

Written evidence submitted by DACS

DCMS Committee inquiry into NFTs

Executive summary

This time of rapid technological advancement presents both opportunities and challenges for those working in the creative industries. DACS represents visual artists, many of whom have taken part in NFTs as a new way to develop their practice and reach audiences. Through research, collaboration with NFT specialists and a developed understanding of the IP framework relating to NFTs, DACS recommends that the UK Government looks to protect and enhance intellectual property rights for creators, whilst also increasing trust and consumer confidence in cryptoassets.

Our key recommendations:

- Strengthen the UK's IP framework to ensure that NFT artists can benefit from copyright and Artist's Resale Right protection in the same way as artists of more traditional methods;
- NFT marketplaces display millions of images, some of which are infringing copyright. Creators have little recourse under UK law other than to perform notice and takedown request. The UK should adopt measures similar to Article 17 of the EU Copyright Directive to enable meaningful licensing on platforms and marketplaces.
- NFTs have impacted some consumers negatively through misrepresentation, fraud or a lack of clarity on what is traded. Some jurisdictions have introduced cryptocurrency regulations that include measures to create consumer certainty such as Know Your Customer checks, registration for cryptoasset service providers, or licenses to operate. These measures could provide more certainty in the NFT market without requiring harsh regulation.

About DACS

Established by artists for artists, DACS is a not-for-profit visual artists' rights management organisation. Passionate about transforming the financial landscape for visual artists through innovative new products and services, DACS acts as a trusted broker for 180,000 artists worldwide.

Founded in 1984, DACS is a flagship organisation that campaigns for artists' rights, championing their sustained and vital contribution to the creative economy. DACS collects and distributes royalties to visual artists and their estates through Payback, Artist's Resale Right, Copyright Licensing and Artimage. In 2021, we paid £17.2 million in royalties to 79,000 artists and estates.

For more information

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Introduction to NFTs

A non-fungible token is a unique digital identifier that cannot be copied and is stored on a blockchain. It is used to certify authenticity and ownership of that very token. NFTs often contain a reference to a digital file, which is most popularly an image file. The trade of an NFT, however, does not automatically equate to the transfer of ownership in the image file.

NFTs gained popularity predominantly due to high-profile and high-value sales of NFT artworks, such as Beeple's *Everydays: The First 5000 Days*, which was the first purely digital artwork to be sold at auction and fetched \$69.3 million. Since then, NFTs have been very strongly associated with contemporary art and contemporary art practices.

Sectors such as music, sport, gaming and collectibles have also participated in NFTs, however these trends may not be long lasting. A survey in February 2022 demonstrated that 70% of game developers worldwide were not interested in using NFT tools in their games:

<https://www.statista.com/statistics/1288947/game-developers-studio-interest-nfts/>

Meanwhile, the contemporary art sector continued to trade NFTs. In March 2022, NFTs were reported to constitute 16% of the global art market. The annual UBS and Art Basel art market report (the most comprehensive study on the global art market) valued the global art market in 2021 at \$65.1 billion. This demonstrates the huge value inherent in NFT contemporary art.

<https://d2u3kfwd92fzu7.cloudfront.net/Art%20Market%202022.pdf>

NFT artworks are traded on platforms, many of which are based in the USA. Some of the most popular NFT platforms include OpenSea, Rarible, Larva Labs, Nifty Gateway, SuperRare, MakersPlace and more. Traders use cryptocurrencies to buy and sell NFTs. As of May 2022, OpenSea hosted over 80 million NFTs.

NFTs give artists the opportunity to put in place a mechanism that requires a secondary payment to go to the artist if the NFT is resold. This 'NFT royalty' is recorded on what is known as a Smart Contract.

A Smart Contract is not a contract per se, however it may have the ability to be contractually binding should the threshold for a contract be met. A Smart Contract is in fact a set of rules in code that are self-executing, similar to a vending machine. If X happens, Y is delivered. It is a mechanism by which the original NFT creator could potentially reap further benefits from their work.

Harms of NFTs and NFT speculation

1. Loss of rights to ongoing equity

NFTs became popular in the USA and markets that did not have any legislative form of resale right, due to the appeal of Smart Contracts and the possibility of releasing equity back to the creator on the resale of the NFT. Smart Contracts may not be legally binding, enforceable, or have the elements of a legal contract (offer, acceptance, consideration and intention to create legal relations), but instead are self-executing lines of code.

