crowell moring

CLIENT ALERT

NFT Risks and Opportunities in the IP, Advertising, and Brand Management Spaces

Apr.16.2021

NFTs (non-fungible tokens) hit the scene in 2017 with CryptoKitties, a game on the Ethereum blockchain for buying, selling, and breeding digital cats. Clearly, CryptoKitties represents a humble start for NFTs, the technology that has since captured astonishing public and media attention. More recent NFTs—like the NFT-based digital artwork by Beeple that sold at Christie's for $69 million last month—demonstrate the rising importance of these novel digital assets.

Each NFT is a one-of-a-kind digital information file typically associated with a digital image, like an artwork, video, gif, tweet, or even event ticket. At least in theory, NFTs can also be created for physical objects, a possibility just beginning to gain meaningful attention.

Where associated with a digital image, the NFT does not generally contain the image but functions like an integrated smart contract with a link to the image file. This smart contract uses blockchain technology to track changes in ownership and affirm authenticity, much like a digital provenance. NFTs also contain a feature that can disseminate royalties whenever the NFT is sold, exemplifying the design flexibility and diverse functionality of these assets.

NFTs are a new form of non-tangible property with substantial implications in the art, entertainment, fashion, and marketing/advertising realms. Individuals and businesses operating in these spaces should carefully consider the merits of NFT platform or portfolio ownership and should anticipate new applications of and perhaps changes to existing bodies of law, like copyright and false advertising, that will address NFT issues.

NFTs and Copyright Law

Because NFTs are commonly associated with copyright-protected digital art, they are subject to copyright law considerations. U.S. copyright law protects original works of authorship fixed in a tangible medium of expression from which they can be perceived, reproduced, or communicated for more than a short time and provides a "bundle of rights" to the copyright owner. While copyright law does not specifically contemplate rights related to NFTs, several implications have become increasingly clear.

First, purchasing an NFT does not automatically convey ownership of the copyright in the associated digital artwork, unless specifically acquired via contract. Absent such a contract, an NFT owner would lack the right to make or sell copies of the artwork, to transfer the copyright in the artwork, or to create derivative works based on the artwork—rights included in the copyright "bundle."

This means, for example, that an NFT owner (who has not acquired the artwork copyright or an appropriate license) would not be permitted to take pictures of the associated artwork for use on merchandise or display on third-party platforms. Even posting an NFT image to Instagram would be suspect under copyright law, since such posts automatically create an unauthorized digital copy. This reality may significantly limit the ability of NFT owners to post, share, or otherwise publicly display the NFT-associated image without exposure to liability for copyright infringement.

The lack of copyright ownership of the digital image could also conceivably affect the ability to resell the NFT and the associated digital work. Notably, under the first sale doctrine, physical artwork owners can resell physical copies of copyrighted works without owning the copyright. But current copyright law has no first sale doctrine for digital works. In conformance with this principle, a U.S. district court famously prevented the sale of digital music files as copyright infringement, even where no copy or access was retained by the seller.[i] Unless views on this issue change, the absence of a first sale doctrine for digital works may greatly impact the resale rights of NFT owners.

Second, because anyone can create an NFT, even for an image they do not actually own, NFTs may significantly impact the nature and frequency of copyright infringement. NFTs allow infringers to commodify art by creating tokens without the permission of the original artist. This practice has produced a new wave of copyright theft, impacting even Banksy works.[ii]

Even assuming the Copyright Act is already sufficiently broad to capture and prohibit this conduct, NFT-based copyright infringement will be something entirely new to judges. Thus, it may produce costly litigation uncertainty for individuals and businesses affected by infringement.

In addition, because NFTs are made of open source code and are unique, they may be entitled to their own copyrights, separate from the copyright for the associated digital image. Separate copyrights may increase the overall value of NFT ownership. However, this bifurcation of ownership in NFT digital works could further complicate infringement proceedings, as where a legitimate NFT owner is being sued for copyright infringement by the legitimate owner of the associated artwork.

