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Licensing in the Brave New World of NFTs

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I. Introduction

While the frenzied speculation that saw some non-fungible tokens (NFTs) bid up to seven or even eight digits may have abated, the fundamental value of NFTs remains—validation of ownership and the ability to efficiently transact in digital assets. Despite the slowdown of NFT transactions during 2022, NFT markets generated approximately $24.7 billion of trading volume over the course of the year.[1] Major brands, from Gucci to Starbucks to the NBA, have released or plan to release NFT collections as they incorporate the technology into their business strategies. Regardless of whether cryptocurrencies manage to achieve any significant adoption or usage in the foreseeable future, it is clear that NFTs have a unique role to fill in our increasingly digitized economies, and over time will be increasingly disconnected from ebbs and flows in crypto trading markets.

From a legal perspective, NFTs bring a world of new opportunities for content and technology licensing. With NFTs comes the exciting possibility of markets in which IP owners, purchasers, and licensors/licensees can transact in IP rights on a highly efficient basis, maximizing value to all parties. Creators will have the ability to continue to share in the value of their IP as it is transferred, licensed, modified, and perhaps fractionalized. To reach that point, however, will require an understanding of how NFTs fit in to our current licensing regime and what special considerations may apply. This article explores (a) the relationship of NFTs and intellectual property rights as they currently exist; (b) the role of the "smart contract"; and (c) recent updates and litigation in the NFT licensing space.

II. NFTs and IP Licensing

To date, popular understanding of NFTs has largely been associated with "profile picture" projects, such as the oddly appealing, smirking primates of Bored Ape Yacht Club, and other tokenized lines of computer-generated images. Although many articles have been published concerning the very limited "ownership" that passes to purchasers of these NFTs under the typical Terms of Use (TOU), there continues to be a belief by many NFT purchasers that they also gain ownership of the underlying artwork. While this certainly could be accomplished through the mechanism of NFTs, it generally has not been to date, even as some NFT publishers have started to use terms like "full commercial rights" in their promotions. "Ownership" in the context of these projects means only ownership of a ledger entry in the blockchain (most often Ethereum or Solana). The ledger entry includes a URL link to the image itself, which is located “off chain,” in the old-fashioned world of webpages. The ledger entry is not the image and has no value in itself.

Although there is some variation in how popular collections approach intellectual property rights, rights granted in NFT project TOUs generally fall into one of three categories: (1) limited rights, where the buyer receives no intellectual property rights to the asset associated with the NFT except to display it (perhaps even limited to a particular platform); (2) broader rights, where the buyer may receive, in addition to personal display rights, reproduction, and specified rights for commercial exploitation, which may include the rights to create and print copies of the image on physical items and to market and sell those items (usually subject to a number of limitations); and (3) a mixed bag, where the buyer receives some rights but not others (*e.g.*, IP rights granted only for personal use or commercial exploitation rights up to only a certain dollar amount). Thus, when dealing with NFT collections it is crucial to examine the TOU and identify what rights are licensed to effectively understand and enforce intellectual property rights.

Due to the novelty of NFTs and the still-emerging and developing NFT market, companies interested in creating NFTs may have concerns regarding misappropriation or undesirable uses of their intellectual property. Since the NFT content is (in almost all cases today) only licensed to the purchaser, the TOU often will list prohibited uses of the NFT such as modification, display in connection with offensive content, and masking of attributions. However, licensing executives will often express concern about a loss of control over their intellectual property once an NFT is “put out on the blockchain.” As anyone who’s spent some time in the conventional Web1 or Web2 world knows, users don’t always observe the restrictions of a company’s carefully drafted TOU. What happens when NFTs featuring the company’s teddy bear character are minted and sold, and a purchaser posts theirs on a Nazi recruiting site?

First, it’s important to remember that as a practical matter anyone who can right-click and copy the client’s artwork, character or logo from a webpage already has the ability to display it anywhere and in any way they choose, and the company will realistically have little or no ability to stop that. Perhaps more significantly, since the NFT image exists “off chain,” in fact the IP owner may be able to simply decouple the image from the blockchain entry, leaving the NFT “purchaser” with nothing but a ledger entry. Whether or not this is a practical alternative will depend on the underlying blockchain and other technical factors, and such a step could result in significant resistance from the community and bad publicity. However, this may be another example of how the blockchain provides more (or at least new) tools for private and public enforcement, contrary to the overused “Wild West” narrative (the principal example being the simple fact that blockchain transactions are public and immutable, which US Department of Justice soon discovered could be very useful in locating and recovering stolen assets). While the likelihood that the client will exercise this mechanism in the future may be low, the TOU should provide that a breach could result in disassociation of the licensed artwork from the NFT.

