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Fintech & Virtual Asset

Legal Updates

December 2021

Key Issues Related to NFT (2)

Kim & Chang's Fintech & Virtual Asset Team would like to discuss potential legal issues and considerations related to Non-Fungible Tokens ("NFT").   This Part 2 provides a general overview of copyright issues related to NFT.

I.   Introduction

NFT attracted general public attention when NFT for a digital art work was sold at a price much higher than expected at a Christie's auction.   Attempts are being made to utilize NFT in various areas such as games and media, but the most active field of application is the area related to digital works.   Various NFT marketplaces are already in operation to trade digital media art, and NFTs for many digital media are actually traded on such marketplaces.

From a technical perspective, NFT is a package of data generated by a smart contract operating on blockchain.   Various blockchain platforms, such as Ethereum, standardize and disclose the functions required to implement NFT on a blockchain, but do not restrict what data should actually be contained in the token. Typically, the token contains information such as the title or creator/producer of the digital media that is the subject of the NFT and the URL in which the media data is stored.[1]

In the process of issuing an NFT for tangible material or digital work and trading thereof, there are various issues related to copyright law.   Currently, the copyright law does not have separate regulations on NFT, which means that NFT will be regulated according to existing copyright laws.   We will discuss below how NFT-related issues could be characterized and treated in relation to the issuance and trading of NFT, as well as the rights of NFT owners.

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[1] Depending on NFTs, there are cases where data regarding the contents of a token are stored in an external storage space that is not a blockchain, and only a hyperlink that provides access to the external storage space storing the ID and contents of said token is stored on the blockchain.

II. Issues in NFT Minting Process

Whereas the term "mining" is used for the new issuance of a cryptocurrency coin on blockchain, the term "minting" is used for the new issuance of tokens including NFT.[2]

Minting NFT refers to the process of creating a new NFT using a smart contract that exists on blockchain and recording it on blockchain.   Specific operations may differ depending on the blockchain on which the NFT is issued and the rules should be followed.   However, the following steps are generally taken: a work that is subject to the issuance of NFT is digitized; an identification number is generated to identify the digitized work; a token that includes metadata regarding the work is generated; and the issuance of the token is recorded on blockchain.

1. Digitization of Original Contents

When the subject of NFT to be issued is a tangible work that exists in the real world, as opposed to a digital work, it must go through a process of digitization first.   According to copyright law and practice, the digitization process, which converts a work in an analog form to a digital form, is considered as an act of reproduction under the copyright law.   As such, except for special cases where the issuance of NFT may be allowed for fair use, the approval of the original copyright holder is necessary for the digitization process of an original work.[3]

Further, even if the original copyright holder agrees to such NFT issuance, there is still a possibility of an infringement of moral rights of the author including the right of integrity and the right of attribution, if the subject of the digital work included in the NFT differs from the actual work.

Meanwhile, the process of issuing NFT includes preparing and storing metadata and URL in the NFT. There is a discussion of whether a minted NFT that includes metadata and URL corresponds to an adaptation.   However, we believe it would be difficult to claim that NFT is a newly created work (i.e., an adaptation) which is a modification based on the original work, merely because it includes metadata, in the absence of special circumstances.

2. Transfer of Digitized Work to Storage Space

For a digitized work to be usable, it must be stored in a location accessible through a network.   Many NFT platforms make use of a distributed file system platform called "interplanetary file system (IPFS)," while some platforms store the digitized work on their blockchain itself.

The digitized work, rather than being recognized as a separate creation, is viewed as a reproduction of an original work.   Therefore, the process of storing the digitized work on IPFS or blockchain in the minting process may be viewed as another reproduction of the original work.   Further, the issue of infringing the right of communication may occur, because the digitized work is transmitted through a network in the

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2 Although there is no strict legal definition, a coin generally refers to a virtual currency that has a mainnet blockchain that operates exclusively for the specific virtual currency, while a token generally refers to a virtual currency that makes use of the functions offered by an existing blockchain and operates on said blockchain.

