



ARTICLE

THE FREE CIRCULATION OF NFTS IN QUESTION



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The unstoppable rise of NFTs

Since the record-breaking sale of crypto-artist Beeple's "Everydays: the First 5,000 Days" for \$69.3 million in March 2021, the NFT (non-fungible tokens) phenomenon continues its irresistible rise[1].

The craze around these assets of a new kind is more and more prevalent, and many actors join the world of NFT: graphic artists[2], musicians[3], directors[4], to creators of memes and collectible images[5].

The business world is not left out, many companies perceiving in the NFTs a unique potential for growth. Thus, many companies have created and put on sale NFTs - from the luxury sector like Gucci[6], Guerlain[7] or Dolce & Gabbana[8], to sports[9], through the restaurant industry[10], the press[11] or the video game sector[12].

In addition, new players entirely dedicated to NFTs are emerging. This is the case of Sorare, a French unicorn that raised the largest amount of funds in the French Tech sector in September 2021[13]. Sorare offers an online fantasy soccer game in which players can use virtual player cards in NFT format for soccer tournaments. More recently, the French-Portuguese start-up Exclusible, which offers an NFT marketplace for luxury brands, sold 3,000 NFTs in 48 hours for \$2.4 million[14].

NFTs have even been named "the most influential art phenomenon of 2021" by Art Review[15], the authors of the list explaining that "NFTs have disrupted the art market, bringing together contemporary art and the culture of millennials".

The recent change of name of the Facebook group to Meta, and the announcements of its founder and CEO Mark Zuckerberg concerning the construction of a "metaverse" (a fictional and persistent virtual world) in which NFTs would play a crucial role[16], contribute to this enthusiasm. At the moment, NFTs that can be used in metaverses are already being sold at high prices: a virtual yacht was sold for \$650,000 in the metaverse The Sandbox[17], a 564 square meter virtual plot of land was sold for \$2.4 million in Decentraland[18]... The possibilities seem limitless.

The technical and legal nature of NFTs

The attractiveness of NFTs is explained by their non-fungible nature, which allows for the creation of a new paradigm in the digital age, where until now any asset was easily and infinitely reproducible in identical form, so that everyone could own a "copy" of it. Conversely, an NFT allows a digital asset to be individualized and its owner to be identified in a certain way, thus introducing uniqueness and rarity into the digital sphere, characteristics that were previously reserved in principle for assets in the physical world.

In concrete terms, an NFT can be considered as a cryptographic certificate of ownership of a digital asset, of whatever nature, stored on a blockchain and associated with this digital asset - thus benefiting from the tamper-proof and traceability properties of the blockchain technology. The smart contract on which an NFT is based also makes it possible to organize the contractual terms and conditions applicable to its initial sale and subsequent resales (including, where applicable, the remuneration due to the original issuer of the NFT, which is then similar to a "contractual" resale right, the articulation of which with the "legal" and inalienable resale right of Article L. 122-8 of the French Intellectual Property Code applicable to the successive resales of original graphic and plastic works - including "on audiovisual or digital support"[19] - will necessarily raise questions[20]).

An NFT is thus distinct from the asset it represents: it identifies the author of this underlying asset, as well as its owner, but is quite distinct from this asset which exists "off-chain".

From a legal point of view, the qualification of NFTs is not obvious.

The two definitions of "digital assets" in Article L. 54-10-1 of the French Monetary and Financial Code, which originate from the PACTE Act of May 22, 2019, are not adapted to NFTs, as they do not meet the criterion of non-fungibility that characterizes NFTs.

The first definition refers to "tokens mentioned in Article L. 552-2 [French Monetary and Financial Code]", namely "any intangible asset representing, in digital form, one or more rights that can be issued, recorded, stored or transferred by means of a shared electronic recording device that allows the owner of said asset to be identified, directly or indirectly". This provision is part of the regulation of initial coin offerings (ICOs), i.e., "fundraising operations by which a company in need of financing issues tokens, to which investors subscribe mainly with crypto-currencies [and which] may allow them to access, in the future, products or services of this company"[21]. However, these tokens are in principle fungible, which de facto excludes NFTs.