Reddit’s Collectible Avatars is an example of an NFT collection with only personal use rights granted to the buyer. Reddit released the Collectible Avatars in August 2022, and the collection has become one of the most widely adopted NFT collections to date, with over 4.25 million unique wallets reported as holding at least one collectible. The Reddit Previews TOU provides that users are granted a non-exclusive license to use, copy, and display the NFT art for personal, non-commercial use only, with reselling permitted (other than transactions for the purpose of gambling, money-laundering and other illegal purposes).[2] License grants limited to personal display (and resale) are commonly found in mainstream projects, with many specifically prohibiting display in connection with offensive or violent content. Projects based on third-party licensed rights, such as NBA Top Shot, will invariably include that limitation as well as prohibitions on creation of derivative works.

A contrasting example is the World of Women NFT collection, released in July 2022, which is a collection, intended to build a community of female Web3 enthusiasts. With the stated goal of promoting creative expression within this community, the World of Women TOU provides for generous grants of both personal and commercial rights. World of Women NFT holders may reproduce and sell their NFT images in any format or media with no dollar limit, and may create and exploit derivative works as well.[3] Rather than a general ban on certain types of derivatives or display of the NFTs with offensive content, World of Women purchasers agree that the project may prohibit any uses of the NFT artwork that “alter its spirit, devaluate it or otherwise [may] be deemed prejudicial to the reputation of the author.”

In the unique context of NFTs, reducing or relinquishing limitations or royalty rights on user exploitation can result in potentially exponentially greater proceeds to the licensor. Greater engagement and a growing community will result in higher secondary trading volume of the NFTs, which typically generates commission to the company. That gamble appears to have paid off for World of Women, which has an impressive user base and partnerships with the likes of Reese Witherspoon's production company, Hello Sunshine.

III. NFTs and Resales

Although NFTs can represent tangible items, application of the first-sale doctrine to NFTs themselves is unclear. Under US law, once an original copyrighted work of authorship is sold, the buyer and all subsequent purchasers may transact in that work without compensation to the original author. However, to date, courts have been unwilling to apply the first-sale doctrine to digital works. For example, in *Capitol Records LLC v. DeRigi Inc.*, the Second Circuit Court of Appeals held that the first sale doctrine did not apply to a digital music file, on the basis that resale of such a file would require the making of an unauthorized second copy, which is infringement of the author's reproduction right (not covered by the first-sale doctrine). In another case, *Disney Enterprises Inc. v. Redbox Automated Retail LLC*, the District Court of Central California held that the first-sale doctrine did not apply to digital download codes since the sale of download codes enabled purchasers to create physical copies at any point. The concept of potentially never-ending control of an asset by the creator conflicts with the Web3 ethos of ownership and personal control of digital items, just like physical items, so it will be interesting to see what sort of legal analog to the first-sale doctrine may develop with respect to NFTs.

In any event, the first-sale doctrine has little relevance to current mainstream NFT projects, which are governed by a license model rather than an ownership model, as discussed above. As NFT applications grow and users become more sophisticated, however, it is inevitable that NFTs carrying true ownership of their associated content will begin to predominate. With no first-sale doctrine, NFT copyright owners could retain limitations on exploitation of owned NFT content that would be contrary to user expectations. This will likely be mitigated by the profit potential to these owners from commissions on secondary trading.

IV. The Role of Smart Contracts

The term "smart contract" is often used by both businesspeople and practitioners with little understanding of what it actually is, and some people in the space seem to possess the conception (or hope) that smart contracts will someday allow them to dispense with lawyers. However, as has been said, a smart contract is neither "smart" nor a "contract." A smart contract is simply a coded "if-then" mechanism, which can accomplish, for example, change of title of an asset upon deposit of funds into a specified crypto wallet or distribution to NFT owners of future NFT releases (airdrops), though the original NFT may have changed hands several times. Just the same, smart contracts hold tremendous potential for simplification, lowering of transaction costs, and risk of loss in both digital and real-world transactions of all kinds. Smart contracts can also provide NFTs with "utility," allowing them to be used in innovative ways (that is, beyond just as an ownership record for linked artwork), for example as a ticket that allows access to exclusive events.

