

Non-Fungible Tokens (“NFTs”) and the Entertainment Industry

Part 1: Ownership of NFTs and its Implications with Intellectual Property Law

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published 05/08/2023

Ownership of non-fungible tokens (“NFTs” and each an “NFT”) is an innovative, evolving area of intellectual property (IP) law dealing with digital goods and essentially turning them into high-value collectibles. Given the digital era we are in, this area is bound to become a significant part of IP law going forward.



Recently, it has been an explosive method for creators to monetize work that may not have otherwise had a platform. In the entertainment context, NFTs can represent a wide range of digital content, including digital art, music, videos, and even tweets or memes. When an NFT is sold or transferred, the ownership of the unique item or content it represents is transferred to the new owner, along with the associated NFT identifier.

NFT basics

NFTs are a type of digital asset that represent ownership of a unique item or piece of content on a blockchain. Unlike traditional cryptocurrencies, such as Bitcoin or Ethereum, which are fungible (i.e., interchangeable), NFTs are unique and cannot be replicated or exchanged for something else.

NFTs rely on blockchain technology also referred to as “blockchains”, such as Ethereum, which are decentralized blocks of data akin to a digital ledger or “receipt” chained together in a way that renders it

GLOSSARY

NFT or Non-Fungible Token

- A unique digital certificate, registered on a blockchain, used to record ownership of an asset.

Blockchain

- A digital ledger of data across a global network that is publicly verifiable (accessible and transparent) and immutable, as opposed to centralized and controlled by a single entity.
- Technology used by cryptocurrencies to allow secure transactions to take place. May also be referred to as a “Platform”.
- E.g., Ethereum (supports Smart Contracts).

Cryptocurrency

- Decentralized digital money usually based on blockchain technology and usually kept in a cryptocurrency wallet.
- E.g., Ether.

Marketplace

- A website where you can buy, sell and trade NFTs based on the same blockchain.

impossible to replicate, or duplicate (i.e., immutable). As a result, the immutable nature of blockchain technology adds to the rarity and scarcity of NFTs.

The Ethereum blockchain also allows for the creation of smart contracts that specify the unique properties and ownership of the NFT, including information about the item or content it represents, such as the artist or creator, the date of creation, and any associated metadata.

In other words, NFTs are made up of the (1) underlying digital good; (2) the data code stored on the blockchain; and (3) the metadata that forms part of the ledger of additional information about the digital good.

The blockchains which form the NFT are created or “minted” on NFT platforms or marketplaces where they may also be sold. Typically, these blockchains are stored within a large network of computers connected to the cloud where the data is transparent and accessible to everyone. This way, an NFT’s “chain of title” can be easily tracked. On the other hand, NFTs may be stored in different ways. For example:

1. NFT-Embedded Storage – where the NFT is stored on the same blockchain;
2. Off-Chain Centralized Storage – where the NFT is stored on a different blockchain or decentralized storage; or
3. Centralized Storage – where the NFT is stored in a private or centralized server.

NFT-embedded storage is the most desirable for purchasers of NFTs as it ensures that the digital asset will be accessible as long as the NFT exists.

While minting a digital work as an NFT cannot

Minting

- Creating an NFT and having it hosted in a smart contract on the blockchain.
- Once on the blockchain, the asset is “minted” as a token and cannot be altered, replicated, or duplicated (i.e., it is immutable).

Wallet

- An encrypted software application that serves as a blockchain secured bank account.
- Can also store purchased NFTs.

Centralized vs Decentralized Systems

- Centralized systems are closed, private ledgers managed and operated by governing bodies or “gatekeepers” that have full control.
- Decentralized systems are publicly accessible, transparent ledgers where transactions are verified and recorded across a large network of computers.

prevent copies from existing on the internet, the NFT process provides a method to validate authenticity. It can ensure that there is only one original, and that copyright and reproduction rights are assigned to one individual person – i.e., the creator – just like with physical works – while a buyer purchases a “license” to the “digital original”.