Smart Contracts have often failed for interoperability reasons: an NFT sold originally on one platform but resold on another may not deliver the equity back to the creator as intended. The creator has little way of enforcing this. Smart Contracts and a right to the so-called 'royalty' also depends on the functionality of the platform or marketplace. Towards the end of 2022, several NFT trading platforms announced that they will make 'royalties' optional or eliminate them all together:

<https://www.forbes.com/sites/leeorshimron/2022/10/24/nft-creators-are-suddenly-losing-a-major-source-of-income/?sh=61a327ab3063>

Although NFT commentators have regarded Smart Contracts as a solution to resale royalties, it is a demonstrably inferior position for the artist in comparison to a unwaivable statutory resale right. The artist can be made to waive their opportunity to collect the 'royalty' through changing terms and conditions of platforms, and ineffective Smart Contracts may mean that no payment is received, often leaving an artists without recourse to down-stream purchasers.

2. Consumer confusion

Most NFTs consist solely of the piece of code that identifies the authenticity and ownership of a token. It is a block on a blockchain that is being transferred from seller to buyer, and usually not the actual digital file or a physical work (unless that is factored in specifically on the NFT).

Many purchasers making speculative acquisitions via cryptocurrencies were dismayed to find that they did not actually receive physical ownership of an asset, or any rights or title to an asset or digital file. During the user-journey of a marketplace such as OpenSea, there is not a lot of information for a lay-person to understand what exactly is included when purchasing NFT art. Furthermore, the terms and conditions of OpenSea's website states that OpenSea is not liable for third party content. Clause 1 states that the onus is on the purchaser to 'bear full responsibility for verifying the legitimacy, authenticity, and legality of NFTs that you purchase from third-party sellers'.

By way of example, someone wanting to make a purchase on OpenSea would go to the page containing the desired NFT:

<https://opensea.io/assets/ethereum/0xb47e3cd837ddf8e4c57f05d70ab865de6e193bbb/1030>

This page shows an image of CryptoPunk #1030; its price history; transfer activity; some basic features and a link to the contract hosted on Etherscan.io. This page does not clearly define whether or not transfer of the digital image file is contained in the sale; whether the creator receives equity on resale; or whether there has been any transfer or IP rights and whether the purchaser can use the image how they wish. As per the terms and conditions, the potential purchaser must verify the legitimacy, authenticity and legality of the NFT themselves, which would include whether or not this image infringes the copyright of the creator. The potential purchaser can review the contract on Etherscan.io by clicking on the contract tab:

<https://etherscan.io/address/0xb47e3cd837ddf8e4c57f05d70ab865de6e193bbb#code>

The potential purchaser then sees what they would be buying: a cryptographic hash and several lines of code that give certain details and conditions to the sale of the token. This is not only very complicated code for a lay person (even compared with the language of the terms and conditions of OpenSea), but also certain information is not available. It is not entirely clear whether or not the purchaser of the token has any rights to use the image of the CryptoPunk; whether the seller has the requisite copyright or copyright licence to display the CryptoPunk image or certain other information that would satisfy the prospective purchaser of the legitimacy and legality of this transaction.

If the purchaser does go ahead and buy this NFT, which appears to only be the code displayed on Etherscan.io and not the image represented on OpenSea, the purchaser may be able to use a URL to access the image. However, if the image is removed from that URL, the purchaser has no recourse. This is known as an 'empty NFT' – where the purchaser is given a link to access to an image file, but where it is no longer available.

It is clear that a lay person needs to be very familiar with coding, with the terms and conditions of the NFT marketplace and other third parties including the provider of the cryptocurrency used to make the purchase, with the process of purchasing an NFT which includes paying fees to the platform known as 'gas fees', with understanding how to verify the legality and legitimacy of their purchase, not to mention the fluctuating value of their cryptocurrency and the tokens they purchase. There is a high potential for many non-expert users to be confused about this process, with the added risk of financial loss for any fiat currencies converted into cryptocurrency.

3. Copyright infringement

Copyright existing in digital image files, and in other work, is often subject to infringement in NFT marketplaces. Uploading a digital image to an NFT marketplace platform, to accompany the sale of the token, is in itself a restricted act under copyright. This is akin to a user uploading an image of someone else's artwork on a social media platform: the creator's rights have been infringed if they did not give permission to make that work available or communicate it to the public.

Furthermore, as described above in respect of consumer confusion, a person purchasing an NFT that is represented by an image that infringes the creators' copyright may not be able to ascertain whether or not they can use the image without limitation, or if indeed it is an infringement. The information they have access to via the selling platform will rarely make the copyright position of an accompanying image clear to the purchaser. This leads easily to unintended ongoing copyright infringement if the purchaser uses the image however they please.

