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FEATURE

The Risks and Rewards of Adding NFTs to Your IP Portfolio

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It is said that a picture is worth a thousand words, but in the digital age where emojis, GIFs, and “likes” have replaced traditional forms of conversation, it may come as no surprise that digital assets are being valued as worth more than a thousand words—some have price tags in the millions of dollars. Although we are finding it tricky to find the right words to describe Nyan Cat—the animated flying space cat with a Pop-Tart for a body—the remastered GIF sold for 300 ETH, or about \$590,000, in February 2021.¹

The total sales volume of non-fungible tokens (NFTs) in 2021 surpassed \$14 billion,² with Christie’s auction house sales exceeding \$150 million³ and Sotheby’s sales reaching \$100 million.⁴ But it’s the peer-to-peer NFT marketplaces like Rarible, Nifty Gateway, and OpenSea spearheading the jaw-dropping NFT sales. Rarible tokens have racked up \$27 million in sales over the past two years.⁵ Between May 2020 and September 2021, Nifty Gateway recorded roughly \$409 million in NFT sales.⁶ And, since its founding in 2017, OpenSea has established itself as one of the largest marketplaces for NFTs, handling more than \$10 billion in sales and trading volume over the period.⁷

Seeing the massive potential in the NFT market, artists, brands, and companies alike have taken to minting NFTs and participating and pushing the bounds of the NFT market in various ways. For example, Taco Bell made its NFT debut by selling taco-themed animated GIFs and images.⁸ In

December 2021, Nike purchased a virtual shoe company to sell digital kicks and NFTs in the metaverse.⁹ Luxury brands have jumped on board, too; in August 2021, to commemorate the 200th birthday of the brand, Louis Vuitton launched its adventure-based game, *Louis the Game*, through which users venture into different worlds searching for items to collect.¹⁰ Also embedded in the game are 30 NFTs designed by artist Beeple, which are accessible only through playing the game.

But What Exactly Drives and Dictates the Value of NFTs?

As with most goods, value is tied to several factors, such as exclusivity and rarity of the item, the fame or notoriety of the issuer or creator, and the ownership history.¹¹ Even more than these, though, the narrative for the NFTs and the community access conferred to purchasers often define their value. For example, through purchasing certain NFTs, owners are afforded access to an online community and/or club membership that comes with additional benefits. These can include exclusive events or experiences, access to online forums,¹² or other content or items made accessible only to NFT owners, such as new music releases or signed jerseys.¹³

But value can also be driven by whether the sale grants intellectual property (IP) rights in the underlying work. Certain NFTs (including Bored Apes, which are some of the most popular and highest valued NFTs) come with rights in the underlying artwork (including the right to commercialize the artwork through derivative works).¹⁴ Generally, however, those rights are not conferred through the sale of an NFT; and the accompanying license and/or terms and conditions impose restrictions on commercializing the underlying IP.¹⁵

This misconception and the general lack of legal framework in the NFT marketplace have resulted in recent IP disputes, with some IP owners experiencing their works being used and offered for sale in the form of an NFT without their consent.¹⁶ These disputes, some of which are discussed below, give rise to several NFT-specific IP issues and questions regarding ownership, contract drafting, trademark registration considerations, and even fair use and First Amendment rights.

Recent Disputes Involving Trademarks and Copyrights

Because of the unique properties of NFTs, they can be used to represent and authenticate ownership, with ownership and other information recorded and secured on the blockchain.¹⁷ But although there can be only one official and authenticated NFT owner, the ownership of the

underlying property is not always as clear. And, unfortunately, the blockchain cannot tell the purchaser if the good sold is an unauthorized copy of a copyrighted work or if the seller has the legal right to sell an NFT tied to existing assets.

A recent example of this type of snafu is the pending litigation between Miramax and Quentin Tarantino in the U.S. District Court for the Central District of California.¹⁸ At the NFT.NYC conference in November 2021, Tarantino announced his plans to auction off seven “exclusive scenes” from the 1994 film *Pulp Fiction* in the form of NFTs, which would contain previously unknown behind-the-scenes secrets from the American classic.