NFTs in the Entertainment Industry

One unique factor that NFTs offer is that up until now, there was no such thing as a “digital original”. Another feature of NFTs is that they can represent almost any real or intangible property, including artwork, music, videos, collectibles, trading cards, video game virtual items, or even real estate. Together, they provide an opportunity for individual artists and entities in the film, television, music, and gaming industries to generate new potential revenue streams while distributing content directly to their audience. This allows them to initiate and maintain connections in the pursuit of building a fanbase willing to invest in their careers.

For example, in May 2007, the digital artist Beeple started to create and post a new digital work of art online every day for 5,000 days. Each individual artwork was known as EVERYDAYS. However, collectively the pieces form what is called EVERYDAYS: THE FIRST 5000 DAYS which sold for \$69 million USD in the form of Ether in March 2021. Another example is associating NFTs with physical goods or experiences, such that the NFT acts as a “digital password” or key. For instance, Kings of Leon, in addition to their new album, auctioned off a limited number of NFTs guaranteeing VIP rights to four front-row seats to one show of every headline tour for life.

NFTs are bound to have massive monetary and social impacts on the entertainment world and beyond, so unsurprisingly, this exciting and innovative space is bound to present legal complexities and drive legal development in the context of intellectual property law – the law is much slower than technology after all.

What do NFT Buyers *actually* buy and what rights of use do they get?

While innovative, there is nothing about NFTs that render our traditional intellectual property laws inapplicable or change the operation of copyright.

An effective NFT analogy, although not by any means direct, occurs with real estate:

Imagine an NFT as a title to a residential property. A title is not the residential property itself, rather a record of ownership of the residential property. Similarly, an NFT is not the digital asset itself, but rather an NFT is a digital record or certificate of ownership of the digital asset – i.e., the data file that contains the work.

Once a residential property is purchased, we record the newly issued title in an index kept at the land titles office. When an NFT is purchased, that transaction is recorded on the blockchain – an immutable ledger which may have one or more entries that can't be modified.

BUT, owning an NFT does NOT necessarily mean ownership of the asset underlying the NFT. It is important to distinguish between *ownership of the NFT* and *ownership of their underlying intellectual property*. The rights granted by an NFT Creator/Seller/Author (the

“Author”) depend on the rights transferred via a license or assignment, and these can vary with every NFT.

Generally, unless the Author’s bundle of rights are expressly assigned or licensed away, the Author remains the owner of the underlying IP who retains the exclusive rights to copy, modify, distribute, publicly perform and display the art. The NFT transfer would convey an interest in a licensed copy of the work while the intellectual property rights and copyright ownership of the underlying work itself would not be transferred.

It is also important to note that the Author of an NFT retains certain “moral rights” in the work that limit what the Buyer can do with the work. For example, a Buyer who purchases a painting and writes hateful words, commentary, or obscenities over it may still infringe upon the Author’s moral attribution and association rights. These moral rights cannot be transferred or assigned but can be waived in whole or in part at the discretion of the Author.

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 Buyer. 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 Buyer may not be permitted to reproduce, distribute copies, publicly perform, display, or make derivative works of the original work.

For example, a Buyer may own a particular video clip or photo from NBA Top Shot of LeBron James dunking in NFT form, but the

underlying rights to the video clip or photo remains with the NBA. Similarly, someone who buys a DVD does not purchase ownership of the work itself and would not own any rights to the audio-visual content of the work. In either case, the Buyer of the NFT or DVD would not be permitted to sell copies of the work. Rather, unless otherwise agreed upon, the Buyer purchases a limited license to use the copyrighted work associated with the NFT or DVD for personal use.

However, permitted uses of the work can vary depending on how the NFT and the purchase-sale transaction is structured. For example, music producer Illmind's NFT "Alorium" contains an exclusive link to a digital file that contains individual audio tracks of his compositions and comes with a "royalty-free guarantee" and a contract that gives the NFT Buyer rights to use the audio files for their own purpose.

Overall, it is important for creators and buyers of NFTs to be aware of the intellectual property ownership considerations involved in this emerging technology, and to work with legal experts to ensure that their rights are protected.

If you have legal questions regarding NFTs and the IP ownership considerations involved, please contact **Silvia de Sousa** and **M. Ingrid Ruiz**.

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