

About Those NFTs . . . Can We Talk?

Nancy Wolff and Sarah Conley Odenkirk

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In March 2021, when Beeple’s now infamous non-fungible token (NFT) *Everydays—The First 5000 Days* was auctioned for \$69 million, ⁽¹⁾ artists worldwide jumped on board the NFT train, dreaming of newfound wealth. Lawyers from all practices were inundated with NFT questions and were expected to be experts in blockchain, cryptocurrency, smart contracts, and business development in this nascent world full of promise and pitfalls.

Today, the enthusiasm for NFTs has been tempered by the decline in the cryptocurrency market and a growing number of lawsuits around ownership and rights in content sold as NFTs. Intellectual property issues are finally taking center stage, and conversations around standards and protocols are heating up and starting to generate some real traction. ⁽²⁾

NFTs are unique packages of metadata that are registered on the blockchain and associated with content (generally some creative visual expression) or utility (general access to experiences or merchandise) that is stored off-chain on a distributed server such as the InterPlanetary File System (IPFS). ⁽³⁾ The computer code comprising each NFT was dubbed a “smart contract” early on, and the catchy moniker stuck. Smart contracts, upon dissection, lack any actual contract structure; do not contain the terms, conditions, representations, and warranties normally associated with legal contracts; and serve only to automatically execute simple instructions relating to basic transactional functions. ⁽⁴⁾

One feature that has attracted many artists, and in particular visual artists, to the world of NFTs is the promise that smart contracts can build in an immutable resale royalty enabling artists to receive additional compensation every time the NFT resells on the secondary market. ⁵ NFT holders, however, must understand the inability of smart contracts to reliably ensure resale royalties or effectively replace traditional bills of sale, invoices, or certificates of authenticity when acquiring artwork and other creative expressions.

NFTs have the potential to be a tool not only to superiorly manage intellectual property rights but also to elevate artists' rights. But, it is clear that NFTs need to include clearly articulated intellectual property governance and ownership parameters if they are going to form the basis of a reliable and sustainable marketplace for creative and engaging content. ⁶

This article first addresses preliminary questions that practitioners should be prepared to ask and answer for clients and then presents considerations, including contract terms unique to NFTs, about which practitioners should be aware when advising clients who are creating, selling, and licensing works as NFTs.

Why NFTs, and What Are You Selling?

When a client calls with an NFT project, the first questions should be: What are you selling, and why are you using an NFT? Is it a work of art? Is it a collectible? Is it memorabilia? The type of content will inform which blockchains might be the best choice for minting that NFT and the best marketplace for the NFT to have the best chance to sell well. Each marketplace, with few exceptions, tends to support only one or two blockchains, and within each blockchain ecosystem, different marketplaces tend to have specific focuses. For example, one marketplace may feature photography while another focuses on collectibles. Some marketplaces are highly curated while others sell just about anything.

One mistake many clients make is believing that if they build their own websites for the sale of NFTs, they will be able to sell their NFTs without an intermediary. Unless the client has deep pockets to fund the development of a new business (i.e., an online platform), a tremendous number of dedicated collectors, and a high profile in the digital asset space, the drop on a client's website, regardless of how beautifully designed, will not likely succeed. It is almost always the case that creators need to collaborate with intermediaries to mint, market, and establish a sustainable practice that can generate enough sales to justify their foray into NFTs. This, of course, runs

counter to the highly touted claims that NFTs would allow for the disintermediation of the art world, but it is the reality.

What Rights Should Be Licensed in the Content Associated with the NFT?

The next question should be about what rights the creator owns in the digital content that is to be associated with the NFT. Is your client the sole owner or creator? Does anyone else have any ownership interest in the digital work? Is the digital work a derivative work, for example, a photomontage, a manipulated photograph, an audiovisual work with music, a work that incorporates others' works in whole or in part or is "inspired" by someone else's work? All underlying rights in the digital work should be cleared for use as an NFT, unless the work is in the public domain or clearly qualifies as a fair use. Larger marketplaces such as OpenSea are known to sell high numbers of NFTs derived from images scraped online that may or may not be digitally manipulated before they are sold as original works.

Further, if your client owns the underlying digital artwork but worked with a third party to enhance the work, such as adding motion or other features, there should be a written agreement between your client and any third-party contributor to ensure that your client owns all the rights or has all the rights in the derivative work needed to sell the work as an NFT. Unless your client has a written agreement with any independent contractor articulating the rights ownership, that third party could claim rights in the derivative work to the extent copyrightable material has been added.

