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Detail Commercial Solicitors

NON-FUNGIBLE TOKENS AND LEGAL CONSIDERATIONS IN NIGERIA

Image courtesy– istockphoto.com

**NFTs will continue to attract a lot of attention and will become even more popular as the world fully embraces virtual currencies and digital assets.*

INTRODUCTION

With the ongoing rave on the use, utility and acceptance of digital currencies and digital assets around the world, there have been a lot of innovations with the use of blockchain technology. More recently, non-fungible tokens ("NFTs"), which are said to have been in existence since the mid-2010s, have gained traction especially among creative professionals and are said to be the next big thing after cryptocurrencies such as Ethereum and Bitcoin, which are fungible.

The hype surrounding NFTs is linked to the mega purchases of NFTs around the world. Worthy of note is the sale of a digital art collage for $69.3 million through the British auction house: Christie's. According to data from Cryptoart.io, a cryptocurrency art analytics platform, over 604,900 digital artworks have been sold since April 2018 for a combined art value of 251,380.913 ETH (i.e., Ethereum), estimated at $649 million. The recent boom can also be attributed to the upswing in the value of Ethereum, which can be used to purchase NFTs in part or full in some cases; and as the value of the assets in Ethereum grew, so did the buying power of the underlying owner.

Nigeria is not exempt from the NFT wave as practitioners in the Nigerian creative sector are already taking advantage of it, with Jason Osinachi selling two NFTs for $16,227 and $23,633 as reported by Techcabal.com.

With the attraction NFTs have garnered, there are legal issues and considerations that have also arisen which affect the creators and buyers of NFTs.

WHAT ARE NFTS?

An NFT is basically data that is stored or accounted for on a digital ledger, and that data represents something specific. It can, for example, represent a piece of art, a music album or other types of digital files. NFTs are unique digital items that are not easily exchangeable for another value or item. They are used as a means of identifying someone or something in a unique way and provide individuals with the right to claim ownership of digital assets that are accessible to others on the internet.

NFTs are digital tokens created on a blockchain through a process called minting. The Blockchain is an electronic ledger of transactions that keeps the record of NFT ownership. Every transaction on the block-chain is verified by computers across the world. This eliminates the requirement for third parties or middlemen for verification or validation purposes.

NFTs improve the ease of transferring digital creative assets, compared to the traditional sales models, since they can be sold on NFT markets or peer to peer, without the need for an intermediary or restriction to the use of third-party platforms. NTF transactions are done through digital currencies like Ethereum or WAXP - a purpose-built blockchain and protocol token designed to make e-commerce transactions faster, easier, and safer for all participants.

NFTS AND THEIR USE CASES

Although one of the most popular use cases of NFTs in recent time is digital art, the uses of NFTs are, however, countless as NFTs can be used to represent any kind of digital media.

The usage of NFTs range from recognising an individual's sole rights to digital music, fashion, videos, artwork, online gaming tokens, digital collectibles and online event ticketing, which are all forms of digital assets and in certain instances, physical assets.

HOW NFTS DIFFER FROM TRADITIONAL CRYPTOCURRENCIES

NFTs share some similarities with cryptocurrencies since they are purchased, sold and held using blockchain technology. The similarities end there. Unlike cryptocurrencies, NFTs cannot be directly exchanged for the same amount, and are not of the same kind because no two NFTs are identical. Each NFT holds several different functionalities and characteristics.

Cryptocurrencies are typically fungible token (FTs) *i.e.,* they can be easily exchanged for another item or value, without a loss of value or change in attributes for the transaction parties, much like any naira can be substituted for another naira. They are also equal in value: one dollar is always worth another dollar; one Bitcoin is always equal to another Bitcoin. Crypto's fungibility makes it a trusted means of conducting transactions on the blockchain. NFTs are different. Each has a digital signature that makes it impossible for NFTs to be exchanged for or equal to one another (hence its non-fungibility).

Another distinguishing factor between FTs and NFTs is divisibility. NFTs are indivisible. This means they cannot be divided into smaller denominations like bitcoin. Where a person borrows something with an NFT, it can only be returned whole.

LEGAL CONSIDERATIONS FOR NFTS

1. *Intellectual Property Rights*

   The interests and rights of authors over their artistic and/or musical works, including the right to reproduce any of such works in any material form, publish it, distribute it to members of the public for commercial purposes, make any adaptation to the work, etc. are protected by the Copyright Act in Nigeria.

   The right of an author to reproduce the work created in any material form implies that such author can convert same into a digital asset and continue to enjoy its rights as protected under the Copyright Act, including the right to assign the work to third parties.

   Copyright, in traditional works, typically pass from the author to the licensee by way of an assignment, testamentary disposition, *e.g.,* gift or operation of law. This is done either orally or in writing. However, an exclusive assignment of the author's right shall require a written agreement under the Act. Similarly, copyright to digital assets can be assigned by a creator protected under the Copyright Act to subsequent purchasers, either in writing or orally.