The second definition refers to "any digital representation of a value that is not issued or guaranteed by a central bank or public authority, that is not necessarily attached to legal tender and that does not have the legal status of money, but that is accepted by natural or legal persons as a medium of exchange and that can be transferred, stored or exchanged electronically". Again, the criterion of non-fungibility is lacking, and NFTs cannot be equated with the "digital representation of a value" used "as a medium of exchange".

The inadequacy of these definitions for NFTs was the subject of a written question to the French Minister of the Economy [22] and of an amendment to the 2022 Finance Bill, adopted in committee and then withdrawn in the public session [23], which proposed to orient the taxation of NFTs according to their underlying value, rather than assimilating them to digital assets - which they clearly are not.

For the Financial Action Task Force (FATF), an intergovernmental body created in 1989 to develop and promote standards to combat money laundering, terrorist financing and other related threats to the integrity of the international financial system, NFTs "are in practice used as collectibles rather than as payment or investment instruments, [and] are generally not considered to be [Virtual Assets] under the FATF definition"[24], which includes any "digital representation of value that can be digitally traded, or transferred, and that can be used for payment or investment purposes".

The legal qualification of NFTs therefore seems to have to be sought rather on the side of the underlying assets that they represent.

The necessary free circulation of NFTs

Once an NFT has been created and made available on the blockchain (this is known as "minting"), it should circulate freely on the blockchain. Regardless of how an NFT was first acquired (on a platform such as Rarible, OpenSea, Coinbase NFT, in a video game such as Sorare or Ubisoft's "Tom Clancy's Ghost Recon Breakpoint", etc.), its owner should in principle be able to dispose of it freely and thus keep it, sell it, give it away, or in some cases use it (when the NFT has a utility function, in a video game for example), with the only restrictions being those that are applicable to the blockchain concerned [25].

The initial issuer of an NFT necessarily agrees, when it is put up for sale, to dispose of it completely and to allow its purchaser to dispose of it as he/she sees fit, and this without any time limit.

In this respect, an NFT can be assimilated to the digital equivalent of a good of the physical world on which exists a tangible property right distinct from its possible intellectual property. Article L. 111-3 of the French Intellectual Property Code indeed provides that "the intangible property defined by Article L. 111-1 is independent of the ownership of the material object. The purchaser of this object is not invested, because of this acquisition, with any of the rights provided for by this code [...]".

However, as mentioned above, the NFT is not in itself the digital file that it represents, which is stored off-chain, but a sort of certificate of ownership identifying the said file. This identification is generally achieved by means of a simple URL address written in the *smart contract* of the NFT.

If from a technical point of view, the use of a URL address can present difficulties related to the fact that the immutability of the underlying digital asset of the NFT is not ensured [26], this drawback can be mitigated by the use of more secure hosting protocols, such as IPFS (InterPlanetary File System) which is based on a decentralized peer-to-peer architecture, which is more and more used.

In any case, the primary purpose of an NFT is to identify a digital file in a certain and permanent way, so that the NFT and the digital content it identifies form a consubstantial whole.

This raises the question of the free circulation of this whole in the event of successive sales. In particular, can the intellectual property rights that may apply to an NFT and/or to the digital file it identifies constitute obstacles to this free circulation?

In the material world, the free circulation of goods is ensured by the rule of exhaustion of rights, which ensures, for each of the intellectual property rights [27], a compromise between property rights and free circulation of goods. In application of this rule, once the copy incorporating the intellectual property is voluntarily marketed in the European Economic Area by the holder of an intellectual property right on the good in question or his licensee, the said holder can no longer invoke his intellectual property right to limit the circulation of the copy in question [28]. The medium of a work (a book, a CD), as well as goods to which a trademark is affixed, must thus be able to circulate freely in the European Economic Area after their first authorized circulation, notably between successive purchasers, without the holders of the intellectual property rights in question being able to oppose this.

Although European law refuses to enshrine an international exhaustion of intellectual property rights, the rule has an equivalent in many countries, starting with the United States under the name of "first sale doctrine" [29].

Historically, the rule of exhaustion of rights, like its American counterpart, was intended to apply only to the distribution of physical copies, by virtue of the distinction between the intellectual property and its medium.



