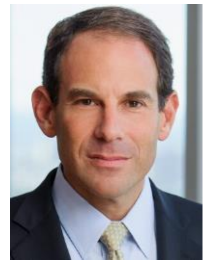
The Growing Complexity Of Commercial Rights Issues In NFTs

By **Stuart Levi, Mana Ghaemmaghami and Gabriel Mohr**

Although it has only been a little over a year since nonfungible tokens came into the mainstream, the industry has taken a number of twists and turns, not the least of which is the granting of certain commercial exploitation rights in the digital works associated with an NFT.



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However, this trend has uncovered an inherent issue with attaching contractual rights to NFTs. It is an issue for which there is not yet a definitive solution, which is creating potential issues for rights holders, NFT issuers and NFT owners.

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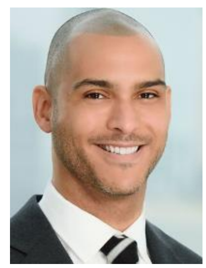
In order to understand this issue, one needs to keep in mind that an NFT is typically comprised of two components: the on-chain token and the off-chain digital work or real world asset to which that NFT attaches or identifies.

The link between these two components is reflected in the metadata of the NFT, which most often includes a pointer to where the digital work is located. As a general matter, while the NFT purchaser owns the on-chain token, the digital work is typically only licensed to the NFT owner.



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When NFTs hit the mainstream in early 2021, almost every project sharply limited the scope of the license to the digital work. Most terms of use specified that the NFT owners had the right to display the digital works for their own personal, noncommercial use, and for no other use other than as necessary to list the work for sale on a blockchain-compatible platform.

These terms typically also included, lest there be any uncertainty, a list of uses that were prohibited, such as using the work for commercial gain, incorporating the work in video content, using it to promote or advertise other products or services, creating derivative works, etc.

This explicit limited grant of rights, and the accompanying restrictions, have been critical for NFT owners. This is because the default rule is that intellectual property rights, particularly rights in copyright, which are at the heart of most NFTs, remain with the owner of those rights unless they are explicitly granted, even where someone buys a physical work that embodies those rights.

This reality of intellectual property law is often more apparent to purchasers of physical objects. For example, purchasers of physical art or video games appreciate that they do not own the intellectual property of their purchased product such that they can now use the underlying images and content for their own commercial purposes.

The understandable concern of NFT issuers was that purchasers of NFTs may not appreciate this distinction, and may believe that ownership of an NFT came with ownership of the intellectual property rights in the underlying work. Hence, the explicit and strict limitations laid out in the terms of use to which a purchaser agreed when they acquired an NFT.

As NFTs became more popular in 2021, there was a groundswell of vocal pushback to this concept from the NFT community. This community asserted that limiting intellectual property rights in this manner was counter to the decentralized, community-based ethos of Web3, and that holders of NFTs, especially ones minted as a defined collection, should enjoy the same broad intellectual property rights as the original creators.

The result has been a series of projects granting varying bundles of intellectual property rights in the underlying digital work, ranging from limited rights, e.g., rights for certain types of products or capping how much revenue can be earned per year, to very broad unlimited rights to commercialize the underlying work. This trend toward the granting of commercial rights is commonly seen within the area of profile picture NFT collections.

NFT License Rights and Restrictions

All of this would seem fairly straightforward if it were not for the decentralized nature of blockchain technology. A defining attribute of NFTs is that they are freely transferable to others without the need for an intermediary.

In such an environment, initial creators of the NFTs — often also the owners of the intellectual property rights in the digital work — want to make sure that any license grant, including any restrictions on those rights, travels with the NFT such that future purchasers are aware of, agree to, and enjoy the benefits of, that license.

How that happens, however, is far from clear in today's NFT ecosystem. This is a particularly important issue since the commercial rights granted in the works underlying NFTs may not be as broad as purchasers believe.

For example, the terms and conditions for the NFTs associated with Yuga Labs LLC's Mutant Ape Yacht Club caution:

Other than the rights to the Art, nothing herein gives you any rights to any other trademarks or other intellectual property rights belonging to Yuga Labs, including, without limitation, to Bored Ape Yacht Club, BAYC, Bored Ape Kennel Club, BAKC, Mutant Ape Yacht Club, MAYC, and the associated logos. All of these rights are expressly reserved in the name of Yuga Labs LLC.