   The dilemma with NFTs is the fact that ownership of an NFT does not necessarily mean ownership of an original work. A mere digital transaction might not suffice for an assignment of an exclusive license to the digital asset as contemplated under the Nigerian copyright law. Generally, buying an NFT does not give the buyer the underlying copyright in the content being purchased. What the buyer owns is a blockchain receipt (digital files) that acts like a receipt showing that the holder owns a version of a work and not the actual NFT and this does not prevent the creator from sending the copies of the work to other people.

   Thus, buyers of NFTs cannot exercise the rights conferred on authors, including the right to the payment of royalties. NFTs are composed of software codes which allow for the distribution of funds for the payment of royalties to the creator each time the work is resold.

   It should be noted that most NFT transactions are cross border, which gives rooms to conflict of intellectual property laws on the treatment of NFTs and application of intellectual property rights to

NFTs.

Potential buyers have to carefully determine whether the creator is transferring copyright or other intellectual copyrights in the NFT or simply licensing the NFT to them and should take into consideration the intellectual property laws of the different jurisdictions.

2. *Data Protection*

Some data protection laws give individuals the right to erase and rectify inaccuracies in their personal data. Under the Nigeria Data Protection Regulation 2019, individuals have a right to request for the erasure or rectification of inaccuracies in their personal data. However, the immutable nature of NFTs as blockchain-based creations poses an obstacle to the execution of this right and might make this right functionally impossible to exercise. As such, it appears that NFTs that contain personal information might violate data protection laws in Nigeria as currently drafted.

3. *Regulation of NFTs by the Security and Exchange Commission*

The position of the Nigerian Securities and Exchange Commission (SEC) is that virtual crypto assets are securities which fall within the regulatory purview of the Commission where the character of the investments qualifies as securities transactions, unless proven otherwise. The SEC defines a crypto asset as a digital representation of value that can be digitally traded and functions as: (i) medium of exchange; (ii) unit of account; and (iii) store of value but does not have legal tender status in any jurisdiction. Crypto asset is neither issued nor guaranteed by any jurisdiction and fulfils the above functions only by agreement within its community of users. Crypto assets are treated as commodities by the SEC.

NFTs by their very nature can be linked to a variety of different assets and represent numerous rights and obligations, making it difficult to classify them, according to https://www.jonesday.com. Thus, whether an NFT will be classified as a security will be analysed on its specific facts – the purpose of the NFT and how it is marketed to buyers. For example, NFTs that constitute art or collectibles, will arguable not be deemed to be securities. On the other hand, an NFT would be considered as a security where it is created and sold as a way for members of the public to earn investment returns.

According to the SEC, issuers or sponsors are expected to prove that crypto assets do not constitute securities, by making an initial assessment filing to determine whether it will be classified as securities. Thus, where the nature of the NFT is such that it qualifies as a security, it will fall under the regulatory purview of the SEC unless proven otherwise.

Any person whose activities involves any aspect of blockchain-related and virtual digital asset services, including but not limited to reception, transmission and execution of orders on behalf of other persons, dealers on own account, *etc.*, must be registered by the SEC.

Persons seeking registration may apply for the Regulatory Incubation (RI) program for Fintechs as introduced by the SEC. The RI program is designed to address the needs of new business models and processes that require regulatory authorisations to continue carrying out full or ancillary technology-driven capital market activities. Participation in the program will encompass an initial assessment phase and the regulatory incubation phase.

The RI program will also enable the Securities and Exchange Commission to determine whether NFTs will be viewed as securities. The SEC encourages Fintechs who consider that there is no specific regulation governing their business model, or who require clarity on the appropriate regulatory regime for seeking authorization, to complete a FinTech Assessment Form. This is one of the pre-qualification requirements for admission to the RI program.

CONCLUSION

In conclusion, it is expected that NFTs will continue to attract a lot of attention and will become even more popular as the world fully embraces virtual currencies and digital assets. In the same vein, regulation of NFTs and other digital assets will continue to be top on the mind of regulators all over the world and regulators in Nigeria will continue to develop policies aimed at keeping up with innovations in this space.

As such, creators and potential buyers are encouraged to seek professional advice to guide and protect their interests as they deal in NFTs. In addition, persons who intend to carry out NFT related activities in Nigeria are encouraged to explore the RI program and complete the Fintech Assessment Form.

Detail Commercial Solicitors is distinct as Nigeria's first commercial solicitor firm to specialize exclusively in non-courtroom practice. Based in Lagos, Nigeria's business capital, DETAIL is totally committed to its clients' business objectives and reputed for dealing with the minutiae. Email: info@detailsolicitors.com

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