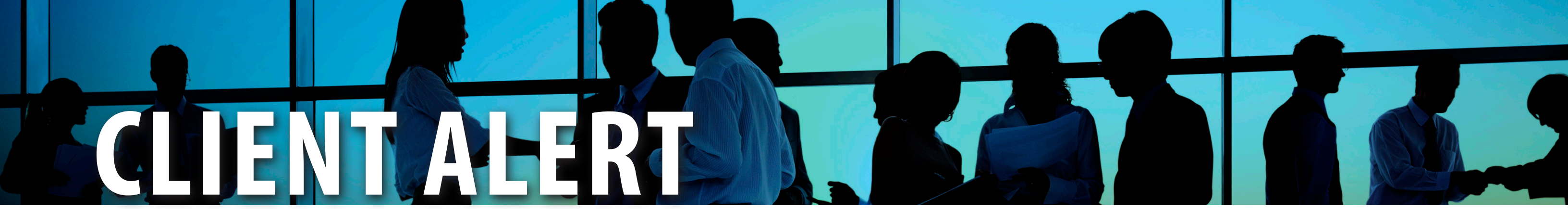


WHAT YOU NEED TO KNOW: INTELLECTUAL PROPERTY AND NON-FUNGIBLE TOKENS

by Paul E. Bain, Cindy A. Villanueva, and Caleb L. Green

Over the last several years, you may have heard the term "blockchain." Blockchain technology has emerged as an innovative, record-keeping technology, most notably recognized as the underlying technology behind Bitcoin cryptocurrency. The most innovative part of blockchain is that it is *decentralized*: not controlled by any one person or company. It is *transparent* in the sense that anyone can view the ledgers (if you know where to look). Blockchain technology can be used in several applications and is not limited to cryptocurrencies. Non-fungible tokens (NFTs) are the newest high-profile example of broad applications of this emerging technology. Once "minted" (the Non-fungible token field's term for "created"), NFTs are said to be *immutable* because the information, once entered on blockchain is permanent and irreversible.

NFTs are now taking the world by storm as sports memorabilia companies and art auction houses leverage these tokens to exploit increased value from digital assets. NFT sales exceeded $2 billion in the first quarter of 2021, with nearly twice as many buyers as sellers. Musicians, artists, and publishers, for example, have harnessed NFTs to monetize their works and exploit their intellectual property rights. In this article, we discuss intellectual property law aspects of NFTs and related innovations.

WHAT ARE NFTS?

An NFT is a digital asset whose authenticity has been certified on a blockchain ledger. The term "non-fungible" means unique or one of a kind. Although they both use blockchain technology, an NFT is different from cryptocurrencies. Cryptocurrencies, like Bitcoin, Ripple, and Ethereum, are fungible tokens, which means each cryptocurrency unit is the same as any other. Like regular government-issued money, these tokens are interchangeable and indistinguishable. If you own one unit of Bitcoin, it doesn't matter which exact Bitcoin you own. Likewise, the U.S. twenty-dollar bill in your pocket has the same value as any other U.S. twenty-dollar bill. On the other hand, with non-fungible tokens, each unit is distinctly identifiable and is defined by metadata, secured on a blockchain ledger that incorporates a unique role, function, and value.

To wrap your mind around NFTs, consider the following illustration. Owning an NFT is akin to owning an autographed photograph of a movie star pinned to your bulletin board. Only you can be the owner of that photograph. Similarly, only one person can own an NFT. However, as discussed in more detail below, the original creator of that photograph may own underlying intellectual property rights that permit them to make copies, prints, or derivative works of that photograph.

NFTs are not a novel technology. In fact, video game developers have used NFTs in gaming for many years. A prominent example of previous applications of NFT includes CryptoKitties, which was one of the earliest adaptations of non-fungible token technology and enabled players to collect and trade digital cats using NFTs. They can also be used inside gaming environments to represent in-game assets, which can be controlled by the user instead of the developer. Similarly, digital art is not new. The artist Andy Warhol began using computers to make and display art in the 1980s.

WHY NFTS?