Thus, while owners of the artwork in a Mutant Ape can broadly exploit that work, they cannot, under the current terms, use the very valuable Bored Ape Yacht Club name. The terms and conditions governing the InBetweeners NFTs — the profile picture collection of teddy bear NFTs supported by Justin Bieber — contains similar language.

Holders of the InBetweeners bears can exploit the artwork but they cannot use the InBetweeners name.

The Invisible Friends NFT project also illustrates how commercial rights may not be as broad as purchasers believe. Holders of Invisible Friends NFTs have rights to produce and sell physical merchandise portraying their NFT artwork, but are restricted from creating any digital merchandise using the artwork.

Granting Rights as Part of a Primary NFT Sale

An overview of the transaction life of an NFT highlights the important missing links in the contractual rights flow. When NFTs are first minted and offered for sale or otherwise distributed, there are several ways the NFT creator or issuer may grant rights, or purport to grant rights, in the underlying artworks to NFT purchasers, assuming they themselves have the appropriate rights to do so.

Most often, NFT issuers make the NFTs available for initial sale or distribution through the issuer's own website platform or a platform offered by the issuer's business partner. In these cases, the NFT issuer can rely on a clickwrap agreement pursuant to which purchasers must affirmatively click to agree to the applicable terms and conditions in order to obtain an NFT.

Alternatively, the NFT issuer might include a link to the terms and conditions on the website hosting the initial launch — often on the bottom of the page — that the user is not directed to review, let alone affirmatively agree to, prior to purchasing the NFT.

These browsewrap agreements sometimes state that mere use of the website constitutes assent to the terms and conditions. In still other cases still, commercial rights are granted through posts to online NFT-community fora — such as those of Twitter or Discord — or through a FAQ or road map on the NFT issuer's website.

The analysis of whether such terms and conditions are binding on the initial purchasers of an NFT is no different from the analysis that has traditionally been applied to online contracts. Courts consider whether purchasers: were on notice of the terms; and actually or implicitly assented to them.[1]

Applying this framework, courts generally enforce clickwrap agreements because they require purchasers to physically manifest assent — e.g., clicking an "I accept" button that explicitly indicates assent to the terms of use.[2] In contrast, since browsewrap agreements do not require explicit physical assent, courts typically will only find them enforceable if they are presented in a clear and conspicuous manner.[3]

This can be a high bar, as courts have refused to enforce terms placed on a submerged screen,[4] located exclusively at the bottom of a website,[5] situated among many other links,[6] or even in a link included on every page of a website near other relevant user prompts.[7]

The U.S. Court of Appeals for the Ninth Circuit's April 5 dicta in a concurring opinion in Berman v. Freedom Financial Network LLC about the enforceability of different online contracts is instructive.

There the court found that the font size and format of a website's contractual terms were not conspicuous enough for a reasonable consumer, and that clicking a large green "continue" button placed near these terms did not manifest unambiguous assent.[8]

Guided by two internet contract formation cases decided by the California Courts of Appeal,[9] the concurring opinion took the analysis further, asserting that, under California law, clickwrap and scrollwrap agreements — i.e., agreements where users must physically scroll to the bottom to click an "I accept" button — are presumptively enforceable,[10] while browsewrap agreements are per se unenforceable.[11]

The concurrence also outlined the requirements for enforceable sign-in wrap agreements — i.e., agreements where users are notified of, but not required to affirmatively consent to, a website's terms before signing up for an online product or service.

Much like browsewrap agreements, the enforceability of sign-in wrap agreements turns on the clarity of notice provided to users such that registering or completing a transaction on the website constitutes consent to the website's terms.[12]

Thus, simply placing the terms and conditions that apply to an NFT, including any commercial rights being granted, on a link accessible at the bottom of the NFT issuer's website is unlikely to bind the initial NFT purchaser. Similarly, folding terms and conditions into the registration process for an NFT purchase or "allow list" — i.e., preregistering for access to purchase NFT through a sign-in wrap agreement does not necessarily give rise to an enforceable contract in all jurisdictions.

General online statements in social media or in FAQs, without more, are also likely to be unenforceable. The issue with granting rights through social media statements is also exacerbated by the fact that in many cases the poster of the statement may not have the authority to even grant such rights — e.g., a third-party moderator on an NFT issuer's channel.