However, over the past decade, the rule has - to some extent - been extended to the digital world. The Court of Justice of the European Union (CJEU) has thus accepted to consider that the exhaustion of the distribution right should also apply to the resale of dematerialized software for which licenses have been granted by their publisher for the duration of the related intellectual property rights and for a fixed price^[30]. However, this same Court recently refused to extend the rule to the resale of digital books^[31], considering that the marketing of these works was covered by the right of communication to the public, not subject to exhaustion, and not by the right of distribution, contrary to a decision of the Paris First Instance Court rendered a few months earlier on the resale of second-hand digital video games^[32].

These solutions (in particular the UsedSoft ruling of July 3, 2012) deeply divide digital actors and do not allow one to conclude that the rule of exhaustion of rights has been purely and simply transposed to the digital universe.

On the other hand, the situation of NFTs is quite different: their specificities (and in particular their storage on a blockchain) give them particular properties - first and foremost their non-fungible nature - which tend to assimilate them to tangible goods and should, logically, plead in favor of an exhaustion of the distribution right of the whole constituted by the NFT and the digital content it identifies^[33].

Indeed, an NFT is by nature unique, and its sale by its owner necessarily implies a dispossession of the latter, contrary to an "off-chain" digital asset which sale does not by nature entail the deletion of the file by the seller. The sale of an NFT is therefore in principle comparable to the sale of a physical copy, despite the digital nature of the token: this is the whole point of NFTs, which should therefore fall under the distribution right (exhaustible), and not the communication to the public right (inexhaustible).

The digital content identified by an NFT, which as we have seen is consubstantially linked to this NFT, should by extension follow the same regime. This is indeed the will of the parties to an NFT sale contract: to transfer the ownership of the digital content by transferring the associated "property title" (the NFT).

Thus, in cases where the digital content identified by an NFT can be qualified as an intellectual work within the meaning of article L. 112-2 of the French Intellectual Property Code or is covered by a registered trademark, and that it has been the object of a first release authorized by the concerned rights holders, then the distribution rights of the said holders should be considered as exhausted by the first sale of the said NFT.

In any event, pending a possible legal or jurisprudential confirmation of this extension, the parties to an NFT sale contract are encouraged to contractually secure the free circulation of the NFT and the digital content associated with it, both upstream (at the stage of the issuance of the NFT or "minting") and downstream (at the stage of its acquisition).

[1] <https://www.christies.com/features/Monumental-collage-by-Beeple-is-first-purely-digital-artwork-NFT-to-come-to-auction-11510-7.aspx>

[2] Notably Damien Hirst (<https://www.courrierinternational.com/article/art-contemporain-currency-et-damien-hirst-entre-dans-la-danse-des-nft>), Murakami (<https://www.forbes.com/sites/cathyhackl/2021/11/29/the-evolution-of-a-metaverse-brand-rtkfts-clonex-drops-today/>), Trevor Jones (<https://www.businessinsider.com/nft-artists-make-millions-traditional-galleries-adapt-cryptoart-2021-3?r=US&IR=T>) and many more

[3] For example, the French rapper Booba sold 25 000 NFT giving access to his new single (<https://www.strategies.fr/actualites/marques/4069389/W/booba-premier-artiste-francais-a-se-lancer-dans-les-nft.html>)

[4] For example, Quentin Tarantino has put on sale unpublished scenes from "Pulp Fiction" in the form of NFTs (<https://www.lesinrocks.com/cinema/quentin-tarantino-met-aux-encheres-des-nft-de-scenes-inedites-de-pulp-fiction-421599-08-11-2021/>)

[5] See for example the NFT collection "Bored Apes Yacht Club" (<https://boredapeyachtclub.com/>)

[6] <https://journalduluxe.fr/fr/mode/nft-gucci-se-lance-sur-le-marche-de-l-art-numerique>

[7] <https://journalduluxe.fr/fr/beaute/guerlain-nft-durable-goodplanet>

[8] <https://www.vogue.fr/mode/article/dolce-gabbana-nft-venise-collezione-genesi>

[9] For example, the American national basketball association (NBA) publishes a marketplace on which short videos of games are traded (<https://www.lefigaro.fr/secteur/high-tech/nft-sportifs-l-editeur-de-nba-top-shot-valorise-plus-de-7-milliards-de-dollars-20210923>)

[10] For example, McDonalds (<https://business.ladn.eu/news-business/actualites-annonceurs/mcdonalds-lancement-nft-non-fungible-token-agence-ddb/>)