The plans, however, were kept secret from Miramax, which sued Tarantino, alleging breach of contract, copyright and trademark infringement, and unfair competition. In its complaint, the movie giant argues that Tarantino assigned all rights in *Pulp Fiction* to Miramax in 1993 and thus cannot legally sell the NFTs and accompanying content.¹⁹ Although the 1993 agreement between the parties does not reference rights to the production and sale of *Pulp Fiction*-related NFTs, Miramax argues that its rights include “all rights . . . now or hereafter known . . . in all media now or hereafter known,” and Tarantino’s limited “reserved rights” do not contain forward-looking language such that they would encompass any rights to create or sell NFTs tied to *Pulp Fiction* assets.²⁰

The U.S. District Court for the Southern District of New York addressed a different ownership issue in June 2021 and granted the copyright owner a temporary restraining order to prevent an NFT sale.²¹ Roc-A-Fella Records (RAF) sued one of its three joint owners, Damon Dash, seeking an order enjoining him from making any sale of the copyright in the master recording of Jay-Z’s album, *Reasonable Doubt*. RAF is owned equally by Shawn Carter (Jay-Z), Kareem Burke, and Damon Dash and is the record label under which Jay-Z released his debut album in 1996. Under the impression his one-third ownership of RAF gave him a joint interest in the copyright of the musical recording of *Reasonable Doubt*, Dash announced plans in June 2021 to sell his share as an NFT and has been exploring outlets through which to offer it up. RAF sued, arguing that Dash has no right to sell what he does not own.²²

Specifically, RAF argues that the 1995 agreement between Jay-Z and RAF concerning the album states that RAF would own “[t]he Masters and the LP, from the inception of the recording thereof, and all Phonograph Records and other reproductions made therefrom, together with the performances embodied therein and all copyrights therein and thereto (excluding the copyright

in the underlying compositions) throughout the world, and all renewals and extensions thereof.”²³ Based on this language, RAF insists that Dash holds no individual ownership interest in *Reasonable Doubt* and cannot legally sell the underlying copyright.

Besides questions of ownership, issues of First Amendment and fair use defenses have arisen in the context of NFTs that feature brand logos, designs, and trademarks. For example, digital artist Mason Rothschild received a cease and desist letter from Hermès in December 2021 after he debuted his MetaBirkins NFT collection at Art Basel.²⁴ Hermès claimed that the NFTs were marketed using the Birkin name without its authorization or consent. In addition to bearing a strong resemblance to their real-world namesake, the MetaBirkins have been highly lucrative in the virtual marketplace, with the first MetaBirkins NFT selling for about \$40,000.²⁵

Rothschild took to social media to respond, arguing that his collection is protected by the First Amendment, which gives him the right to create artistic commentary on the fashion world and to use Hermès’s Birkin bags as inspiration for his work. Hermès filed suit in the U.S. District Court for the Southern District of New York in January 2022, and Rothschild’s motion to dismiss was denied.²⁶ This case should be interesting to follow as the dispute gives rise to questions regarding the merit of Rothschild’s First Amendment defense, particularly where the goods in question are both luxury and/or collectible pieces and where the classes of goods are different and do not overlap.

NFTs and Patents

In some industries, such as high tech and biotech, the IP portfolio derives a significant portion of its value from patents, whether utility or design. A strong portfolio comprises patents on key aspects of a company’s products that provide defensive assets in a particular space or provide revenue through licensing. Many believe that the existence and illiquidity of patents stymies product development and critical research in biopharma.

NFTs seem poised to affect the patent sphere in a number of different ways. First, it remains to be seen what types of NFT-related patents may be obtained. So far, fewer than 20 U.S. patents have issued claiming a “non-fungible token” (or similar),²⁷ and under 60 mention such tokens in their specification.²⁸ Because patent applications typically remain unpublished for 18 months after filing, there is no way to reliably predict how many are in the pipeline, and it is difficult to conduct due diligence. If history repeats itself, however, we should expect many patents on various uses

for NFTs. Nike, for example, has obtained a patent on tokenizing the ownership of shoes.²⁹ If a Nike customer purchases a “CryptoKick,” the purchaser also receives an NFT that verifies the authenticity of the shoe and can be used to transfer ownership. CryptoKicks also allow customers to “breed” new custom shoe designs by digitally combining tokens. All companies should be considering patents on innovative ways that NFTs can be used in their particular fields, often bridging the gap between physical goods and digital assets.