This means that many initial purchasers of NFTs may not have a formal grant of commercial rights, nor may they have agreed to any limitations attached to the NFT. We address the repercussions of that later in this article.

Implications for Secondary Sale NFT Purchases

The issue of whether terms and conditions are binding on the owner of an NFT becomes far more complicated with respect to downstream purchasers of NFTs, often referred to as secondary purchasers. That is because there currently is no effective and generally accepted mechanism for legal terms to travel with an NFT.

That means when a secondary purchaser acquires an NFT through one of the many NFT marketplaces or directly from an NFT owner, they likely were not presented with the terms of use that accompanied the initial sale. Instead, they are simply provided with an image and certain identifying information about the NFT, and its price. While secondary marketplaces typically have their own terms and conditions, these relate to the use of the marketplace, not the individual NFT.

Thus, even assuming the best-case scenario where the initial purchaser agreed to the terms through a clickwrap or scrollwrap agreement, it is far from clear how a secondary purchaser would be aware of, let alone agree to, the terms of such an agreement.

To date, there have been a number of approaches to address this issue, each of which presents its own shortcomings, and none of which have been universally adopted:

Walled Gardens

NFT issuers could make sure that their NFTs are only available for purchase through closed ecosystems, known as walled gardens. NFT owners therefore would not be able to offer their NFTs for sale on secondary marketplaces or to off-platform wallet holders.

This approach allows the NFT issuer to ensure that every purchaser, including all secondary purchasers, must assent to a clickwrap agreement or other form of enforceable agreement.

The downside with this approach is that it cuts against the ethos of Web3 in which individuals are seen as holding their own digital assets and being able to freely transfer them. A walled garden is perceived by many in the NFT space as unwanted centralization.

Marketplace Requirements

NFT issuers could require that any NFT marketplace where their NFTs are sold include a link to the issuer's terms and conditions on the issuer's page on that marketplace along with an "I agree" button or a statement that says "by bidding on or purchasing an NFT on this page you agree the following terms."

This could be accomplished by having the marketplace pull in certain text from the issuer's website or from the metadata of the NFT — an area within the NFT that includes certain data or information about the NFT.

The problem with this approach is that it is labor-intensive, requiring the NFT issuer to seek marketplace-by-marketplace implementation since not all marketplaces operate the same way; it also assumes that all marketplaces will agree to this arrangement.

This approach also does not solve the issue of wallet-to-wallet sales that do not go through a marketplace.

Metadata Links

The NFT issuer could include a link to its terms in the NFT's metadata and even a statement that use of the digital content associated with the NFT is subject to those terms. However, the overwhelming majority of NFT purchasers never look at the metatada of an NFT, so this approach likely fails the "clear and conspicuous" test for browsewrap agreements. The same problem exists with putting the full text of the terms and conditions in the metadata.

Legal Tech

A new technological solution could be developed such that legal terms always travel with the NFT, and NFT holders can only transfer the NFT if the subsequent purchaser or recipient agrees to the terms. This technology could be platform, marketplace, or wallet agnostic. While this approach may be the optimal solution, it would require widespread adoption and integration with numerous marketplaces.

Secondary Purchasers

NFT issuers could require that the initial NFT purchaser commit to passing on the terms or just the commercial rights license they have to a secondary purchaser, and require each secondary purchaser to then do the same.

Some NFT issuers who have adopted this approach actually require that the terms be "attached" to the NFT. It is unclear, however, how the NFT owner would attach the terms to the NFT or how they would be able to effectively convey the terms to any downstream purchaser.

What Are the Risks?

The fact that the primary purchaser of an NFT may never have agreed to the NFT's terms and conditions, and the fact that secondary purchasers may never have even seen those terms, creates a number of risks for NFT issuers and owners.

As noted, without an explicit grant of rights, intellectual property rights are not conveyed.

An NFT owner may consider this low risk if an NFT issuer has gone "on record" — such as through an FAQ — with the commercial rights NFT owners have, concluding that it therefore has an implied license.

However, if an NFT owner is relying on implied rights, it runs the risk that a new owner could purchase the overall NFT project and all the intellectual property rights therein, and announce that it is no longer permitting commercial exploitation, likely vitiating any implied license.

