

What you need to know from the legal perspective to approach the NFT market in China.



CHINA

I. INTRODUCTION OF NFT AND THE CHINESE MARKET

According to the decision of the first Chinese NFT case, an NFT (non-fungible token) is a group of metacode stored in a blockchain. Every NFT is different. It cannot be converted into another NFT and cannot be split into subunits, which is the key difference from fungible tokens such as bitcoin etc. It irrevocably and eternally refers to certain digital contents, such as photos, audio, or videos. The information of that digital content, including the publisher, publishing date, and every transfer of ownership, are all stored and cannot be changed by using the smart contract. By this setting, every NFT is unique and thus has its value.

In 2021, great public attention has turned to the NFT market after the NFT artwork "Everyday: The First 5000 Days" was actioned to the skyrocketing price of nearly 69.3 million US dollars. Companies have also started to try out NFTs. For example, Coca-Cola's first NFT, which contains a cooler, a card, a speaker that can play classic Coca-Cola sounds, and a jacket that can be worn in the visual world Decentraland, was sold at the price of 575,883 US dollars.

In China, such a market has been developing too, and it has received governmental support. For example, in June 2022, Shanghai municipal government released the Shanghai Action Plan for Cultivating "Metaverse¹" New Track (2022-2025), in which it set the goal that by 2025, Shanghai's Metaverse related business should reach 350 billion RMB.

Here are some basic information you need to know from the legal perspective of the Chinese NFT market.

II. POSSIBLE LEGAL ISSUES

Before entering the market, one cannot avoid the most fundamental question: Is it legal to do NFT related business in China?

The answer largely depends on the business model you choose, whether you want to mint or purchase NFT artwork for collection, or whether you want to build NFT platform.

1. Minting or purchasing NFT artwork for collection

1.1 NFT art collection

Among all the NFT applications, NFT art collection is the most developed market.

In general, it is legal to mint or purchase NFT in China. Most of the major tech companies have launched their own NFT platform such as Tencent, Alibaba, Netease, etc. There are also many companies focusing on the NFT market such as Bigverse (platform NFTCN). Every platform has its own policy. Some only allow purchasing NFT for "collection" purposes, i.e. no resale or even transfer as a gifts. Some allow transfer as gifts after a certain period to prevent speculation. There are several platforms that allow resale, such as NFTCN which is the platform involved in the first NFT related litigation in China, but they are the minority.

1. The «Metaverse» refers to a virtual world, a virtual universe, or rather a digital and connected universe accessible with the appropriate hardware, in which users carry out actions by incarnating avatars.

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However, although it is legal in general, it is worth noting that there are differences between the Chinese system and the mainstream foreign systems.

Under Notice on Further Preventing and Dealing with Speculation Risks in Virtual Currency Trading Yin Fa [2021] No.237 issued by Central Bank and other departments ('Notice 237'), cryptocurrencies based on public blockchains such as Bitcoin and Ethereum are prohibited to circulate in China. Thus all the NFTs in China are only allowed to be purchased by RMB. Also, none of the blockchains in China is public blockchain. That means the NFT in China cannot be circulated to the major international public blockchain. The current Chinese NFT market is still far away from the decentralization concept the web 3.0 world embraces.

That difference is especially important for companies who want to mint or purchase NFT solely for the purpose of investment. In April 2022, China Internet Finance Association, China Banking Association, and China Securities Association issued an Initiative on Preventing NFT-Related Financial Risks ("Three Association Initiative"), in which it specifically says that they call for their association members not to directly or indirectly invest NFT and not to provide support for investing NFT. Although it is not mandatory, those three associations manage almost all the banks and security participants in China, and thus their initiative is very powerful.

Apart from that, when purchasing NFT, common considerations in purchasing properties also apply to NFT. Specifically, because many of the NFTs are artworks, the buyer should carefully inspect the copyright issues before purchasing.

2. Building NFT Platforms

While it is great to buy or sell NFT on the platform, it is more exciting and imaginative to build the platform itself.

2.1 Qualification

In China, depending on the exact business model, the relevant licenses needed for NFT projects are generally the following:

- Blockchain Information Service Filing

According to Administrative Regulations on Blockchain Information Services, a blockchain information services supplier shall file its information through the CAC's filing management system for blockchain information services within 10 working days from the date of providing the service to complete the filing formalities for the record. For blockchain business, there is currently no direct restriction on foreign investment.

- Value-added telecommunications business operation license

If the platform does value-added telecommunications business, for example, issuing NFT or allowing NFT to circulate, which is providing online data processing or transaction service, under Administrative Measures on Internet-based Information Services, it needs to have value-added telecommunications business operation license. According to Special Administrative Measures (Negative List) for Foreign Investment Access (Edition 2021), the proportion of foreign equity in value-added telecommunications services cannot exceed 50% (e-commerce is an exception).

- Network Culture Business Operation License

If the service on the NFT platform can be considered as conducting commercial internet culture activities, Under Interim Provisions for the Administration of Internet Culture (Revised in 2017), the Network Culture Business Operation License is required.

- Online Publishing Service Operation License

If the service on the NFT platform can be considered as providing online publications to the public, under Regulations on the Administration of Online Publishing Services, Online Publishing Service Operation License is required. Foreign investments, including JVs and WOFE, are not allowed to engage in online publishing services.

- Auction license

If the NFT platform allows the NFT to be sold under auction, then under the Auction Law of the People's Republic of China, the auction license is required.

From the above, it can be seen that foreign companies might face difficulties to invest directly into the market. However, that is the situation for many internet related businesses in China. There are solutions to that, such as using the VIE (Variable Interest Entity) structure.

2.2 Other Issues:

After getting the qualifications, like all other business, the platform needs to be aware of the legal risks in the business. Here are two major concerns:

- Private rights protection, especially copyright

First of all, the platform needs to be aware of its responsibility not to violate other people's rights, especially copyright. A large proportion of the NFTs in the Chinese market now are digital artworks. The copyright of the source of those artworks, for example, an image or a piece of audio, are very likely already belong to another person and are thus protected. Besides, some of the NFTs might contain the image or name of a person and that could be linked to the protection of portrait rights or name rights etc. This is the major area where legal disputes arise in the NFT field in China. For example, in the first NFT related litigation case in China, the plaintiff sued the NFT platform because an NFT minted by a user on that platform, which is an image, violated the plaintiff's copyright. Hangzhou Internet Court ruled that the platform has the duty to establish a review system to prevent potential intellectual property rights violations.

Second, more importantly, the platform should think very carefully about how to design its product in order not to cause legal disputes later. For example, what kinds of rights should be transferred along with the NFT when a user buys an NFT on the platform? Are the rights exclusive? Those settings should match the logic behind the product designs and be written clearly in the service agreement and user agreement of the platform.

- Compliance

Apart from the qualifications mentioned above, the platform should be mindful of the compliance issues throughout the business operation. This can be vital. For example, the popular "move to earn" game StepN banned all Chinese users in May. It claimed that it was an attempt to follow Chinese regulatory requirements. That has caused a more than 30% drop of its token price. Although it did not specify the exact requirement, it is possible that there are problems involving its collection and storage of the user's data, including geographical information, which can be considered as "sensitive personal information" under Chinese law.

Apart from data protection, compliance with other regulations such as financial regulations and, if applicable, even consumer protection rules are unavoidable issues for the platform company.

III. CONCLUSION

In the era of Web 3.0, there are far more applications of NFT than just digital collections. China's regulation on NFT and other digital economies is different from other countries. Because of its vital effect on the business, we suggest that companies who want to enter the market obtain legal advice so as to be fully prepared.



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