

Patents as NFTs: Tokenization and Implications for Ownership, Valuation, and Licensing; Securities Law Compliance

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Patents as NFTs: Tokenization and Implications

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What Is a Non-Fungible Token?

- An NFT is “minted” to document digital ownership of an underlying physical or digital asset
- NFT is like a digital certificate of authenticity on a blockchain
- Non-fungible: distinct assets unlike identical, interchangeable blockchain assets (like Bitcoin)
 - Might appear the same: artist may sell a limited number of songs as NFTs
- Indivisible: Can’t divide an NFT into smaller denominations
- Immutable: Owners actually own the NFTs, not the company that creates it
 - Only one owner at a time
 - Contrast: buy music and the license to listen to the music; can’t resell a downloaded MP3
- Non-interoperable: May only be used on a certain platform (e.g., a particular game)
 - Can’t transfer to another blockchain
- Underlying asset can be tangible or intangible
 - E.g., song, artwork, video, real estate, tweet, trading card, or even a patent
- Verifiable: Can track chain of title to original creator

Creating an NFT

- Connect your digital wallet to an NFT marketplace (e.g., OpenSea, Rarible, Mintable)
- Upload your media (e.g. artwork) and any details about it
- Creates a token and appears on your wallet
- Not necessarily stored “on-chain”
 - Contains a unique identifier:
 - URI (uniform resource identifier): could be an HTTPS API call to JSON file containing name, description, image, attributes
- Can use cryptocurrency tokens to buy an NFT

Attributes of an NFT

- Has a unique identifier
- One owner that is easily verifiable
- If based on Ethereum, can be bought, sold, or traded on any Ethereum-based NFT market
- Nobody can manipulate it
- Can sell it and even earn royalties
 - Can be programmed so that it happens automatically in future sales
- Creator can determine the scarcity

Valuation

- Beeple's collage "Everydays: The first 5000 Days" sold for \$69 million
- This copy of the artwork is not worth \$69 million, even though it looks the same
- Owning a verifiable original version is the key
- Market will determine value



Gaming Use

- Purchase of NFT allows access to item in a game
- Secondary market for these items outside of the game
- You own the NFT, not the gaming company
- NFT can outlive the game

Securities Issues

- Consider each NFT for compliance based on how it is monetized
- Underlying collectables, including artwork, likely should not be securities
 - No expectation or need for a third party to extend efforts to enhance the value
 - If NFT is a digital representation of real-world asset (song, photo, art), then not likely a security
- *Howey* Test and SEC “framework” document
 - Howey test: an investment contract is a security if there is (1) an investment of money, (2) in a common enterprise, and (3) with profits derived solely from the efforts of others.
 - “Price appreciation resulting solely from external market forces (such as general inflationary trends or the economy) impacting the supply and demand for an underlying asset generally is not considered ‘profit’ under the *Howey* test.”

Securities Issues

- NFTs more likely to be a security when used for seed capital, there is widespread secondary trading, marketing or trading via crypto exchanges, or bulk pre-sales at a discount
- Marketing can cause an NFT to be a security
 - Marketing for potential appreciation, profit, or dividends?
- Consider a royalty for an IP license in resales – is the NFT a debt security?
- Other considerations
 - CFTC regulations
 - Registration as money transmitter

IP Considerations in a Transaction

- No automatic grant of ownership in an original work
 - Copyright ownership vests in the creator
 - Consider rights transferred as part of a transaction
 - What rights does the buyer need?
- Does a trademark cover uses in NFT technology
- How do you monitor uses of a brand in an NFT marketplace
- How are payments and royalties made?
- Does the smart contract represent your intentions?
- How do you resolve a dispute?
- Smart contract: encoded clauses automatically executed
 - Example: upon resale, automatically pay a royalty fee to minter

Patent Protection for NFTs – Patent Eligibility

- Spectrum of innovation
 - NFT with a new underlying asset
 - Likely more challenging
 - Is a blockchain considered generic computer functionality?
 - New application or functionality of an NFT
 - Likely easier to patent

Patent Protection for NFTs – Prior Art

- Plenty of articles on the internet
- Few published patents and patent applications available
- Prior art searching: consider alternative search terms
- Patent Office examination
 - No art unit specializing in NFTs (yet)
 - Blockchain applications assigned to various art units
 - Same searching challenges
 - May take some time for Patent Office to get up to speed

Patent Protection for NFTs – Detecting Infringement

- Who is the targeted infringer?
- End users may be anonymous
- Consider targeting marketplace or distributed ledger

Patents as NFTs: Tokenization and Implications

The Global Patent Registry (GPR)

- IPwe partnered with IBM to create a marketplace (GPR) for patent rights using NFTs
- IBM, of course, has been historically the largest patent owner in the U.S.
- Having IBM's patents in the marketplace lends credibility to IPWE's effort
- IPwe claims that the GPR contains 80% of the world's patents
- According to IPwe, the GPR used blockchain and AI technology to analyze ownership of patents

The Global Patent Registry (GPR)

- Tracking patent rights via NFTs has a lot of upside:
 - It greatly facilitates keeping track of ownership of patent rights
 - it provides easily verifiable authentication of the rights through the blockchain
 - it facilitates transfer of the underlying patent rights
- BUT it comes with some caveats:
 - the NFT is NOT a patent right in and of itself
 - so, the actual patent rights would still need to be transferred using a separate legal document

Ownership of NFTs and transfer of ownership/rights

- Actual transfer of patents rights would still require a separate legal instrument, likely cross-referencing the NFT
- BUT, simply transferring ownership of the NFT by itself would NOT transfer any patent rights
- Thus, transfer of patent rights would still be the subject to state contract laws

Ownership of NFTs and transfer of ownership/rights

- NFTs are separate from the underlying digital assets
- So, to use an example, a NFT for a given U.S. Patent in the IPwe GPR is separate and does not convey any rights in the actual patent
- However, the NFT in the GPR is an easily verifiable way of authenticating ownership of a patent or a license to the patent

Litigation Pitfalls

- Most of the cases thus far have focused on cryptocurrencies and, specifically to whether cryptocurrencies comply with securities laws
- By definition, cryptocurrencies are Fungible Tokens
- So, at a definitional level, **Non** Fungible Tokens (NFTs) are designed to avoid the securities laws implications common to cryptocurrencies
- Yet, the way NFTs are used and traded can raise potential securities laws issues

Dapper Labs Litigation

- For example, Dapper Labs was recently sued in NY Supreme Court for its Top Shot Moments
- Top Shot Moments are NFTs that users of the Dapper Labs platform can trade amongst themselves and/or sell
- By definition, these NFTs are not fungible and, in fact, derive value from their rare/unique nature, much like trading cards
- According to the complaint, however, Top Shot Moments should be treated as securities
- The issues the Court will have to decide in this case will offer guidance on how NFTs will be treated under securities law