Brand Protection Alert

April 2022

Brands and NFTs: Licensing and Contracting Considerations

In November 2021, an online crypto collective paid nearly $3 million to buy a copy of a "story bible" for director Alejandro Jodorowsky's *Dune*, the 1970s film adaptation of the sci-fi novel that famously never was completed.

Shortly after, the crypto group tweeted about its plan to adapt the book into a movie. There was just one problem: Owning a copy of a book gave the group no rights to the actual intellectual property it would need to produce that movie. They were no closer to owning the necessary rights to produce a movie based upon *Dune*'s intellectual property than they were to owning the rights to produce a movie featuring a certain famous cartoon mouse.

The story illustrates the legal and IP issues inherent in the world of Web3. Over the past year, the space has been dominated by the hype about non-fungible tokens (NFTs). While NFTs have been around since at least 2017, they began to boom in popularity in March 2021, hitting an inflection point when auction house Christie's sold an NFT for a digital artwork by artist Beeple for $69.3 million. After that, it seemed a new NFT craze grabbed headlines every week. Video clips of LeBron James dunking sold for more than $200,000; brands from Adidas to Dolce & Gabbana dropped NFT collections, selling out in minutes and netting millions in sales. In all, the NFT market generated more than $23 billion in transactions in 2021, up from just $100 million the year prior.

NFTs represent a convergence of blockchain technology and creative intellectual property. But what exactly is an NFT, and how does the novel technology map onto our current understanding of intellectual property? Beyond that, what can brands do to both leverage and protect their intellectual property as they draft licenses to govern NFT sales and other Web3 transactions?

A (Brief) Introduction to NFTs

In simple terms, NFTs are often thought of as digital collectibles, a blockchain-infused version of trading cards or Beanie Babies. In technical terms, an NFT is a unique crypto token that is created and managed on a blockchain, a decentralized, public ledger that tracks the ownership and transaction history of anything stored on it. An NFT is a unit (i.e., "block") of data on the blockchain with its own unique identifier.

The main difference between NFTs and cryptocurrency is their interchangeability. Cryptocurrency like Bitcoin is fungible, meaning that one Bitcoin in one person's wallet is the same as one Bitcoin in another person's wallet. In contrast, each NFT is completely unique, and NFTs are not interchangeable. NFTs can be original and scarce, which makes them interesting for their potential applications to digital media.

NFTs also use software code (called smart contracts) that runs on the blockchain to govern actions such as verifying ownership of an NFT, governing the permitted uses of an NFT, handling the transferability of an NFT, or determining whether and how royalties are paid for secondary sales

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of the NFT. Smart contracts can also be used to link the NFT to any number of other assets, including art, music or other digital files; this can also be applied to physical assets. Today, most of the popular NFT projects link to digital art files and are on the Ethereum blockchain (leveraging its ERC-721 NFT standard).

What Do You Own When You Buy an NFT?

It is important to distinguish between ownership of an NFT—the unique token on the blockchain—and ownership of the asset that may be linked to or associated with that NFT. When someone purchases an NFT linked to an asset, they have not necessarily purchased any intellectual property rights in that underlying asset. The IP of the underlying asset is still governed by traditional intellectual property laws. For instance, under the U.S. Copyright Act, the copyright owner has the exclusive right to reproduce, prepare derivative works of, distribute, perform and display the copyrighted work. The purchase of a work that is protected by copyright (like the Dune book) does not automatically grant the purchaser any of these underlying rights.

Rights or ownership in the asset underlying the NFT transfers to the purchaser only if the owner of that asset expressly transfers those rights in a license agreement along with the NFT purchase.

NFT License: A Survey of Approaches

Surveying the terms and conditions and licenses granted by brands releasing NFT collections reveals a spectrum of approaches to licensing rights in underlying IP. While not comprehensive, the following three main categories are illustrative and informative: (1) a "traditional" approach, where buying an NFT grants the owner no rights in the underlying IP (much like the purchase of a traditional physical product); (2) a middle-ground approach, where some rights are granted in underlying IP; and (3) a "crypto-native" approach, where purchasing an NFT grants the owner full rights in the underlying IP.

Much of the potential and promise of Web3 and NFTs centers on the technology's ability to support creators and community and, through tokens, the ownership by these creators and community members of the value they help create. This spectrum of approaches illustrates how brands can harness this promise while still protecting their own IP.

Adidas 'Into the Metaverse'

In December 2021, Adidas released its "Into the Metaverse" collection, a collaboration with NFT community Bored Ape Yacht Club (more on Bored Ape Yacht Club below) and various crypto artists. The drop was a limited-edition digital collectible that sold out in minutes.

But from an IP perspective, what did those who bought into the collection actually get? The Metaverse's Terms and Conditions state that Adidas maintains all IP ownership, granting NFT buyers only a limited, nonexclusive right to display the underlying asset:

- "You acknowledge and agree that adidas AG owns all legal right, title and interest in and to the Art, and all intellectual property rights therein."
- "Adidas grants you a worldwide, non-exclusive, revocable, royalty-free license, to display the Art for your Purchased NFTs, solely for the following purposes: (i) for your own personal, non-commercial use (for example home display, display in a virtual gallery or as an avatar); or (ii) as part of a marketplace that permits the purchase and sale of your NFTs."

These Terms and Conditions represent a traditional approach to IP ownership in NFTs and the assets linked to NFTs. In short, NFT purchasers receive limited rights to use the asset for personal use (for example, displaying it as a social media avatar or in a crypto wallet) or sell the NFT on the secondary market. Under this traditional approach, NFTs are another product line or marketing channel through which brands may leverage and monetize their IP.

