



NFT Pros and Cons: What Companies Need to Know

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- Recognized as a leader in structuring and closing complex mergers and acquisitions and restructurings, and in advising corporate boards
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- Leader of firm’s Copyrights group and Media & Entertainment industry team
- Represents a variety of clients—large and small, U.S.-based and international, and in many different industries
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Blockchain Technology



- According to Merriam-Webster blockchain technology is "an open, distributed ledger that can record transactions between two parties efficiently and in a verifiable and permanent way"
- Transactions are agreed to by the participants in the blockchain when entered into the ledger
 - Transactions cannot be changed
 - Transactions are provably verified
 - Ensures the permanency of the records
- A cryptocurrency (e.g., bitcoin or ether) can be thought of as the digital measure of value that exists only on the blockchain—commonly referred to as a “coin” or a “token”

NFTs: An Overview

- A non-fungible token (NFT) is a unit of data stored on a blockchain that represents a unique item
 - Real-world physical items or digital assets
 - Unlike bitcoin or other cryptocurrency, not mutually interchangeable, i.e., not fungible
- One bitcoin is indistinguishable from any other bitcoin and can be readily exchanged
- By contrast an NFT is unique; it is a one-of-a-kind piece of code, stored and protected on the blockchain

NFTs: An Overview, cont'd

- An NFT can represent anything that exists as or can be represented by a digital
- NFT representing ownership of a digital asset resides in a digital wallet
- Very few restrictions as to what kind of content can be "tokenized" and turned into an NFT



What Do You Get?

- NFTs provide:
 - A way to authenticate ownership
 - Permanency
 - Blockchain recorded provenance
- Distinction between NFT and copies of underlying digital asset:
 - It is possible have more than one NFT representing different copies of an identical piece of digital art or image but the code or token for each copy is unique
 - In that way each owner of a NFT has a one-of-a-kind token for his or her copy of that piece of digital asset



Rights Associated with NFTs

- The code creating the NFT forms a “smart contract”
- Creator can include any terms that are then captured on the blockchain
- Most NFT contracts today are very simple (ownership)
- However, NFT code may also include:
 - Descriptions of the NFT’s features or traits
 - Financial terms
 - Specific rights, e.g., IP rights in underlying asset



IP Issues in NFTs – Copyrights



Copyrights arise automatically when an original copyrightable work is fixed in a tangible medium of expression.

The bundle of rights include the exclusive right to:

- copy
- distribute (i.e., publish)
- prepare derivative works
- perform in public
- display in public

IP Issues in NFTs – Copyrights

- Copyrighted works include the following:
 - literary works
 - musical works, including any accompanying words
 - dramatic works, including any accompany music
 - pantomimes and choreographic works
 - pictorial, graphic, and sculptural works
 - motion pictures and other audiovisual works
 - sound recordings
 - architectural works
- Copyrights do not protect any idea, procedure, process, system, method of operation, concept, principle, or discovery.

IP Issues in NFTs – Copyrights

- If anyone does any of the things within the exclusive rights of the copyright owner without permission from the owner, that is the definition of infringement
- Knowledge and intention are not relevant to liability for infringement but they are relevant to damages

Copyrights are governed exclusively by the federal law, specifically the U.S. Copyright Act

IP Issues in NFTs – Copyrights

- Copyright issues could be raised if NFT artwork depicts an existing work – the process would likely be deemed to involve making a copy, creating a derivative work, a distribution, and a public display or public performances of the underlying work
 - The underlying work could be any kind of artwork, music, video, a protected character, set and costume designs, and any other type of original expression, including a tattoo

Former DC Artist Becomes a Millionaire Selling Wonder Woman NFTs

Jose Delbo, who drew Wonder Woman's comic book in the 1970s and 1980s, recently sold \$1.85 million worth of Wonder Woman non-fungible tokens.