One much-touted feature of NFT smart contracts has, unfortunately, not been realized to date. During the period that NFTs began to enter mainstream awareness, it was widely reported that NFT smart contracts provide a way for creators to be assured of payment for the primary sale of their work as well as to participate in the proceeds of subsequent sales. The smart contract would automatically allocate funds to the creator's wallet, with no need for intermediaries. And for the first time, creators would be able to share in the value being paid for their works in subsequent sales. Although it is true that smart contracts offer this capability, unfortunately it has not yet been implemented on any significant scale. A principal reason for this appears to be limitations in the Ethereum blockchain. Another seems to be the predominance of centralized NFT exchanges (such as OpenSea and Magic Eden), which process nearly all secondary transactions in NFTs. Just as the largest crypto exchanges to date have been built on the traditional model of centralized, trust-based intermediaries, the large NFT exchanges are interposed between sellers and buyers, receiving funds from the buyer, deducting their commission and paying the seller. The purchase process is handled by an intermediary and not by a protocol.

As a further complication, NFT marketplaces have different royalty policies (for example, OpenSea will allow a maximum of a 10 percent royalty to be allocated to NFT creators, while Rarible allows a maximum of 50 percent) so royalty rates do not automatically transfer among platforms, further complicating collection of resale royalties. Another reason given for the fact that smart-contract payments have not been implemented is that such a smart contract would result in a commission being required even for internal transfers by holders (who may, for example, have one wallet they use for transactions and another to hold digital assets). However, it would seem that some sort of technical solution would exist for that.

As a result, rather than allocation of NFT sale proceeds by smart contract, creator commissions have been paid by the exchanges based on directions from NFT publishers.

The fact that NFTs in their current implementation do not in fact provide the assurance of fair compensation to creators came to light in August 2022 when X2Y2, an NFT marketplace looking to gain a competitive edge over other exchanges, announced that it would no longer honor NFT royalty payment directions in NFTs. Instead of pricing NFTs to include the directed royalty payments, X2Y2 would allow buyers to decide whether or not to add the creator royalty payment to the agreed purchase price. Several other NFT marketplaces followed suit, either applying a zero royalty rate or making royalty payment optional. Subsequently, leading exchanges OpenSea and Magic Eden announced work-around tools allowing NFT publishers to prohibit transactions at a zero royalty rate, or to require a certain royalty rate.

What the future holds for automated allocation of proceeds from NFT transactions is unclear, but it seems likely that decentralized NFT exchanges will evolve that operate in this way, and major existing NFT blockchains will incorporate the necessary capability or new NFT blockchains will evolve.

V. Recent Developments in Licensing & NFTs

a. Development of Standardized NFT Creative Commons Templates

In August 2022, to address the issue of intellectual property ownership rights of NFTs, the Andreessen Horowitz fund, a16z Crypto, released a set of free, public "Can't Be Evil" licenses (CBE Licenses).[4] The licenses are based on the copyright framework introduced by Creative Commons, the nonprofit organization that aims to help society overcome obstacles to the sharing of knowledge and creativity to address societal challenges. Under the Creative Commons framework, there are six different types of licenses, ranging from broadly permissive to least permissive. The most permissive license allows individuals "to distribute, remix, adapt, and build upon the material in any medium or format, so long as attribution is given to the creator," and the license allows individuals to use the work for commercial purposes. The least permissive license allows individuals "to copy and distribute the material in any medium or format in unadapted form only, for noncommercial purposes only, and only so long as attribution is given to the creator." The final category allows creators to give up their copyrights and put the works into the worldwide public domain.[5]

In September 2022, Creative Commons clarified its position concerning NFTs due to confusion concerning implementation of the licenses in NFTs. Some NFT creators used the most permissive Creative Commons license for their NFTs on the premise that granting rights to all would cultivate a culture of shared contributions, which is an important part of the Web3 ethos. However, this approach exists in tension with the concept of "ownership" associated with NFTs. To address this issue, a16z Crypto developed the CBE Licenses, based on the Creative Commons framework. The CBE Licenses consist of different combinations of five categories of granted rights: (1) the right to copy, display and distribute; (2) the right to sublicense; (3) commercial use; (4) the right to modify and adapt; and (5) revocation for hate speech. Unlike the Creative Commons licenses, the CBE Licenses do not provide a blanket license to the general public, and instead, define the rights granted from the creator of the NFT artwork to the NFT purchaser. This is intended to solve the issue of ambiguity concerning the rights received by an NFT purchaser, which often arises due to poorly-drafted TOU.

b. Litigation Updates on NFTs and Licensing

i. Miramax v. Quentin Tarantino

In one of the first intellectual property disputes concerning NFTs, in September 2022, Miramax and Quentin Tarantino settled a lawsuit arising over "Pulp Fiction" NFTs created by Tarantino. Miramax had sued Tarantino for breach of contract, copyright infringement, trademark infringement, and unfair competition. The parties' 1993 agreements for the production and financing of "Pulp Fiction" included a typically broad grant of rights to Miramax: "all rights (including all copyrights and trademarks) in and to the Film . . . including without limitation the right to distribute the Film in all media now or hereafter known," excluding only a limited set of reserved rights. These included the right to live performance and sequel rights, and included print publication, which encompassed screenplay publication. Tarantino argued that in creating the NFTs, which consisted of digital images of the handwritten "Pulp