What may end up having the most effect on valuation of patents, and NFTs in general, is the emergence of decentralized autonomous organizations (DAOs), which are essentially groups of people that work collectively to acquire assets and make decisions; the contracts governing their organization are stored as a series of smart contracts on a blockchain. DAOs allow groups of people to form easily, combining their access to IP and financial assets. Because they can be easily formed, DAOs have started to emerge to bid up prices at auctions, including a recent one for a first printing of the U.S. Constitution.³⁰ DAOs have also formed to pool resources and acquire IP, such as VitaDAO, a collective formed to acquire biopharma patents to further decentralized drug development.³¹ Still unknown is how, or even if, a DAO that acquires patents could initiate patent litigation, since they are not yet universally recognized as legal entities.³²

Takeaways, Considerations, and Things to Look Out For

Although much of the law in this area is yet to be established, brands and companies considering entering the NFT space or faced with their IP being used in the sale of NFTs should keep these takeaways in mind.

First, ownership of the underlying IP rights should be carefully considered before minting and selling NFTs as legal principles of trademark and copyright still apply. Minting an NFT incorporating—or even inspired by—copyrighted material not completely owned by the seller could constitute infringement. Authorization should be obtained from each copyright holder, artist, and contributor, where appropriate.

Second, active enforcement of existing and owned IP should be conducted. This includes actively patrolling platforms on which NFTs are sold to identify unauthorized uses. Some NFT marketplaces have stated in their terms of service that they will honor takedown notices under the Digital Millennium Copyright Act.³³ As a result, they will take down infringing works in

response to notices from authorized rights holders and terminate user access if repeat infringement occurs.³⁴

Third, assignments and contracts should be carefully drafted to include forward-looking language, where appropriate, to ensure the negotiated and expected rights are secured despite developing and unanticipated media. Contracts and licenses may also contain provisions setting out what happens in the event the underlying blockchain ceases to exist. Adding such provisions would establish the NFT purchaser's rights, or lack thereof, if the on-chain NFT ceases to exist with the blockchain. NFT developers may consider decentralized storage for the NFT asset to ensure its continuity in the event the underlying blockchain goes defunct. But with the underlying blockchain going dark, the proof of ownership and other records tied to the NFT would disappear, leading to potential legal disputes.

Fourth, IP owners may want to consider contracts that accompany the sale of an NFT and clearly define the rights of the end purchaser. For example, such an agreement may incorporate restrictions on ownership and use to specifically limit or prevent creation of derivative works based on the NFT, commercial use, disparaging or infringing use, or registration or assignment of any rights in the underlying IP—either entirely or without express authorization.³⁵ For brands and companies offering access to in-person events, online forums, or other forms of community engagement as part of the NFT's owner club, agreements requiring compliance with community guidelines should be considered. These agreements allow NFT developers to ban an NFT owner from events and other club benefits if they are being abusive online or violating community guidelines.

Fifth, as the likelihood of confusion analysis central to trademark infringement cases assesses whether consumers are likely to be confused about the source of the goods, trademark owners should consider obtaining trademark registrations to include classes of goods that cover NFTs and NFT-related goods and services, such as classes 09 and 36.

Finally, do not overlook the revenue potential of NFTs. NFTs may just be the latest and greatest way to extract value from IP. Even materials less sexy than designer goods may be candidates. UC Berkeley recently auctioned NFTs of patent disclosures of two Nobel Prize-winning inventions relating to the CRISPR genome editing technology, with the profits going to fund future research.³⁶ What Rembrandts in the attic does your company have that would bring new value as an NFT?

Endnotes

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