

Decoding The Fine Print On Nonfungible Token Licenses

By **Stuart Levi, MacKinzie Neal and Mana Ghaemmaghani** (March 30, 2021)

Nonfungible tokens, also known as NFTs, are digital certificates of ownership or other rights that are stored on a blockchain.

A blockchain renders these certificates immutable and, through cryptography, allows the creator or minter to create one or a limited edition of these certificates.

Works associated with NFTs can include digital creative works — art, music, videos — or, in newer use cases, real- world tangible items.

Part of the value of NFTs to purchasers and sellers is that, because they are immutable, NFTs provide a reliable means of signifying ownership of digital assets and provide a historical chain of title of such work from when the NFT was created.

While blockchains are decentralized, and often autonomous, computer networks, most NFTs are bought and sold through third-party marketplaces that specify in their terms of use certain legal rights and obligations of the purchaser and the person or entity minting the NFT, which is often the seller.

Understanding these legal terms is critical to appreciating what an NFT actually is. Such terms of use also provide helpful guidance for companies, be they technology providers or rights holders, seeking to launch their own NFT platforms.

As a general matter, there are three types of NFT marketplaces today.

The first type, which includes OpenSea and Nifty Gateways, provides a virtual marketplace for buyers and sellers to come together and typically does not conduct any independent verification of the work attached to the NFT.

The second type of marketplace, such as SuperRare, conducts some verification of creators and their work.

The third type of marketplace, such as NBA Top Shot, only offers the works of a single rights holder.

Separately from NFT marketplaces' terms of use, creators and rights holders should consider how NFTs will be handled under their existing agreements and whether to include the right to mint NFTs in any new agreements.

Rights Granted in an NFT License or Terms of Service

The rights a purchaser receives in an NFT are governed by the license provided by a marketplace offering NFTs for sale. A marketplace could provide general terms that apply unilaterally to all sales, or it could allow minters of an NFT to include bespoke terms of use



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that apply to the sales of their specific works.

Most current marketplaces grant a nonexclusive and nontransferable license to use, copy and display the creative works underlying the NFT for personal use.

For example, the SuperRare marketplace provides that, by minting NFTs on the platform, the artist grants to the purchaser of the NFT a limited license to display the underlying work. That display right is limited, in part, to promoting the purchaser's purchase ownership or interest in the underlying work, promoting discussion of the work, displaying the work on third-party marketplaces or exchanges to sell or trade the NFT, or displaying the work within decentralized virtual environments.

In the instance in which the marketplace terms of use are silent on license rights, the NFT purchaser would not have any intellectual property rights in the creative work and would likely only have an implied license to display the work for personal use.

As a general matter, any right to commercialize the work may be expressly carved out. Dapper Labs, the company behind the early-stage CryptoKitties NFTs and NBA Top Shots, proposed a form of NFT license, called NFT License 2.0, which would allow a purchaser to commercialize a work up to \$100,000.

It remains to be seen whether companies adopt this approach since it may be hard to police whether users have exceeded the cap. NFT minters may prefer instead a flat prohibition on commercialization.

The typical NFT terms of use also sets forth certain restrictions on how the creative work underlying the NFT may be used. For example, a number of license agreements, including the NFT License 2.0, prohibit use of a creative work in connection with media that depicts hatred, intolerance or violence, or that otherwise infringes upon the rights of others.

NBA Top Shots grants a limited license to purchasers to display its NFTs, the virtual trading card, on third-party marketplaces or websites, as long as the third party cryptographically verifies that it is the actual purchaser that has the necessary rights to display the NFT.

Purchasers should also note that, notwithstanding messaging that suggests that NFTs guarantee authenticity, the purchaser may in fact be fully responsible for verifying the identity, legitimacy and authenticity of the underlying work related to the purchased NFT, as explicitly stated, for example, in the OpenSea terms of service.

Seller and Purchaser Representations in License Agreements

License arrangements on NFT platforms may also include representations and warranties with which minters and NFT purchasers are required to comply.

For example, Mintable requires each user to agree it will not submit content that is copyrighted or subject to third-party rights, unless the user owns the rights to the content or has permission from the owner.