Fiction" screenplay, he was acting within his reserved rights, specifically the right to "screenplay publication". However, Miramax posited that the proposed sale of a few original script pages or scenes as an NFT is a one-time transaction, which does not constitute a print publication, and in any event does not fall within the intended meaning of "print publication" or "screenplay publication." *Miramax* provides an example of the issues that may arise in the case of creation of NFTs based on legacy intellectual property, created before NFTs existed.

ii. Nike v. StockX

In an ongoing lawsuit that could have a significant effect on the NFT ecosystem, in early 2021 Nike filed suit against StockX alleging that StockX had minted and sold NFTs featuring athletic shoes, using Nike's trademarks without permission. Nike asserted that StockX impermissibly used Nike's goodwill to sell the shoe NFTs at inflated prices to customers, and that StockX knowingly used confusingly similar marks in connection with the sale of the NFTs. StockX responded that it was not selling the NFTs for the purposes of distributing art and that they were instead "digital receipts" to actual sneakers that were authenticated and stored at StockX facilities. StockX used the first-sale doctrine as the basis for its argument and analogized its sale of NFTs to major ecommerce retailers using images and product descriptions to sell physical sneakers. While courts have held under the first-sale doctrine that an entity may resell goods bearing a trademark after the trademark owner has sold the item, one limitation is that the manner of resale must not confuse or deceive customers. Therefore, a decision in this case would provide precedent as to how the first-sale doctrine and trademark law apply to the creation of NFTs by entities other than the IP owner.

iii. Hermès v. Rothschild

In in a case decided in February 2023, Hermès prevailed in its trademark infringement claim against the artist known as Mason Rothschild for his production and sale of "MetaBirkin" NFTs (which depicted faux-fur versions of the luxury Birkin handbags made by Hermès). Rothschild had argued that the MetaBirkin NFTs were protected as creative expression and free speech, referring to the famous trademark case of *Rogers v. Grimaldi*,[6] in which the Second Circuit Court of Appeals held that the defendant's right of free expression outweighed the plaintiff's alleged trademark infringement. The court decided that the *Rogers* test had not been met here, and that the MetaBirken NFTs were therefore infringing (undoubtedly in part because of facts suggesting an intention of Rothschild to profit off the Hermès brand).

Notwithstanding the demise of MetaBirken NFTs, the result here could be considered positive for the development of the NFT artwork space. By applying the *Rogers case*, the court implicitly held that an NFT will be treated under the law as an artistic work even though it's tradeable on the blockchain. The "commoditization" arguably inherent in tokenization does not remove NFT-associated art from the protection of the First Amendment right to free speech.

iv. USPTO and US Copyright Office Joint Research and Public Comment

In November 2022, the U.S. Patent and Trademark Office (USPTO) and the U.S. Copyright Office (USCO) announced a joint study to consider implications of NFT technology for intellectual property law, as well as policy issues. The agencies sought public comment on intellectual property issues arising in the context of NFTs. Among the requested topics for public comment, one requests input on "licensing of IP rights in the asset associated with an NFT." When released, the report may serve as a basis for future regulation of NFTs and as a reference for parties considering licensing for NFTs.

VI. Conclusion

Given the prevailing structure and uses of NFTs today, licensing has an essential role. As NFTs gain acceptance across industries and continue to be adopted by enterprises of all sizes, an understanding of the unique aspects of NFTs and how they function will be essential for practitioners.

1. Andrew Hayward, *NFT Sales in 2022 Nearly Matched the 2021 Boom, Despite Market Crash*, Decrypt, Jan. 4, 2023 (*https://decrypt.co/118438/2022-versus-2021-nft-sales*).
2. *Previews Terms of Use*, last visited Jan. 10, 2023 (*https://www.redditinc.com/policies/previews-terms*).
3. *World of Women Digital Ownership Assignment*, last visited Jan. 10, 2023 (*https://worldofwomen.mypinata.cloud/ipfs/QmRPn2jf3u5tc47Z2PDJRbzKZhBUyi4qBABfSVCDWeUBPz*).
4. The name is derived from Google's maxim "Don't be Evil," perhaps with the implication that this mandate had been insufficient.
5. *About CC Licenses*, last visited Jan. 10, 2023 (*https://creativecommons.org/about/cclicenses/*).
6. - 875 F.2d 994 (2d Cir. 1989).