that hype, let us now see how NFT technology works.

NFTs – THE TECHNICAL NEED TO KNOWS

As already said, NFTs are created by minting wherein the unique token is generated according to the standard set on the blockchain called the 'Token Standard'. While the commonly used standard for fungibles (exchangeables) is ERC-20, the NFTs use ERC-721 specially built for this purpose on the Ethereum blockchain. This ERC-721 helps track ownership and movements of the individual tokens from a single smart contract. The other commonly used token standard for the non-fungibles is the ERC-1155.

The NFT contains a code that can be used to identify the underlying linked asset and consists of an alphanumeric string of characters called the 'hash' serving as the digital authenticity certificate once generated. Of course the other important term 'smart contract' refers to the software code of the NFT that contains the particulars of the underlying digital/ physical assets and the rules, terms of use and the rights attached to that NFT such as invoice, royalty to name a few.

These smart contracts are thus executed for the storage and exchange of the underlying assets after minting an NFT. Smart contracts govern the terms of NFT like ownership, how to transfer, what it represents, etc. This also governs the payment of royalty that is given to the original creator on subsequent resale of the NFTs. Additionally the other aspects of the transfer, what rights/ license of the underlying asset is transferred, what is not to be done with the asset underlying the NFT and what amounts to infringement can also be expressly governed by specific clauses via a separate traditional contract. Basically to put it in a nutshell, the buyer is purchasing a 256-character alphanumeric string that indicates ownership, not of the underlying asset/ work but a unique copy of that work.

INTELLECTUAL PROPERTY RIGHTS CONCERNS

While the NFTs are pretty much transparent and avoids forged transactions, the principle of Caveat Emptor (Buyer Beware) does apply to the transactions as the owner of an NFT owns nothing more than that NFT. The ownership of NFT doesn't mean ownership of the underlying asset. He only owns that particular copy of the work and say, even reproducing that image without permission would amount to violating the rights of the owner of the original image and incurs liability under the various laws. Hence Monetizing the NFT by resale might incur some IPR issues if not done properly. Simply put, remember the NFT auction of first tweet of Jack Dorsey? The buyer cannot use the tweet elsewhere (like make articles with the tweet printed on them) without permission and mint money out of it as it infringes his copyright.

The sale of NFT doesn't include sale of the linked asset or any intellectual property rights vested in it. Assume that the original creator/ seller of the NFT permits the owner (i.e., the buyer) of the NFT to monetize it by commercializing the same. In this scenario, the owner of the NFT can use, copy and display but cannot reproduce, distribute or adapt the work by way of his license. Unless there is an express license, usually the rights of the NFT owner is limited to the right to use or display for personal use along with the right to resale that NFT.

The NFTs can be used unauthorized to monetize leading to infringement of the IPRs mainly that of copyrights and trademarks. The transfer of NFT is governed by the Laws of Contract and the smart contracts are said to be entered between the buyer and the seller with the platforms just taking the role of facilitators. Unless expressly agreed upon by the parties through the terms in the smart contract or through a separate traditional contract, the copyright remains with the creator of the work. The NFT is just a unique recognized replica of the work. It does not create a right of ownership in the original work.

Any unauthorized reproduction of the underlying digital asset amounts to infringement of the copyright of the original creator that is provided for under Section 57 of the Copyright Act, 1957 in the Indian scenario for the creator/ artist with his right to claim authorship over the work and his right to restrain or claim damages in case of any distortion, mutilation or modification of the work.

Even an artist and a publisher can fight over their rights in a NFT of a work. In November 2021, the Production company Miramax sued Director Quentin Tarantino over the proposed auction of Pulp Fiction NFTs. Tarantino announced his plans to auction off the seven exclusive scenes from the famous 1994 movie Pulp Fiction in the form of NFTs without the knowledge of Miramax and later refused to cancel the auction at the demand of Miramax. Miramax contended that the rights relating to the intended sale were transferred to Miramax by Tarantino . They don't want the public thinking that the NFTs are official products of Miramax. As such Tarantino was violating the copyrights and trademarks of the company.

Many companies have released their own NFTs relating to a particular film or series. NFTs could now be seen as a source of revenue that can be made outside of the traditional licensing deals but the rights and liabilities associated with it will have to be decided on a case by case basis. The Miramax case will set a precedent in the area of NFTs in case of films and the rights of the filmmakers.