Creators who see their work used on NFT marketplaces can use the notice and takedown procedure that many other platforms such as social media platforms provide. However, this does not prevent those works reappearing, and creators generally cannot license the use of their works on NFT marketplaces nor other platforms due to the fact the UK law does not have measures in place such as those in the EU (under Article 17 of the EU Copyright Directive) to facilitate meaningful licensing on platforms. When OpenSea alone has over 80 million images, and many artists are finding their work available on these platforms, their only option is to continuously monitor and perform notice and takedown requests.

Many NFT sellers have uploaded the art work of a famous artist and sell their token under the wrapper, or guise, of this digital image of someone else's work. Even if the digital artwork is not transferred, the communication is an infringement and may also prevent the original artist themselves from making this type of offer. Furthermore, many brands have seen their items accompanying NFTs in a way to make the NFT appear endorsed and 'genuine'. There have been numerous cases, predominantly in the USA, where the sale of NFTs have included infringements of an artists' work, false endorsement, or claims of fraud. <https://www.thefashionlaw.com/from-hermes-to-bored-apes-a-running-list-of-key-lawsuits-over-nfts/> Here is a UK example of a claim from artists against NFT sellers, but which has not yet gone to court: <https://www.lexology.com/library/detail.aspx?g=b9885654-9dbb-451a-b906-40649b69b31e>

Benefits of NFTs and NFT speculation

1. New artistic practices

The rise in NFT proliferation and trade demonstrates a development in the dissemination of, and appetite for, cultural goods. Although it has been reported that the trade in NFTs has recently reduced, many artists see this moment as a tide change, where digital-only art receives a proper audience, willing to pay to see and access their work.

2. Opportunity to develop skills and learning

Certain artistic spaces in the UK are now fully equipped to showcase digital art, for example FACT in Liverpool, the Immersive Dome in Plymouth and 180 the Strand in London. These spaces have pulled in wide-ranging audiences to showcase immersive and new artistic expressions, often with a view to create more learning and awareness of newer technologies. Many artists are now using NFTs, blockchain, cryptoassets and various forms of digital technology combined as part of their practice, which demonstrates a need for skills in coding and digital technology to be part of creative curriculums.

3. Opportunity to improve IP framework

Trends in NFT based artistic practice bring to the fore the question over whether the UK's IP framework is fit-for-purpose and can sufficiently protect digital artistic works both for copyright and for the Artist's Resale Right (the statutory right to receive a royalty on resales of artworks on the art market). As mentioned previously, the promise of financial incentivisation and ongoing equity enticed many artists to make and sell NFTs, however it is clear that these rights, where contractual or even simply written in code, aren't always enforceable and can be removed by the marketplace: not at all a replacement for statutory IP rights. The IP framework in the UK should equally incentivise and remunerate those who create a painting to those who create a newer form of artistic expression.

NFT regulation

NFTs are not in themselves regulated in the UK or necessarily in other countries. Some proposed regulation on cryptoassets may include NFTs depending on how they are structured.

In 2022, an application for injunctive relief in respect of an NFT was heard in a UK court (*Osbourne v Persons Unknown & Another*). The claimant sought an injunction against the parent company of OpenSea after NFTs in the claimant's wallet were alleged to have been stolen by an unknown person. The injunction was granted on various grounds, one of which was that it was likely an NFT, as a digital asset, would be considered property. Digital assets are currently being reviewed by the Law Commission and could address issues that parties encounter with NFTs, such as fraud and other harmful activities.

DACS considers that some measures on NFT marketplaces could improve consumer confidence and help to reduce fraud, copyright infringement, anonymity and lack of liability. Some of these measures have been explored by other countries in relation to cryptocurrency regulation:

- The EU's Markets in Crypto Assets Regulations (MiCA): Measures on cryptoasset service providers to be liable for lost investor assets and to protect consumer wallets. It only applies to NFTs if they fall under existing crypto asset categories.
- Estonia's Anti Money Laundering and Terrorism Finance Act 2017: robust regulations for crypto businesses operating in Estonia, who must comply with strict reporting, obtain two licences for trading and apply KYC (know your customer) rules.
- Singapore treats Bitcoin and other cryptocurrencies as 'goods' under the Goods and Services Tax. The Payment Services Act 2019 brought cryptocurrencies under the regulatory authority of the Monetary Authority of Singapore, imposing a requirement for them to obtain an operating licence. Furthermore, the Financial Services and Markets Bill 2022 increases penalties for breaches of technology risk and regulates all persons in Singapore conducting digital token services purely internationally.