What Rights Transfer with the Sale of the NFT?

Only after the above two questions are answered can you turn to the question of what rights, if any, should transfer to the buyer of the NFT. Determining what rights transfer with an NFT should be a well-thought-out process. In the "traditional" art world, and pursuant to copyright law, if you purchase an artwork, whether physical or digital, it is expected that you acquire only the object itself and not any rights to create reproductions of, or commercialize, the artwork without the consent of the artist and/or copyright owner. (7) The Copyright Act is clear that ownership of copyright is distinct from the material object.

While nonexclusive transfers of rights under copyright do not require a writing, any exclusive transfer of rights outlined in § 106 of the Copyright Act requires a writing signed by the copyright

owner or authorized representative. (8) Regardless, it is always best practice to clearly articulate and commit to writing any intended grants of copyright, especially when such grants could impact the rights of secondary purchasers and the value of the NFT in the long term.

One recent example that painfully illustrates the wide misunderstanding surrounding copyright in this space occurred when a purported owner of an alleged Frida Kahlo drawing made the news after he threw an extravagant party in his Miami home to launch the sale of ten thousand NFTs. The NFTs contained a video of him ceremoniously burning the alleged Kahlo drawing in a martini glass. The Frida Kahlo estate is said to be looking into potential legal claims, as the owner of the drawing would have no right to create a derivative work (the video) using the drawing, or to then make reproductions to sell as NFTs. (9)

Consider Supplementing Smart Contracts with Additional Documentation

Smart contracts generally contain limited contents, and while they might include simple statements regarding intellectual property rights in the metadata fields, there is typically not enough space to include any complex or nuanced rights language. Further, most lawyers and consumers do not know how to access the smart contract or read code. The primary purpose of the smart contract is to create a reliable structure governing the NFT transactions. So, for instance, if a purchaser of an NFT is to have the right to publicly display an NFT, such right must be specifically granted in a relatively easily accessible manner and in plain language. In the rush to enter the NFT market, most creators, platforms, and marketplaces overlooked these considerations, leading to sloppily constructed NFTs and lingering confusion in the marketplace.

The popular CryptoPunks was one of the first NFT projects to shine a light on common copyright and licensing misconceptions. CryptoPunks consists of 10,000 pixelated heads randomly generated from a predetermined set of attributes—the digital works were then tied to NFTs. With its fantastical financial trajectory (initially offered for free, prices for Punks peaked this year at records topping \$23 million), CryptoPunks helped to launch an entire ecosystem of similar projects trying to recreate the CryptoPunks' magic. CryptoPunks also inadvertently became an example of the dangers post hoc application of licensing and copyright management structures can pose. CryptoPunks initially adopted the presumptuously named “NFT License,” (10) which dictated some bare parameters outlining what uses under copyright transferred with the NFT. The NFT License did not transfer copyright in the artwork or allow modifications to the artwork, but it did permit the buyer to use the NFT for personal noncommercial use, as well as commercial

use on NFT owner-created merchandise for up to \$100,000 of revenue annually. CryptoPunks later, however, posted contradictory statements concerning the rights associated with the NFTs that deviated from the NFT License terms, creating confusion, frustration, and increased volatility at a moment when the marketplace for NFTs was accelerating exponentially. ¹¹ Ultimately, following their acquisition by Yuga Labs, CryptoPunks clarified the licensed rights, ¹² but not before having to endure the harsh criticism of the CryptoPunks owners' community.

Moonbirds ¹³ is another example of a project with a history of waffling rights. After establishing an unclear rights policy at the launch of the project, the project founder announced in August 2022 that the project was going "CC0" ¹⁴ —the broadest Creative Commons license offered that is the closest to placing the Moonbirds artwork into the public domain. This broad license not only allowed Moonbirds owners to exploit the rights in the artwork in any way, without restriction or obligation to credit the original creators, but also allowed all others the same rights, including making duplicate Moonbirds or derivative works for commercial exploitation. ¹⁵ The unilateral decision was not well-received by all Moonbirds owners, many of whom felt that the community should have been allowed to weigh in before making such a crucial shift in copyright ownership policy. ¹⁶ Notably, the objections stemmed not from concerns pertaining to the legal ramifications of the CC0 designation but because the change was made without consulting the community of owners. ¹⁷

Although the perceptions and engagement of a collecting community can be important for the long-term viability of a project, understanding the potential legal pitfalls of a creator disclaiming all copyright rights is crucial to developing a more sophisticated and sustainable ecosystem for creators to enter this marketplace. The trend to proclaim projects CC0 ignores the subtleties involved with selling creative works and opens the door to exploitation by those who have the resources to do so. While it is possible that CC0 NFTs make sense for generative profile picture (PFP) projects that are more focused on creating a commodity within a digital community, it is rarely a good choice for artists and creators wishing to use NFTs as a viable vehicle to sell and promote their unique, creative content as they lose the right to control reproductions, derivatives, and attribution.