This scenario would leave NFT owners, many of whom may own their NFTs without any formal agreement, in a bind as to what rights they have; with the likely answer that they have no commercialization rights. In addition, NFT owners that want to commercialize their NFTs pursuant to rights they believe they have may find that their potential sublicensees (streaming services, apparel manufacturers, etc.) may want to see more definitive rights before they agree to go forward.

The more significant issues may arise where the terms and conditions impose restrictions on benefits that attach to an NFT. For example, a secondary purchaser of an NFT linked to a real world experience may not learn that the terms and conditions presented to the initial NFT purchaser included age or geographic restrictions on who could access that experience.

The risks to the NFT issuer are similar. Most NFT terms and conditions include some combination of disclaimers, assumptions of risk by the purchaser, liability caps, and a requirement to arbitrate disputes. An NFT issuer may have challenges enforcing those limitations and requirements on secondary purchasers who never saw the terms and conditions or knew they existed.

It is for this reason that some major NFT issuers prefer the walled garden approach until this issue can be resolved through technology.

Conclusion

As more NFT issuers offer commercialization rights in the underlying digital works, or ancillary benefits that may have important terms and conditions attached to them, solving the issue of how legal terms travel with an NFT will become increasingly important.

As a preliminary matter, NFT issuers should bind initial purchasers of their NFTs to terms and conditions in a manner that courts will uphold. This will usually mean a clickwrap or scrollwrap agreement either at the time of purchase or when a potential purchaser signs up for an "allow list" from which NFT purchasers will be drawn.

In addition to such binding terms and conditions, NFT issuers would be well served to notify potential purchasers of any key license terms, as well as other terms and conditions, through a prominent FAQ or similar means.

Although this method of notification would not create a binding agreement with the potential purchaser, and should not be seen a replacement for a formal agreement to which the user must manifest assent, it will help disseminate key applicable terms, and help mitigate the risk of confusion and misunderstandings in the marketplace.

Although the current available approaches for conveying rights to secondary purchasers are imperfect, NFT issuers should still consider how best to bind secondary purchasers to the NFT issuer's terms, or otherwise notify them of their rights and any restrictions.

This may mean reaching out to multiple marketplaces, cumbersome as that might be, to make sure that listing pages include links to the applicable terms and conditions, and at least language that says that by clicking on "purchase" or "bid" the user is agreeing to those terms.

Equally important, NFT issuers should consider the potential risks of secondary purchasers not being aware of the terms and conditions. In other cases, it may mean limiting purchases and sales to a closed marketplace where the issuer can control the availability of the terms.

This may be particularly important where the terms include important restrictions on benefits — e.g., available only to U.S. residents. Likewise, NFT purchasers should investigate the terms and conditions that may attach to their purchase.

Until technical solutions for conveying rights to downstream NFT purchasers are developed, both NFT issuers and purchasers must grapple with the challenges of applying traditional contract law principles to a technology based on decentralization.

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[1] Specht v. Netscape Communications Corporation 306 F.3d 17, 35 (2d Cir. 2002).

[2] Sgouros v. TransUnion Corp., 2015 WL 507584, at *4 (N.D. Ill. Feb. 5, 2015).

[3] Nguyen v. Barnes & Noble, Inc., 763 F.3d 1171 (9th Cir. 2014).

[4] Specht at 19.

[5] Hines v. Overstock.com Inc., 380 Fed. Appx. 22, 2010 U.S. App. LEXIS 11265 (2d Cir. N.Y. 2010).

[6] In re Zappos.com Inc., 893 F. Supp. 2d 1058, 2012 WL 4466660 (D. Nev. 2012).

[7] Nguyen at 1179.

[8] Berman v. Freedom Financial Network, LLC, --- F.4th ----, No. 20-16900, 2022 WL 1010531 (9th Cir. Apr. 5, 2022).

[9] Long v. Provide Commerce, Inc., 245 Cal. App. 4th 855, 200 Cal. Rptr. 3d 117 (2d Dist. 2016), and Sellers v. JustAnswer LLC, 73 Cal. App. 5th 444, 289 Cal. Rptr. 3d 1 (4th Dist. 2021), petition for review filed,No. S273056 (Cal. Feb. 8, 2022).

[10] Berman at 12.

[11] Berman at 14.

[12] Id.