Similarly, OpenSea requires each user to represent and warrant that it has the rights or authority necessary to submit content on the marketplace.

Disclosures

NFT purchasers may be under the impression that NFT transactions provide anonymity. Notably, blockchains are transparent and public keys of participants transacting on the network are observable. To the extent a public key can be linked to an individual, a third party could identify the identity of a purchaser and what NFTs it owns.

Purchasers should be cognizant of the fact that the terms of service of the platform provider, such as NBA Top Shots, may put the purchaser on notice that the purchaser's public wallet address will be visible on the blockchain,

Disclaimers of Liability

NFT marketplaces, like most providers of services matching sellers and buyers, disclaim any liability in connection with providing the platform. Additionally, they will disclaim any liability for the NFTs themselves — an important point since NFTs are basically pieces of computer code residing on a blockchain.

The terms of service commonly state that the marketplace, as well as the NFTs, are made available on an as is and as available basis, and the provider makes no warranties that the marketplace or NFTs will be available on an uninterrupted basis or that they will be accurate, reliable or safe. Purchasers should also expect that platform providers will not guarantee that the marketplace or NFTs will be free of viruses or other harmful components.

Risk Factors and Disclosures

In addition to stating that the marketplace and NFTs are provided as is, platform providers often apprise the user of a number of disclosures and risk factors, many of which are unique to blockchains. These disclosures may cover for example:

- The volatility of blockchain and digital assets;
- The uncertainty of tax treatment for NFT transactions;
- Clarification that the platform provider does not store, send or receive the NFTs, and that this takes place on a blockchain the platform might not control;
- Risks that the asset associated with the NFT may become inaccessible;
- Risks arising from a hard fork in the blockchain on which the NFT is stored;
- Risks arising from the uncertain regulatory environment surrounding blockchain technologies and cryptocurrencies; and

- Risks relating to hardware, malicious software and unauthorized actors.

Those minting, selling or purchasing NFTs should be aware of, and understand, these disclosures, and companies building out NFT platforms should carefully consider what disclosures they want to make.

Dispute Resolution

NFT marketplaces available today generally provide that any disputes arising under the terms of service are to be resolved by arbitration. Note that this would likely apply to disputes arising from use of the marketplace and not, for example, a claim by a copyright owner that its rights are being infringed through an NFT offered on the marketplace.

Similarly, the terms of service for most NFT marketplaces include a governing law provision, and parties using such marketplaces should be familiar with what law would apply if they had a dispute with the marketplace.

Incorporating NFTs Rights Into Existing Agreements

Parties may wish to conform their existing third-party agreements, particularly ones that include intellectual property licensing arrangements, to provide for NFT rights. However, it is important to ensure NFT rights are properly incorporated into an agreement such that the parties' rights are adequately protected.

Due to the technical complexities of blockchains and NFTs and the fact that they are still relatively nascent technologies, parties should not assume the right to mint NFTs is automatically granted or restricted by existing language. Depending on the parties' objectives, the agreement should either ensure the rights granted are sufficient to permit NFT minting or adequately restrict a licensee from minting an NFT.

For example, it may be unclear whether granting a licensee the right to publicly perform and/or display a creative work, or a right to commercialize that work, is legally sufficient to permit the minting of an NFT associated with that work.

Similarly, existing agreements may include catch-all language intended to allow a licensee to use intellectual property on all media or distribution methods, now known or later developed. However, it may be unclear if minting an NFT associated with a work is the same as using that work and therefore covered by that catch-all clause.

If a licensor seeks to grant a licensee rights to mint an NFT, explicit language should be included that outlines the scope of rights and the parameters of the minting. For example, is all of the intellectual property or only a subset permitted to be minted; is there a limitation on the type of marketplace used; what rights can the licensee grant to purchasers of the NFT; can an NFT subsume assets that are outside the scope of the agreement, etc.

This will ensure that the licensor does not inadvertently grant overly broad rights that do not align with its objective and will help to avoid issues of breach of contract or infringement down the road.

Key Takeaways

Although blockchains are decentralized platforms, there is still considerable centralization through NFT marketplaces. Understanding the terms of use of these marketplaces and drafting agreements that address NFT rights will be critical as this industry grows.

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