Further, designating a project CC0 may serve to undermine the facet of NFT culture that arguably has the biggest potential to bring about a long-sought-after market change, at least in the fine art space (both physical and digital), which is to normalize the inclusion of resale royalties for

secondary market NFT sales. Decoupling the right to receive a resale royalty from the creator of unique content, and instead allowing it to be used by whoever can generate the best marketing campaign for their NFT created with CC0 content, recasts a tool meant to promote artist's rights as a much more mercenary means to enrich those who are savvy about navigating the NFT marketplace. Inevitably this will cut in favor of corporate interests and influencers—and against artists.

Drafting Tips for Supplemental Documents

To navigate the NFT landscape, practitioners should consider how to best draft and associate clear rights with each NFT project at crucial junctures. These rights generally make sense at four critical junctures in the creation and sale of an NFT:

- 1 the terms and conditions of the NFT project website;
- 2 the FAQs of the NFT project website;
- 3 the details included in the metadata comprising the NFTs themselves; and
- 4 content associated with the NFTs and stored off-chain.

Terms and Conditions

Terms and conditions (T&Cs) ¹⁸ are usually found linked at the bottom of an NFT platform's website and set out the parameters of using the website for whatever purposes are anticipated. The T&Cs may also limit users' activities, expectations, and recourse for the failure of the website to provide whatever it is trying to provide. For NFT projects, this is where a clear statement is needed to clarify the nature of what is being purchased and where purchases will be stored. ¹⁹

Further, T&Cs set out disclaimers, limitations on liability, dispute resolution options, and how to submit any concerns, complaints, or requests to address controversial content that may appear on the website. The choice of law and selection of jurisdiction for any dispute resolution is an important term to review since websites may be accessed from locations all around the world. Clearly establishing jurisdictional choices and having corporate counsel review these choices to ensure consistency with the corporate strategy is imperative. Ultimately, T&Cs provide essential legal language governing all transactions and use of the website. These terms, while often largely

boilerplate, must be appropriate for the nature of the project and relate to the type of NFTs being sold, as well as be consistent with other language on the website, including the FAQs.

FAQs

The frequently asked questions (FAQs) section of a platform's website should set out clear and concise statements of what purchasers are buying and what rights they receive as part of that purchase. Though FAQs are not legally binding, because they often contain simplified statements conveying material facts and rules of engagement, it is important that practitioners review this language prior to it being posted. FAQs should use plain and simple explanations of what rules govern collecting, or how users can get the most from their engagement in the NFT project. If you are confused when you read a client's FAQs, you can be sure that consumers likely will be too. In addition, road maps may be detailed, explaining future plans for utility that may be connected to ownership of the NFT. The FAQs are also the place for information explaining who to contact in the event of questions or concerns, what happens if anything goes wrong, how to stay connected, and how to engage in the NFT community. FAQs are an important part of smoothing the onboarding process for new users, which is critical to the continued sustainability of the space.

Metadata

The metadata is the code comprising the NFT's smart contract and is permanently part of the NFT's DNA. Thinking creatively about how to organize the metadata fields and include plain language articulating copyright ownership and rights granted in the description that is displayed on marketplaces can help connect crucial information to the NFT itself, ensuring its long-term viability. NFT descriptions that show on marketplaces pull the information from the metadata fields, so thoughtfully creating this information is crucial in ensuring that automatically generated descriptions are accurate and alert the consumer to important legal attributes, in addition to those attributes that are purely aesthetic or determinative of an NFT's rarity. Editing the metadata fields will likely require interfacing with the project's development team, who can better establish the reasonable limits of how metadata can best include additional information such as specific legal rights pertaining to intellectual property. This area is ripe for the adoption of standards and protocols that, if widely adopted, could guide the industry to ensure that NFTs are sustainably constructed for the sale of visual art and other creative content.