BY BRIAN CRONIN

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IP Issues in NFTs – Right of Publicity

- The right of publicity prevents the unauthorized commercial use of an individual's name, likeness, or other recognizable aspects of one's persona
- In the United States, the right of publicity is largely protected by state common or statutory law, and the specifics vary from state to state
 - Virtually all states that protect the right of publicity, however, include protection for the personal name and likeness

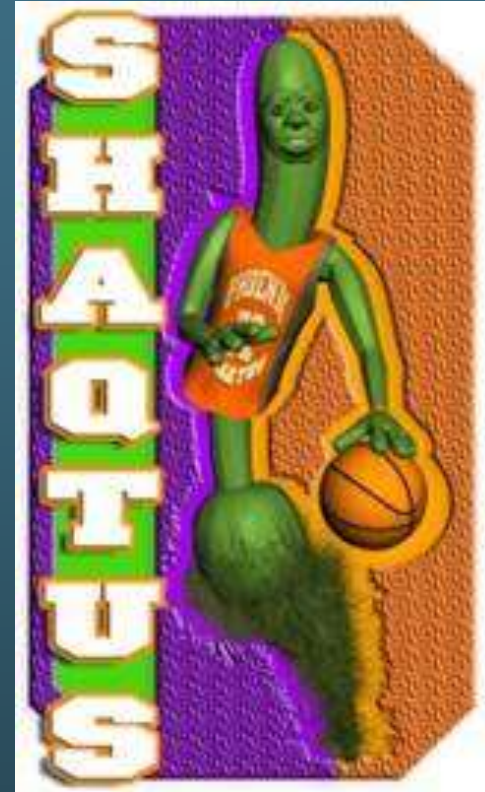
IP Issues in NFTs – Right of Publicity

- ROP issues would be raised when artwork depicts a real person or a character (if there is an actor whose persona is strongly associated with the character)
 - Usually the law of the state in which the person is domiciled governs their right of publicity, but not always
- For artwork, the key defense is the First Amendment, which protects creative expression by an artist
 - Art cases typically balance the ROP of the person depicted with the First Amendment rights of the creator

IP Issues in NFTs – Right of Publicity

- There are many different tests to determine Right of Publicity
 - You need to check the appropriate test(s) for your situation
- Right of Publicity laws vary from state to state
 - You need to review the relevant state law(s)

IP Issues in NFTs – Right of Publicity



In *Mine O'Mine, Inc. v. Calmese*, 2011 WL 2728390 (D. Nev. 2011), aff'd, 489 Fed. Appx. 175 (9th Cir. 2012)

IP Issues in NFTs – Right of Publicity



ETW Corp. v. Jireh Publishing, Inc., 332 F.3d 915, 925-26 (6th Cir. 2003)

IP Issues in NFTs – Right of Publicity



Comedy III Productions, Inc. v. Saderup, 21 P.3d 797 (Cal. 2001)

IP Issues in NFTs – Right of Publicity



No Doubt v. Activision Publishing, Inc., 98 U.S.P.Q.2d 1728 (2d Dist. 2011)

IP Issues in NFTs – Trademarks

- A trademark is a word, phrase, symbol, and/or design that is used in commerce in connection with goods and/or services
- Uses of marks that are the same or substantially similar, in connection with the same or highly related goods/services, would typically be considered to create a likelihood of confusion and could thus be considered an infringing use of a mark
 - A famous brand is protected by “dilution” which will protect that brand for any goods/services

IP Issues in NFTs – Trademarks

- An NFT platform, marketplace, creator, or company can each have one or more trademarks associated with their specific goods or services
- Trademark issues could be raised by NFTs if they depict a third party's mark or a celebrity who uses their image, voice, or other elements of their persona, as a trademark
 - For example, a team logo showing on the uniform of an athlete or a character who is used as a brand in advertising or otherwise

Topps MLB NFT Launch Delivers Digital Baseball Cards, Frustrates Collectors

By Ed Scimia · on April 20, 2021 · 3 min read

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Topps launched its MLB NFTs in earnest on Tuesday, offering digital collectibles to users, but suffering from a rocky pack drop. (Image: Topps Digital)