3 Issuing NFT on a real object that has not been digitized is also possible.   In this case, however, an additional device that can connect the said object to the NFT is required.   Unless there is a separate explanation, it is assumed that the process of issuing NFT entails the digitization of original content hereinafter.

process of such reproduction.   Accordingly, similar to what is discussed in subsection 1 above, storing the digitized work on IPFS or blockchain requires the approval of the original copyright holder.

3. **Minting Multiple NFTs on a Single Work**

There may be instances where only one digitized work exists for one original work, and multiple NFTs are minted on the single digitized work.   Since NFT is "non-fungible," each NFT is unique and has an independent and singular value.

However, if the person who has obtained for approval of issuing one NFT from the original copyright holder arbitrarily issues multiple additional NFTs, such issuance of any additional NFTs may be NFT issuance by an unauthorized person, and it may constitute an infringement of copyrights such as the right of reproduction and the right of communication.

III.   Issues in the Process of NFT Transaction

Once an NFT is issued, it is possible to conduct transactions such as transfer or sale of the NFT to another person using the smart contract function that configures the NFT.   In this connection, there may be a question as to whether the transaction of NFT also covers the rights to both of the original and digitized works including the ownership and the copyright (i.e., whether the rights related to the original work is embodied in the NFT itself), and it would depend on the specific circumstances of each case.

In general, an NFT only holds metadata regarding the original and digitized works.   As such, from a technical perspective, an NFT transaction itself may not correspond to a copyright transfer of the original work. However, it is possible to transfer the rights to the original content through the transaction and transfer of NFT by creating a contract that has the effect of transferring not only a package of metadata regarding the original and digitized works, but also the copyright for the original and digital works.   In practice, transactions in the form of transferring tangible assets as well as their NFT are taking place, and it would be possible to carry out a transaction involving copyright in the same way.

Meanwhile, there are also cases of recording the digitized work itself as well as its metadata on blockchain, although this method is not generally used due to cost and data capacity issues.   Unlike the general case described above, in these cases, the transfer of NFT itself may be deemed as transfer of the rights to the work.

IV.   Issues Related to the Lifecycle (Issuance/Distribution) and Stakeholders of NFT

In light of the discussions above, we discuss copyright issues for each stakeholder involved in NFT transactions, for each of the issuance and distribution stages.

At the NFT issuance stage, the following issues need to be considered.

- Unless the original copyright holder directly implements a smart contract for an NFT on blockchain, NFT will be issued by using functions provided by a platform that has already been configured by an NFT exchange or auction site, or through commissioning a third party to generate an NFT with respect to the

work.   As such, it is necessary to check the terms and conditions provided by the platform and/or the contract with the third party commissioned to create the NFT and make sure that there are provisions dealing with issues that may occur in the process of minting an NFT based on the work (e.g., limiting the right of reproduction of the digitized work to the issuance of NFT).

- On the other hand, a person issuing an NFT need to clarify the license terms, so that copyright infringement issues do not occur in the process of issuing the NFT.

The following issues need to be considered in the process of NFT distribution stage.

- A person who wishes to purchase NFT will do so through an NFT exchange or a direct transfer from the current owner of the NFT.   In both cases, it is necessary to confirm, to the extent possible, whether said NFT was generated by a person with the proper rights.   Since the transaction record after the generation of NFT is all written on blockchain, whether the initial generation of the NFT was done by the original copyright holder of the work can be verified by checking the transaction record.

- Furthermore, since there may be cases in which purchasing an NFT does not constitute a transfer of copyright, the purchaser should also verify whether the purchase agreement includes a transfer of the work that is the subject of the NFT, and not just the NFT itself.

V.   Conclusion

From a technical perspective, NFT is merely a recording, on blockchain, of a set of data related to a digitized work.   Legal and institutional devices that support NFTs are not well established, and the legal interpretation of various acts with respect to NFT may be unclear.   When conducting NFT-related business, it is necessary to continuously monitor the structure, potential utilization, and technical development of NFTs, as well as the legal and regulatory changes with respect to NFTs, so as to properly respond to challenges arising from any such changes.

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