Third, NFTs may have significant copyright-related implications for platform owners. Like YouTube, NFT platform owners may be found to have obligations under the Digital Millennium Copyright Act (DMCA) or other legislation with respect to removing copyright-infringing content, responding to take-down requests, and so forth. As YouTube would likely attest, these obligations can be substantial.

In preemptive response, some NFT auction sites have already created DMCA processes for removing unauthorized NFTs. For example, the NFT marketplace OpenSea states in its terms of service that it will “take down works in response to formal infringement claims and will terminate a user’s access to the Services if the user is determined to be a repeat infringer.”[iii] MakersPlace provides a statement of zero tolerance for intellectual property infringement on its platform; its terms of service provide a designated agent for DMCA notices as well as instructions for submitting copyright infringement claims.[iv]

It is not yet certain to what extent the DMCA applies to NFT platforms. However, it seems likely that NFT platform owners will be subject to at least some responsibility for responding to copyright infringement on their sites.

NFTs and Music/Entertainment

Already, major musicians and entertainers are getting in on the NFT game. Kings of Leon released an NFT package under the group’s trademarked name. Mike Shinoda of Linkin Park launched a single with a parallel NFT for which fans paid thousands. Others artists who have or are expected to launch NFT auctions this month include Shawn Mendes, Post Malone, and Deadmau5.

But the real value of NFTs may be in their potential to disintermediate music and entertainment, allowing independent artists to step out from the shadow of record labels, publishers, and similar entities that, to date, have largely dictated who makes money from their art and on what terms.

Recently, several companies have formed with the business purpose of music sales and copyright tracking. For example, Bluebox uses blockchain technology and NFTs to manage music copyright information, helping artists "reclaim missed monetization opportunities" and "sales of future royalties."[v]

Specifically, Bluebox helps artists instantly create and register a copyright. Bluebox then divides each music track "into 100 NFTs, representing [a] 1% split of that song's copyright and half of them will be sold to the public."[vi]

Bluebox's CEO stated that the site could "spark a copyright sale revolution amongst fans, who will be able to buy pieces of songs and recordings before their favorite artist hits the big time—and then reap the rewards of this investment down the line."[vii]

NFTs could be a gamechanger for independent musicians, and further technological advances could significantly expand this potential. For example, imagine if NFTs could track not only sales or changes in ownership but also song "plays." NFTs could then use their automatic royalty distribution function to reward artists, on a direct and personal basis, for their creative successes.

NFTs and False Advertising

An additional consideration that may affect the value of NFT ownership is the risk of false advertising claims against NFT sellers. Because of the technological and legal complexities of NFTs, it may be unclear to consumers exactly what they are purchasing and what kind of rights they will obtain through the purchase of an NFT. This creates a risk of false advertising liability for those engaged in NFT sales.

Under the Lanham Act, NFT purchasers might have a claim for false advertising if they can show: (1) the seller made false or misleading statements as to the NFT products; (2) actual deception or a tendency to deceive a substantial portion of the intended audience; (3) the deception is material; (4) the advertised NFT goods travel in interstate commerce; and (5) a likelihood of injury to the plaintiff.

To preempt these kinds of claims, NFT sellers should be extremely clear about the ownership contours of each transaction—like that purchase of the NFT does not convey the copyright for the associated digital image, or that the particular digital image is one of some certain number of copies, each sold with their own NFT.

Some NFT platforms, like NBA Top Shot, have already acted to prevent false advertising liability by promulgating NFT license templates that carefully distinguish the NFT token from the associated digital artwork.[viii] These types of templates may be useful to NFT platform owners and sellers in preventing false advertising liability.

NFTs and Brand Management

While NFTs have been regarded by some as a passing fad, substantial investment by major brands suggests real value in possessing an NFT asset portfolio.

NBA Top Shot sold $230 million in NFTs linked to basketball highlights over a four-month period.[ix] Taco Bell recently debuted several taco-inspired NFT gifs, resale prices for which have risen as high as $3,600.[x] Others are not far behind.