IP Issues in NFTs – Moral Rights

- In the US, moral rights protect the right of attribution, and the right of integrity
 - The right of attribution allows an author to prevent misattribution of a work, and to require that the authorship of the work not be disclosed (i.e., remain anonymous)
 - The right of integrity bars intentional distortion, mutilation, or other modification of a work if that distortion is likely to harm the author's reputation and prevents the destruction of any work of recognized stature

IP Issues in NFTs – Moral Rights

- Recently a Banksy work was burnt with an NFT recording the event
- Query whether memorializing and publicizing the destruction of artwork, via an NFT, infringes the artist's moral rights

NFTs as Securities Overview



- Why be concerned about whether NFTs are treated as securities?
 - Offerings would have to be registered under the Securities Act of 1933 or have an exemption
 - Participants in the offerings may have to register as securities broker-dealers
 - Platforms for transactions in NFTs may have to register as securities exchanges
 - Information contained in a securities offering must be complete and not materially misleading
 - Sellers of NFTs may have liability to purchasers under SEC Rule 10b-5 if they “make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading”
 - The Securities Act of 1933 is a statute with criminal penalties for violations

Precedents

- Prior enthusiasms for crypto assets that would not be securities, such as “utility tokens” – e.g., the right to use a product or service
- SEC took position that utility tokens could be securities, and as recently as December 2020, filed a 71-page complaint in an enforcement action against Ripple Labs in for selling “utility tokens” that the SEC claims were securities



So...When is a Crypto Asset a “Security”?

- When is an orange tree a security?
- Supreme Court decision in *SEC v. Howey* (1946)
 - Existence of an “investment contract”
 - In a common enterprise
 - With a reasonable expectation of profits
 - To be derived from the efforts of others

When is a Crypto Asset a “Security”? – Getting into the Details

- SEC “Framework for Investment Contract Analysis of Digital Assets”
 - Focus is not only on the digital asset itself, but on the manner in which it is offered, sold or resold
 - Does the purchaser have a reasonable expectation of profits derived from the efforts of others?
 - Reliance on the efforts of others
 - Does the promoter or sponsor (the “active participant” (AP)) provide essential managerial efforts that affect the success of the enterprise?
 - Do purchasers expect the AP to perform tasks that are necessary for the digital asset to achieve its intended purpose?
 - Does the AP control creation and issuance of the digital asset?
 - Does the AP have a continuing role in making decisions regarding the digital assets?
 - Will the efforts of the AP continue to be important to the value of the digital asset?

When is a Crypto Asset a “Security”? Getting into the Details

- Reasonable expectation of profits
 - *Not* from external market forces
 - Appreciation that comes, at least in part, from the operation, improvement, or other developments in the network, *particularly* if there is a secondary trading market
 - **Is the digital asset marketed in terms that indicate that it is an investment?**
NFT projects often attach extensive rights and royalties to the underlying nonfungible token, thus providing for AP control and providing an investment focus
 - Is the potential appreciation in the value of the digital asset emphasized in marketing or other promotional materials?

NFTs as Securities

- SEC Commissioner Hester Peirce recently addressed the question of whether NFTs may be securities:
 - “If you’re doing something where you are saying, ‘I’m selling you this thing and I’m going to build this, I’m going to put a lot of effort into building something so that this thing that you are buying has a lot of value,’ that’s going to raise the same kinds of questions that these ICOs have raised and so you’ve got to be very careful when you do something like that.
 - “You also have to be careful if you decide [to] take a bunch of these NFTs and put them in a basket and then break them up and sell for a fraction of the interest. If they’re selling for \$69 million, you might want to break them up and sell fractional interests and then you better be careful that you are not creating something that is an investment product, that’s a security.”

Evolving Issues

- NFT Maintenance
 - Long-term accessibility
 - Options for NFT data storage
- Smart Contracts
 - Not true contractual terms
 - Enforceability issues

Contact Us with Questions



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