Kluwer Copyright Blog

NFTs: promisingly transformational, yet fraught with IP pitfalls – Part I

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Image by Tumisu via Pixabay

Non-fungible tokens (NFTs) are altering society's notion of digital 'ownership' and redefining the common perspective on distribution of original works to consumers by introducing scarcity to the digital realm. Although frequently misconstrued, this technology represents an exceptional advancement that can yield enormous revenue streams for both creators and consumers by altering the digital representation of real-world assets. However, the ensuing craze and notoriety generated by many high-value NFT transactions has revealed a slew of unanswered legal copyright questions and issues.

We address these questions in a two-part post. In this part 1, we tackle the first of three questions regarding the legal copyright landscape from an NFT purchaser's perspective, as the extent to which the IP framework applies to NFTs remains uncertain. These questions will be addressed by applying UK law and the EU copyright *acquis* to NFTs, as illustrated by relevant Court of Justice of the European Union (CJEU) case law and global contemporary examples.

Caveat Emptor

The common notion that acquiring ownership of an NFT representing a work in which copyright subsists equates to owning the copyright to the underlying work is clearly false. Under traditional copyright law, the purchase of an NFT representing a work in which copyright subsists does not automatically confer copyright ownership in the underlying work (the traditional approach). The 'Dune' scenario is a well-known 'tale of crypto folly' featuring NFT purchasers who failed to exercise appropriate due diligence in determining what rights are granted when procuring an NFT. Specifically, a group called Spice DAO purchased an NFT displaying a copy of filmmaker Alejandro Jodorowsky's 'Dune' for $3 million, assuming it would grant them the ability to

produce derivative works, such as an animated Dune series. However, *de facto* they merely owned proof of ownership without any proprietary value, as all copyright and any related rights were retained and not granted upon purchase. The UK's Advertising Standards Authority had emphasised this in its April 2021 guidance on advertising cryptocurrencies. Nevertheless, tokens may be used in a digital rights management scheme, as the aforementioned default position is subject to contract modification, as explained below.

1. Assignment

The copyright owner may transfer the entirety of the copyright in the work to the purchaser by assignment. Copyright that is transferred upon selling an NFT may explicitly be outlined in the self-executing smart contract governing the sale. Some intermediary platforms that enable NFT minting incorporate copyright issues, such as transfer of rights, into the transaction. For instance, the person minting an NFT on 'Mintable' can tick a box labelled 'Transfer copyright when purchased', so as to include a clause to this effect in the final smart contract.
Alternatively, the terms and conditions of the online marketplace where the NFT is marketed may state that the sale of the NFT is complemented by an IP rights assignment in the related digital asset, tethering copyright ownership to NFT ownership (the crypto-native approach) (see, for example the Bored Ape Yacht Club (BAYC)).

2. Licensing

A more common approach for NFT creators and IP rights owners is to implement an NFT license agreement coded into a smart contract or specified in the online marketplace's terms and conditions (the middle-ground approach). Marketplaces may offer general terms that apply uniformly to all sales or give NFT minters the option to include bespoke terms of use that only apply to sales of their works.
The traditional approach to IP ownership in NFTs is that of 'General Use' license agreements granting buyers 'limited, worldwide, non-exclusive, non-transferable and royalty-free licenses to use, copy and display the underlying asset in one's token wallet for personal, non-commercial use or resale'. In contrast, some NFT holders have a 'Commercial Use' license, i.e., an 'unlimited, worldwide license to use, copy and display the purchased art for the purpose of creating derivative works based upon the art'. For example, the 'NFT License' pioneered by Dapper Labs, creator of CryptoKitties among other NFT projects, allows an NFT purchaser to commercialise the underlying asset and create derivative works.

Lastly, the most liberal paradigm of copyright licensing is where the artist renounces any ownership claims to the work's copyright and related rights through the use of 'The Creative Commons Zero (CC0) Model', also referred to as 'The No Rights Reserved Model'. When issuing a CC0 NFT, the artist declares the entirety of a project's content to be in the public domain,

allowing the public at large to use, modify or recreate the NFT artwork in compliance with the CC0 license for commercial purposes, without attributing it to the original artist. For instance, CrypToadz is a prominent CC0 NFT project wherein the artwork related to the NFT is in the public domain. As such, the CC0 approach might efficiently address copyright infringement issues in the NFT world, as it seeks to develop viable open content IP. One might express concerns relating to the confluence between CC0 licenses and NFTs, as NFTs are intended to foster digital scarcity and ownership. However, NFTs in the public domain increase the original NFT project's visibility and, as a result, enhance the value of the community assets by association.