Associated Content

Until there is a way to include a longer, more traditional contract, along with a mechanism to facilitate assent of users, as part of a low-friction purchase process, the best strategy for ensuring that rights and restrictions clearly travel with the NFT is to include a separate document attached in the same way as the content being sold with the NFT. (20) This document can be discursive or purely pragmatic and include any restrictions, statements, or grants of rights that define the nature of the project and the intentions of the artist, including the following nonexhaustive topics:

- the conceptual underpinnings of the artwork;
- representations and warranties as to originality and ownership of the artwork;
- rights to display the work either privately or publicly;
- rights to reproduce the work for the purpose of displaying other than in a direct stream from the owner's wallet;
- rights to remix or create derivatives;
- rights to commercialize either or both the creative content as well as any project-wide intellectual property, including trademarks;
- rights to conserve damaged NFTs and/or remint broken NFTs, including onto a new blockchain or future-occurring technological option;
- rights to loan NFTs to other people or institutions and how that is handled logistically;
- resale royalty expectations, until there is a universal interoperable solution that ensures that resale royalties can be automatically enforced across platforms; and
- any other transfer restrictions the creator wishes to impose on the secondary life of the NFT.

These associated contracts may be difficult to enforce due to the anonymity and potential location of a purchaser. It may be beneficial to encourage compliance by setting up a system that rewards respecting project parameters rather than attempting to punish noncompliance. Other mechanisms will eventually emerge for enforcing compliance, including tools like noting on-chain any pertinent facts regarding noncompliance such that future purchasers can essentially do a title check to see how “healthy” the NFT is that they wish to purchase.

One recent attempt at creating a document addressing this lack of standards and the need for a true contract to be embedded in NFT construction was published by Andreessen Horowitz: the a16z contract. ⁽²¹⁾ This agreement, while including some useful guidelines, is clearly written with an overwhelming corporate bent, meant to benefit the collector as opposed to the creator. While touted as being quintessentially Web3 savvy, ⁽²²⁾ it actually serves to further existing power structures rather than support the evolution of new approaches. Nowhere is this clearer than in the omission of any reference to resale royalties or other terms beneficial to the creator.

Conclusion

While the NFT marketplace may currently be soft, the digital marketplace continues to evolve at a blistering pace. There will undoubtedly be more than a few bumps and growing pains before it settles into anything resembling a reliable marketplace, and this marketplace is likely to remain a hybrid of digital and physical engagements. Lawyers have a unique opportunity to be part of the innovation and creation of this new and invigorating space. NFTs offer a chance to reimagine existing systemic structures and dynamics and create contracts that support a healthy, functional, and sustainable future for all creators and those who support them. Lawyers must continue to offer encouragement to clients and others to reject a cavalier attitude toward copyrights. Using these tools, you will be on your way to achieving these important advocacy goals.

Endnotes

1. Scott Reyburn, *JPG File Sells for \$69 Million, as "NFT Mania" Gathers Pace*, N.Y. Times (Mar. 11, 2021), <https://www.nytimes.com/2021/03/11/arts/design/nft-auction-christies-beeple.html>.
2. Peter J. Karol & Guy A. Rub, *Royalty Check*, Artforum (Apr. 5, 2021), <https://www.artforum.com/slant/peter-j-karol-and-guy-a-rub-on-resale-contract-law-and-the-secondary-market-85413>.
3. Sarah Conley Odenkirk, *Navigating NFTs: Considering Best Practices and Avoiding Pitfalls*, Medium: DMLA Insights (Mar. 26, 2021), <https://medium.com/dmla-insights/navigating-nfts-considering-best-practices-and-avoiding-pitfalls-222a7e3c9fcd>.
4. *Id.*
5. Tim Schneider, *Why Better Artist Resale Royalties Are an Opportunity for Better Business in the Art Market (and Other Insights)*, Artnet News (July 13, 2022), <https://news.artnet.com/news-pro/gray-market-artist-resale-royalty-2145967>.