[11] See for example the New York Times (<https://www.nytimes.com/2021/03/26/technology/nft-sale.html>) or 20 Minutes (<https://www.20minutes.fr/arts-stars/culture/3151151-20211019-nft-20-minutes-vendu-3000-euros-piassa>)

[12] The French group Ubisoft has just announced its entering in the NFT market: <https://www.lesechos.fr/tech-medias/hightech/blockchain-le-geant-francais-des-jeux-video-ubisoft-se-lance-dans-les-nft-1370557>

[13] https://www.lemonde.fr/economie/article/2021/09/21/sorare-signe-la-plus-grosse-levee-de-fonds-de-l-histoire-de-la-french-tech_6095400_3234.html



- [14] <https://journalducoin.com/actualites/exclusible-plateforme-luxe-millions-dollars-de-nft-en-48-heures/>
- [15] <https://daily.artnewspaper.fr/articles/les-nft-en-tete-du-power-100-d-art-review->
- [16] <https://www.numerama.com/tech/751378-mais-que-viennent-faire-les-nft-dans-le-metaverse-de-facebook.html>
- [17] <https://www.businessinsider.fr/un-mega-yacht-virtuel-a-ete-vendu-650-000-dans-le-metavers-the-sandbox-189260>
- [18] <https://www.numerama.com/tech/758242-dans-le-metaverse-aussi-les-prix-de-limmobilier-donnent-envie-de-pleurer.html>
- [19] French Intellectual Property Code, Art. R.122-2 and R.122-3.
- [20] <https://www.gazette-drouot.com/article/nft%25C2%25A0%253A-risque-ou-opportunit%C3%A9%253F/29003>
- [21] Definition given by the French Financial Market Authority on <https://www.amf-france.org/fr/quest-ce-quune-initial-coin-offering-ico>
- [22] Written question n°22200 from M. Jérôme Bascher (Oise - Les Républicains) published in the Official Journal Senate of April 15, 2021 - page 2459.
- [23] Amendment No. I-CF879 filed on Thursday, September 30, 2021.
- [24] GARF-FATF, "Updated guidance for a risk-based approach virtual assets and virtual asset service providers", Oct. 2021, n°53 : <https://www.fatf-gafi.org/media/fatf/documents/recommendations/Updated-Guidance-VA-VASP.pdf>
- [25] NFTs are typically issued and circulate on the Ethereum blockchain as ERC-721 tokens.
- [26] In November 2021, Australian developer Geoffrey Huntley created the website The NFT Bay (referring to the famous torrent download site The Pirate Bay), on which he made available the underlying digital files of all NFTs circulating on the Ethereum and Solana blockchains. He said: "*Fundamentally, I hope through <http://thenftbay.org> people learn to understand what people are buying when purchasing NFT art right now is nothing more than directions on how to access or download an image. The image is not stored on the blockchain and the majority of images I've seen are hosted on web2.0 storage which is likely to end up as 303 meaning the NFT has even less value.*"
- [27] In French law, see French Intellectual Property Code, Articles L.122-6 and L.122-3-1 (copyright), L.211-6 (neighboring rights), L.342-4 (database producer's rights), L.513-8 (designs and models), L.613-6 (patents) et L.713-4 (trademarks).
- [28] For a detailed presentation of the rule of exhaustion of rights and its conditions, see N. Binctin, Droit de la propriété intellectuelle, Sept. 2020, Lextenso, n°1410 et seq.
- [29] For a synthetic presentation of this more "international" doctrine than its European counterpart, see P. Kamina, L'épuisement international du copyright aux États-Unis. Understanding Kirtsaeng v. Wiley, CCE Jul. 2013, no. 7.
- [30] CJUE, gr. ch., 3 juillet 2012, UsedSoft GmbH c. Oracle International Corp., Aff. C-128/11
- [31] CJUE, gr. ch., 19 décembre 2019, Tom Kabinet, Aff. C-263/18
- [32] TGI Paris, 17 septembre 2019, n° 16/01008
- [33] As well as the application of the "first sale doctrine." See on this issue Ph. Shaverdian, Blockchain-based Digital Assets and the Case for Revisiting Copyright's First Sale Doctrine, February 2019, UCLA Law Review.
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