Importantly for brand managers, NFTs have potential usefulness not only in association with digital images but also for physical products. According to a Gucci executive, NFTs for physical luxury goods are inevitable, which would open up a new field of NFT uses for brand owners.[xi] LVMH is reportedly already using the AURA blockchain to allow customers to trace the authenticity of luxury goods using NFT-related technology.[xii]

Brand managers should be prepared to address this significant market change and its potential impacts on physical product marketing, advertising, development, and general sales practices.

While NFTs present opportunities for brand owners in both digital and physical markets, they are not without risks—including, specifically, counterfeiting. If NFTs are minted that contain phony information, or if the link between the NFT and the digital image doesn't work, consumers could be misled as to the nature or value of their NFT purchases. If NFTs for physical luxury goods are popularized, as Gucci suggests, they could also contribute substantially to the trade in knockoffs, as where an unauthorized NFT is used to in an effort to demonstrate the authenticity of a fake product.

Brand and business owners should take care when operating in this new space and should consider the possibility of future consumer safety regulation if NFTs are found to create genuine counterfeiting risks.

Conclusion

NFTs are novel digital assets with a wide array of uses for businesses, brand owners, and individuals in the art, entertainment, fashion, and marketing/advertising realms.

However, they are not without risks.

Entities and individuals seeking to enter the NFT market should (1) carefully consider the risk of copyright infringement or false advertising liability; (2) anticipate possible changes to relevant legal doctrines that may create litigation uncertainty or affect NFT ownership obligations; and (3) be aware of the possibility of NFTs for physical products, as well as the brand loyalty monetization opportunities and counterfeiting risks this poses.

Crowell & Moring will continue to monitor these issues as they develop.

---

[i] Capitol Records, LLC v. ReDigi Inc., 934 F. Supp. 2d 640 (S.D.N.Y 2013), aff'd, 910 F.3d 649 (2d Cir. 2018).

[ii] Marion Maneker, NFTs are Creating the Opposite of Everything They're Meant to Fix, Artnews (Mar. 15, 2021), https://www.artnews.com/art-news/market/nfts-create-opposite-of-everything-they-are-meant-to-fix-1234586769/.

[iii] Terms of Service, OpenSea (Mar. 25, 2021), https://opensea.io/tos.

[iv] Terms of Service, MakersPlace (Apr. 13, 2021), https://makersplace.com/terms/.

[v] Carly A. Kessler, NFTs Are Reshaping Artists' IP Rights, Bloomberg Law (Mar. 24, 2021), https://news.bloomberglaw.com/us-law-week/nfts-are-reshaping-artists-ip-rights.

[vi] Id.

[vii] Id.

[viii] Ghaith Mahmood, NFTs: What Are You Buying And What Do You Actually Own?, The Fashion Law (Mar. 18, 2021), https://www.thefashionlaw.com/nfts-what-are-you-buying-and-what-do-you-actually-own/.

[ix] Sam Dean, $69 Million for Digital Art? The NFT Craze, Explained, L.A. Times (Mar. 11, 2021), https://www.latimes.com/business/technology/story/2021-03-11/nft-explainer-crypto-trading-collectible.

[x] Kayleigh Barber, WTF is an NFT, Digiday (Mar. 11, 2021), https://digiday.com/media/wtf-is-an-nft/.

[xi] Marc Bain, NFTs for Fashion are Inevitable, Quartz (Mar. 19, 2021), https://qz.com/1986615/nfts-for-fashion-in-the-real-and-virtual-worlds-are-inevitable/.

[xii] Ian Allison, Louis Vuitton Owner LVMH is Launching a Blockchain to Track Luxury Goods, Coindesk (Mar. 26, 2019), https://www.coindesk.com/louis-vuitton-owner-lvmh-is-launching-a-blockchain-to-track-luxury-goods.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

David Ervin
Partner – Washington, D.C.
Phone: +1 202.624.2622
Email: dervin@crowell.com

Deirdre Long Absolonne
Senior Counsel – New York
Phone: +1 212.803.4065
Email: dabsolonne@crowell.com

Carissa Wilson
Associate – Washington, D.C.
Phone: +1 202.508.8739
Email: cwilson@crowell.com