

Outside Counsel

What Lawyers Need To Know About Non-Fungible Tokens: Part 2

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In Part 1 of this series, we provided an overview of non-fungible tokens (NFTs), including what they are, whether they constitute securities under federal law, and related regulatory implications. In this article, we address another key legal dimension of NFTs: intellectual property (IP) protections.

What Do You Own When You Own an NFT?

An NFT is a unique digital token whose ownership is recorded on a distributed blockchain ledger.

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A token is simply a vessel to convey ownership, and any type of asset can be attached whether it be an underlying intangible asset (e.g., digital artwork or media) or to a tangible, physical asset (e.g., physical artwork or real estate).

Several characteristics specific to NFTs make them particularly attractive to creators. First, a clear chain of custody and ownership transparency:

The interplay of NFTs and IP protections will continue to be refined as the marketplace adapts to this burgeoning technology.

Once the transfer of ownership is recorded on the blockchain, the transaction history is public and cannot be altered or erased. Second, a creator may sell NFTs without the need for traditional intermediaries such as galleries,



MetaBirkins online NFT shop

auction houses, or exchanges. Third, NFT creators can utilize code to embed certain sales conditions, such as the provision of automatic resale royalties.

Those characteristics often drive platforms and entrepreneurs to expand the scope of NFTs to new products, platforms, and offerings in the blockchain space—sometimes forgetting that IP laws still protect the rights of the underlying asset creator.

How Do Intellectual Property Protections Apply?

Patent, copyright, trademark ownership, and individual

publicity rights are all IP rights that subsist in the underlying asset. Crucially, these underlying IP rights exist “off-chain,” separately from the NFTs themselves, and they *may or may not* be transferred when an NFT changes hands.

The default rule in the United States is that an intellectual property right is not transferred unless it is clearly stated in writing and signed by the patentee, copyright owner, or trademark owner. See 35 U.S.C. §261 (“Applications for patent, patents, or any interest therein, shall be assignable in law by an instrument in writing.”); 17 U.S.C. §204(a) (“A transfer of copyright ownership ... is not valid unless an instrument of conveyance, or a note or memorandum of the transfer, is in writing and signed by the owner of the rights”).

The IP holder will often retain ownership of his or her copyrights in the underlying asset and in turn grant a license to allow others to use or display the image of their original work for a limited purpose and over a set period time. A copyright license is a simple written contract that allows the IP holder to control how images of the work they created is used, displayed, and monetized by others. NFTs

do not change these fundamental principles: the image attached to the NFT will require some degree of approval from the IP holder.

Smart Contracts

The creation, or “minting,” of NFTs provides the opportunity for creators who own the IP rights in the underlying asset to set the terms for the license that will be transferred to the NFT buyer. Parties who wish to transfer IP rights and are blockchain-savvy typically turn to “smart contracts” to memorialize the express written terms of the assignment or licensing of IP rights. The term “smart contract” refers to software code that generates a self-executing transaction that is triggered by an encoded condition.

For example, if an NFT is resold, then a smart contract can ensure the creator receives an automatic percentage of the sale price—akin to a royalty payment—in perpetuity. As such, smart contracts can be readily deployed without the need for an intermediary or a central authority. The opportunities for leveraging and monetizing NFT-linked assets are therefore significant.

Other smart contract conditions might include common licensing agreement specifications such as (1) whether the

grant is exclusive or non-exclusive to the licensee; (2) the buyer’s rights to display, copy, and use the NFT (e.g., general or commercial use), (3) limitations on the platform(s) or marketplace(s) on which the NFT can be resold, and (4) governing law and dispute resolution terms.

Unauthorized Use and Enforcement

On the flip side, NFTs present substantial infringement risks. Copyright infringement plainly occurs when works are copied, sold, or otherwise publicly displayed without proper authorization from the copyright holder. The anonymous minting of fraudulent NFTs is on the rise, and examples of stolen or plagiarized art abound. Moreover, trademark infringement can occur if customers are confused by the source or sponsorship of the NFT. Design patents can be infringed if the designs bear substantial similarity, and an individuals’ right of publicity can also be violated if the NFT depicts individuals. Yet attempts at enforcing IP rights in the courts are still in early stages.

One notable case has been brought by French luxury group Hermès to protect its Birkin trademark from alleged appropriation. *Hermès*

International, et al. v. Mason Rothschild, 1:22-cv-00384 (S.D.N.Y.) In that case, the defendant, Mason Rothschild, created an NFT business based on “MetaBirkins,” which are digital depictions of Hermès’s highly coveted Birkin handbags. By allegedly capitalizing on this cultural cachet—including the popularity and goodwill of Hermès’s Birkin mark—Rothschild’s NFTs have sold for prices comparable to real-world Birkin handbags. The amended complaint filed by Hermès contains claims for, among other things, copyright infringement under the Lanham Act; false designations of origin, descriptions, and representations; and trademark dilution.

Specifically, Hermès alleges that Rothschild “adopted MetaBirkins as a trademark and promoted his MetaBirkins business in conjunction with the use of other Hermès trademarks in a calculated attempt to explicitly mislead the general public into believing Hermès authorized his MetaBirkins business, including his MetaBirkins collection of NFTs.”

For his part, Rothschild maintains that his NFTs are digital artworks—described as “unique, fanciful interpretation[s] of a Birkin bag”—and therefore

entitled to First Amendment protections. In an ironic twist, however, the complaint alleges that Rothschild himself has “repeatedly complained of ‘counterfeited’ MetaBirkins on NFT marketplaces.”

Rothschild filed a motion to dismiss, which was recently denied by Judge Jed Rakoff on May 5, 2022 following oral argument. In the opinion, filed on May 18,

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2022, the Court references factual allegations regarding the NFTs’ “explicit misleadingness” and allegations that the use of the Hermès trademark is “not artistically relevant” to Rothschild’s work. Accordingly, the court concluded that the complaint “contains sufficient factual allegations to make out the trademark infringement and other claims” and therefore survives the motion to dismiss.

Following discovery and additional motion practice, the case is

scheduled to be ready for a jury trial by November 2022.

Conclusion

The interplay of NFTs and IP protections will continue to be refined as the marketplace adapts to this burgeoning technology. IP owners may need to remain vigilant in seeking to enforce their IP rights. NFT buyers may benefit from additional due diligence to mitigate the risk that their NFT will be removed from the marketplace as a result of IP infringements. And, given the centrality of complex code in determining how NFTs function, market participants who are not programmers may benefit greatly from consultation with technical experts.