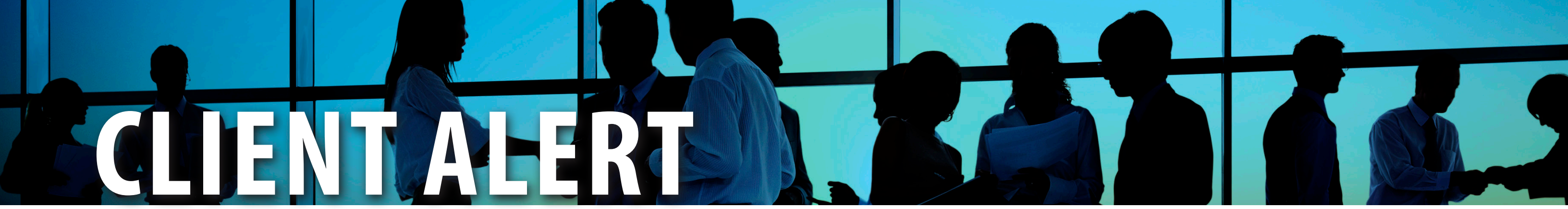
Now that we understand what NFTs are, you may be asking why they are so prevalent? A lot of this is driven by speculation; NFTs are a 'store' of value and many are betting on the value going up. There are already signs that this is a bubble. Nowadays, everything is being tokenized, resulting in an emerging market and record prices for NFTs. NFTs can represent ownership of nearly any real or intangible property in digital form. This includes works of art, musical works, multi-media works, and collectibles, such as trading cards. Put simply, an NFT is the digital version of a certificate of ownership or authenticity securely recorded on a blockchain ledger.

Given its ability to verify authenticity through blockchain technology, a new market for NFTs has emerged wherein companies and individuals buy and sell these non-fungible tokens through online auction websites, and the traditional auction houses like Sotheby's are now in on the craze. Examples of these NFT marketplaces include Superfarm, Ethernity, and OpenSea, which have facilitated the exchange of millions of dollars for various digital assets such as trading cards and digital collectibles. One of the largest NFT sales to date was MetaKovan's purchase of the NFT for Beeple's *Everything: The First 5000 Days*, for an estimated $69.3 million. An NFT for Jack Dorsey's—the CEO of Twitter—first-ever tweet ("just setting up my twttr") sold for $2.9 million. Creators are also driven to use these NFT trading marketplaces and platforms because they implement royalty "down-streaming," which means that the original creator receives royalty payments each time the work resells.

INTELLECTUAL PROPERTY & NFTS

The non-fungible nature of NFTs has created a new distribution model for monetization of intellectual property. Given some of the unique aspects of NFTs, intellectual property owners need to rethink their intellectual property protection and licensing strategies. As NFTs continue to grow in popularity, companies and creators should include specific NFT protections in their intellectual property protection strategies. Due to some of the unique aspects of NFTs, various new considerations need to be addressed when licensing, assigning, or transferring intellectual property rights. Further, NFT creators need to be mindful of potential infringement issues when using third-party intellectual property and should also consider intellectual property protection for their original creations.

It is no surprise that third-party intellectual property is often intertwined in NFTs without proper authorization or permission from the rights holder. In some cases, NFTs include unauthorized copyright-



protected content. Predictably, intellectual property rights owners are increasing their enforcement efforts against unauthorized uses of protected content in NFTs. NFTs have massive monetary influence in the entertainment and collectibles worlds, but, it remains unclear how NFTs impact the underlying intellectual property. What is clear, however, is that the rights associated with acquiring NFTs (other than the right to own) are limited.

There appear to be immediate applications of NFTs. Specifically, this tokenized technology could be used in fields such as watermarking, where creators can use NFTs to verify the authenticity of digital artwork or trading cards. Regardless of how NFT technology is exploited in the future, one thing is certain—NFTs should not be confused with inherent confirmation of the authenticity of goods themselves. This is especially important as reports of fraudulent NFTs increase.

When considering intellectual property implications of NFTs, it is important to distinguish between ownership of the NFT and ownership of their underlying intellectual property. The rights granted by an NFT seller depend on the rights transferred via a license or assignment, and these can vary with every NFT. You may own a particular video clip or photo of a LeBron James dunk in NFT form, but the underlying rights belong to the NBA. In the context of copyright, ownership of the underlying rights will only transfer if the author of the original work expressly agrees to transfer those rights to the NFT owner. Generally, without such an agreement, ownership of an NFT will not grant ownership of the underlying content or any associated intellectual property rights. As a result, an NFT owner may not be permitted to reproduce, distribute copies, publicly perform, display, or make derivative works of the original work. Instead, the copyright owner retains the exclusive rights.

CONCLUSION

As with any new application, clients involved in non-fungible tokens and blockchain technology, including companies, creators, and artists, should seek legal counsel to ensure their intellectual property rights are preserved and properly enforced. Intellectual property attorneys can assist companies in identifying protectable content and subject matter, recommending best practices and proper safeguards to protect works from improper exploitation.

Dickinson Wright's attorneys across North America have considerable experience in assisting companies and individuals in protecting their intellectual property rights in emerging technologies. The firm is committed to helping clients navigate this unprecedented time, and we are available to provide any assistance that may be required.

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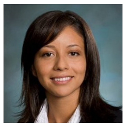

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