When licensing IP rights, it is imperative to specify the scope of permissible and prohibited uses, however, as this carries additional legal risk, NFT minters may favour a categorical ban on commercialisation. Furthermore, the rights being transferred are often ambiguous and susceptible to misinterpretation due to the vague and frequently incomplete character of relevant statements. As an illustration, BAYC is seen as particularly incoherent, as the BAYC terms stipulate that purchasers own the underlying art for their token, while additionally granting licenses that directly contradict this claim. Plus, BAYC terms distinguish between 'personal use', which is without royalties, and 'commercial use' which is not expressly described as royalty-free, yet it is not specified if a royalty is envisioned. A BAYC NFT holder might believe they are permitted to utilise their NFT for commercial endeavours, while Yuga Labs as the creator of the BAYC NFT collection may afterwards seek royalties from the holder.

3. Valid Transfer of Rights?

The question of whether a smart contract could serve as a legal means to assign or license exclusive rights in the digital sphere poses multiple copyright and contract law concerns. In the absence of harmonisation across EU Member States and other jurisdictions on the extent of legal formalities for the alienation of copyright, this is a matter of domestic copyright law.
UK copyright law mandates that an assignment of copyright be 'in writing signed by or on behalf of the assignor'. Similarly, in the EU copyright licensing must be in writing and an assignment must be in writing and signed by the assignor and assignee. While this is not explicitly outlined in EU law, the aforementioned is a general principle that can be found in various copyright laws of EU Member States.

The Electronic Commerce Directive (ECD) legislatively allows for the acknowledgement of electronically conducted contracts, and, whilst an assignment of copyright is not *per se* a contract in the traditional sense, pertinent case law and interpretation of the written and signature criteria may clarify what constitutes a legal assignment. While opinions on the formal legitimacy of smart contracts under existing contract law are divided, there is an emerging acceptance that they could function as a legal means of rights transfer.

Firstly, as regards copyright assignment, ‘a written document’ has been broadly interpreted to include a variety of formats, including electronic records such as emails. There is some ambivalence as to whether smart contracts satisfy the ‘writing’ requirement, as they are written in programming code rather than natural language. Nevertheless, most experts seem to consider as ‘writing’ terms on a website and a smart contract whose code element is recorded in readable source code outlining the material terms of the parties’ agreement.

Secondly, the UK eIDAs (electronic IDentification, Authentication and Trust Services) Regulation, codified into UK law as a revised version of the EU eIDAs regulation via a Brexit statutory instrument, grants electronic signatures identical legal standing to their handwritten counterparts, recognising the validity of various electronic signatures intended to authenticate the electronic record. Despite the fact that the usage of electronic signatures has proliferated over the years and existing regulations are general and inclusive of a variety of electronic formats, it is not yet apparent whether those rules could incorporate cryptographic signatures used to sign an NFT. According to the EU’s Blockchain observatory and forum thematic report, a blockchain-based digital signature can only be considered lawful when verified by a Trust Services Provider (TSP). TSPs are natural or legal persons responsible for the validation and security of digital signatures. The use of regulated trust service providers instead of multiple collaborating parties can be seen as competing with the distributed nature of blockchain technology. Plus, note that the term ‘digital signature’ rather than ‘electronic signature’ is used accurately to describe signatures generated on the blockchain. Even though these concepts are often used interchangeably and belong in the same category, not every electronic signature is a digital signature. Furthermore, the UK Jurisdiction Taskforce issued a legal statement on whether a statutory ‘signature requirement’ can be met by using a private key, which enables the cryptographical authentication of transactions and other actions involving the crypto asset through a digital signature. They contend that a digital signature created with private-key cryptography is merely a specific kind of electronic signature and can therefore satisfy the statutory signature requirement.

Lastly, the use of a ‘tick box’ establishing a copyright assignment on an NFT marketplace is akin to the widely accepted practice of a click-wrap agreement and/or ‘I Agree’ checkboxes. It shows ‘the intent to sign’ and legally digitally captures the acceptance of a binding contract.

In Part II we will discuss other copyright law implications of NFTs.

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