When it comes to trademark infringement, it may be due to the use of the same/ similar mark or logo by an unauthorized person for identical/ similar items likely to cause confusion and try to gain unfair advantage of the reputed product. This may even be the case for dissimilar goods. Here the unauthorized person may try to sell NFTs by using the artist's registered trademarks. To expand on how trademark for NFTs work, basically trademarks relating to NFTs can be the name or the logo of the NFT.

Many companies do create brand awareness in the form of NFT auctions. The best example would be that of RTFKT, a shoe company that makes sneakers ready for the metaverse, Nike acquired this company getting itself ready for what is coming . When such a scenario happens, the NFT brand itself can be trademarked along with the properties represented by the NFTs.

Already the NFTs are exclusive for their authenticity and transparency which further enhances the value of the brand associated with the trademark based on the increased trust value. Say, you trademark the name of your NFT, only you can use that name even with respect to the related crypto-properties. So another person using my trademark in an online selling platform/ marketplace misusing my brand value would be infringement of my rights. One recent example is 'CROCS' Inc had applied for Trademark, Service Mark of their name in Colorado under 15 U.S.C. Section 1051 vide US Trademark Application number 97212947 filed in January 2022. For the brand owner to get protection under the Trademark law, now it becomes a necessity to apply for additional trademarks for his digital crypto assets and virtual goods that is authenticated by the use of NFTs. Around 1500 NFT Trademark applications have been received by the US Patent and Trademark Office in the past year.

In February 2022, Nike sued an online marketplace called the StockX who is a reseller of various products including sneakers. As of January 2022, StockX introduced the concept of 'Vault NFTs' that link the NFTs with the physical goods displayed and that can be redeemed or traded. Nike alleged that the digital assets constituted trademark infringement and other trademark violations. As a result, issue was raised as to whether those NFTs were just a digital receipt or did they constitute a right in themselves. The claim by Nike is that those digital assets of StockX look similar to the Nike products and StockX is using the trademark of Nike to promote their goods and attract more potential buyers. Provided that Nike itself had acquired RTFKT to delve into the crypto business, it does not want any brand confusions.

The case itself presents an issue as to how these trademark infringements can raise new and different issues. The fact that the other party may contend its case based on the 'Doctrine of First Sale' wherein the marketplace does have a right to resell and display images of goods including trademarks without the permission of the holder of the Intellectual Property. How this case is going to turn out is something to keep an eye on as this is not the end of crypto-trademark fights.

With regard to patents, the block chain owner can license the technology he uses for his NFT and obtain a patent on the same that lets his consumers possess collectibles that are genuinely of the brand. For instance, Nike itself owns a patent to generate crypto digital assets for its shoes that will allow its consumers to own a digital collectible version of their shoe in the wallet called Cryptokicks while assuring the genuineness and the originality of the product purchased. But the essential to obtain a patent as to how the invention must be novel is applicable in case of patenting the NFTs.

From the discussion above, it is pertinent to remember that a clear delineation of what can be done and what is permitted while outlining what is not should be expressly stated either in the smart contract or the terms of sale of NFT so as to avoid any intellectual property rights infringements by a genuine purchaser/ owner of NFT.

While NFT is an upcoming form of financial investment, the associated legal issues and lacunae must be addressed with a clear statutory framework. Although IP rights pertaining to NFTs can be claimed under the various IP legislations in India, with the limitations and regulations on crypto currency, the future of NFTs in India seems questionable.

CONCLUSION

The NFT technology is taking the world by storm and becoming worth millions of dollars with the possibility of the metaverse becoming the near future but the NFTs are the now. Widespread in the fields of gaming, fine art collection, the NFT, that can take any digital form like that of a picture, audio or a video, can be treated as a commodity, property or an investment depending upon the laws of the state if and when the governments of the world decide to pass such legislations and/or regulations. But for that to happen, the ambiguities relating to the treatment of the NFTs for the various purposes of law must be clearly discussed upon. I mean, starting from sharing memes to digitally created stickers to real estate, NFTs have begun to make their mark in every industry. Sports? Fashion? Automobile? Yes, NFTs have touched upon them all. And who knows, now I can sell my pokemon cards as NFT, maybe in future this article can be sold as an NFT? So, how to tax the NFTs? What about the infringements? The jurisdiction? While India is still dealing with a clear cut regulation regarding the cryptocurrencies, the world moves on ahead with or without a legal framework.