6. Megan E. Noh et al., *GM! Time to Wake Up and Address Copyright and Other Legal Issues Impacting Visual Art NFTs*, 45 Colum. J.L. & Arts 315 (2022), <https://journals.library.columbia.edu/index.php/lawandarts/article/view/10007>.
7. 17 U.S.C. § 202.
8. *Id.* § 106 (identifying the exclusive rights under copyright to include the rights to reproduce, to prepare derivative works, to distribute copies, to broadcast copies publicly, to display works publicly, and to perform works publicly).
9. Even if the owner of the drawing created a copy to burn, that reproduction would not be permitted either in the initial copying or in the derivative works made when he filmed the burning. Elaine Velie, *Collector Who Says He Burned Frida Kahlo Work for NFT under Investigation*, Hyperallergic (Sept. 30, 2022), <https://hyperallergic.com/765443/collector-who-burned-frida-kahlo-work-for-nft-under-investigation>.
10. The NFT License allows for the personal noncommercial use of the artwork but does not allow NFT owners to acquire any intellectual property rights in the artwork, modify the artwork, use it in connection with the sale of third-party products, or associate it with hate speech. NFT License, <https://www.nftlicense.org> (last visited Feb. 14, 2023).
11. Eric Paul Rhodes, *CryptoPunks and Copyrights: What's All the Fuss About?*, Outer Realm (July 12, 2021), <https://www.theouterrealm.io/blog/cryptopunks-copyrights>.
12. CryptoPunks Terms, <https://licenseterms.cryptopunks.app> (last visited Feb. 14, 2023).
13. Moonbirds, <https://www.moonbirds.xyz> (last visited Feb. 14, 2023).
14. A creator who chooses the Creative Commons Universal Public Domain (CC0) designation puts the work into the public domain by waiving all rights to the work worldwide under copyright law, including all related and neighboring rights, to the extent allowed by law. This means that anyone else can copy, modify, distribute, and perform the work, even for commercial purposes, all without asking permission or providing attribution to the original creator. *CC0 1.0 Universal (CC0 1.0) Public Domain Dedication*, Creative Commons, <https://creativecommons.org/publicdomain/zero/1.0> (last visited Feb. 14, 2023).
15. See CC0, Creative Commons, <https://creativecommons.org/share-your-work/public-domain/cc0> (last visited Feb. 14, 2023).
16. yycrader, *Moonbirds' Public Flight Sparks Debate about Intellectual Property Rights*, Defiant (Aug. 5, 2022), <https://thedefiant.io/moonbirds-cc0-license-nfts>.
17. Ornella Hernandez, *From Moonbirds to CryptoPunks, Terms of Service Are Changing*, Blockworks (Aug. 16, 2022), <https://blockworks.co/news/from-moonbirds-to-cryptopunks-terms-of-service-are-changing>.

18. Also referred to as terms of service or terms of use.
19. Some project websites provide custodial accounts for users that can be accessed only through the website. Others provide a way to link to existing third-party digital wallets into which digital products purchased on the website may be deposited. This is a major point of not only security concerns but also user experience considerations. The initial interface of users with the website, the options available for purchasing whatever is being sold, and the mechanism by which those purchases are received, stored, and accessed in the future are a central focus of most companies and an aspect of the marketplace that could benefit greatly from widely accepted protocols and standards. The onboarding of new users in any meaningful way will be limited until this aspect of engagement is resolved.
20. Other content can be associated with the NFT to provide additional value to the project and a way to distinguish an NFT project from its physical equivalent. Music projects may include the song or album associated with the NFT or extras like concert footage or artist interviews. An NFT can be viewed as an empty box that can be filled with “goodies,” including digital merchandise and well-crafted legal documents.
21. *a16z Contracts*, GitHub, <https://github.com/a16z/a16z-contracts> (last visited Feb. 14, 2023).
22. Down to the redux of the phrase “Don’t Be Evil,” originally championed as a guiding principle for Google in its early years, “Can’t Be Evil” is the a16z contract presentation mantra. *Id.* In some ways, this new use-with-a-twist of an old phrase used by one of the behemoths in the Web2 space is ominous. Hopefully, other options will be offered that take a more inclusive and collaborative approach that truly values the community voice.

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Authors

Nancy Wolff

Cowan, DeBaets, Abrahams & Sheppard LLP

Nancy Wolff is a partner at Cowan, DeBaets, Abrahams & Sheppard LLP in New York and cochair of the firm's art law and NFT practice group. She offers full legal support to a wide range of traditional and digital media clients, including individual creators and multimedia companies of all sizes.

Sarah Conley Odenkirk

Cowan, DeBaets, Abrahams & Sheppard LLP

Sarah Conley Odenkirk is a partner at Cowan, DeBaets, Abrahams & Sheppard LLP in Los Angeles and cochair of the firm's art law and NFT practice group. She has a core practice in fine art and emerging technologies and advises clients on matters pertaining to navigating the art market, business transactions, intellectual property, blockchain, public policy, and strategic planning.