Many of the recent fashion brand activations in the metaverse fall under this traditional approach, which represents a massive opportunity for fashion brands. The market for video game skins alone is estimated at $40 billion annually; over the past year, brands from Gucci and Balenciaga to Nike and Ralph Lauren have partnered with gaming ecosystems like Roblox and Fortnite to craft new digital branded skins (add-ons that let players customize their avatars) or virtual experiences. While some of these partnerships have released NFTs, others focused solely on virtual or digital fashion, which are also lucrative. A digital Gucci bag on the gaming platform Roblox recently sold on the secondary market for more than $4,000; (the IRL physical version retailed for $3,400. This bag was not an NFT but simply a digital version of the brand's popular Dionysus Bag with Bee.

Because this approach to leveraging IP is similar to one brands use to create products in the physical world, the brand protection risks are largely analogous to those that established brands face in the IRL marketplace.

Nike and RTFKT

Meanwhile, in December 2021, rival shoemaker Nike acquired digital fashion company RTFKT. Similar to Adidas' terms and conditions, the RTFKT terms state that RTFKT retains all ownership in the underlying asset and grants a limited display right to the purchaser.

Additionally, however, the RTFKT Commercial use license terms permit NFT owners to use the underlying IP of their NFT to create and sell physical merchandise, generating up to $1 million in revenue. With this commercial license option, RTFKT grants two additional rights as compared to the Adidas "Into the Metaverse" collection: a limited right to commercialize the underlying asset, and the right to create derivative works.

These additional rights offer a middle ground between a traditional approach to IP and the crypto-native approach pioneered by collectives like Bored Ape Yacht Club. It represents an evolution beyond the typical fashion brand model of leveraging IP in new markets or product lines, since it allows buyers to build on top of the underlying IP asset to which their NFT ownership is linked.

This middle-ground approach gives potential creators limited license rights to the underlying IP of the NFTs they purchase, allowing brands to harness the potential of Web3 to support creators. However, this approach is not without additional legal risk, as the final section of this article will illustrate.

Bored Ape Yacht Club and World of Women

One of the more publicized NFT projects to date has been the Bored Ape Yacht Club, an NFT collection of 10,000 unique "Bored Ape" NFTs. Celebrities including Jimmy Fallon, Paris Hilton and Eminem have all acquired their own Bored Apes. Brands including Adidas have jumped on the Bored Ape trend as well, acquiring their own Bored Ape NFTs. Unlike many of the NFT collections released by established brands, Bored Ape Yacht Club has taken a different approach to IP; when someone purchases a Bored Ape NFT, they own the NFT as well as the underlying asset and IP.

From the Bored Ape Yacht Club's Terms & Conditions:

- "Each Bored Ape is an NFT on the Ethereum blockchain. When you purchase an NFT, you own the underlying Bored Ape, the Art, completely. Ownership of the NFT is mediated entirely by the Smart Contract and the Ethereum Network: at no point may we seize, freeze, or otherwise modify the ownership of any Bored Ape."
- Yuga Labs LLC grants you an unlimited, worldwide license to use, copy, and display the purchased Art for the purpose of creating derivative works based upon the Art."

Since buying a Bored Ape NFT gives the buyer full intellectual property ownership rights, owners have jumped at the chance to turn their Bored Apes into all kinds of media projects, including movies, music, podcasts, books and streetwear. Some owners have even signed their Bored Apes to traditional talent agencies and music labels as an additional intellectual property asset.

Also in this category of approach to IP ownership is World of Women, an NFT project launched in 2021 and featuring 10,000 unique pieces of artwork. World of Women's mission is focused on representation, inclusivity and equal opportunities in crypto. The artwork features women from around the world, each created by a female artist. Like Bored Ape Yacht Club's Terms & Conditions, the World of Women Digital Ownership Agreement grants NFT purchasers full rights in and ownership of artwork linked to the purchased NFT:

"Creator hereby assigns, on an exclusive basis, for the legal duration of the intellectual property rights and for the whole world, all exploitation, reproduction, representation and adaptation rights relating to the Art attached to the Purchased NFT to which this Agreement is linked. It is specified that the rights of reproduction, representation and adaptation are granted to the [NFT owner] for all modes of exploitation, including commercial ones, and on all medium and/or media."

This approach has already garnered the interest of media companies looking to develop the rights granted in this agreement. Reese Witherspoon's Hello Sunshine media company recently entered into a partnership with World of Women that promises to create films, TV, events and other storytelling.

Projects leveraging the intellectual property of NFT collectives like Bored Ape Yacht Club and World of Women illustrate how this crypto-native approach can unleash the full opportunity of crypto communities and creators to use the IP they own in ways that a single-brand house might never have had the vision or resources to realize on its own. Unlike long-established brands like Nike and Adidas, Bored Ape Yacht Club and World of Women are new, crypto-only efforts, making adoption of a crypto-native approach integral to their success.

Unfortunately, It Is Not Risk Free

Of course, both the middle-ground approach and the crypto-native approach—giving NFT owners rights to the underlying assets that have been minted—also come with increased brand protection risks.

First, brands don't have a traditional licensor-licensee relationship with the buyers of their NFT collections, especially when dropping larger collections. For instance, the Adidas "Into the Metaverse" collection included 30,000 NFTs. While this collection did not grant NFT buyers any rights in the underlying IP, the difficulty of policing all the projects and derivative works created if a collection of this magnitude did grant IP rights would be nearly impossible for any brand to manage.

When licensing buyers IP rights in the NFTs—such as to commercialize or to create derivative works—it is imperative to set out clearly in the terms and conditions the scope of permissible uses as well as restrictions on use.

For example, the NFT License, developed by Dapper Labs (creators of CryptoKitties and NBA Top Shot, among other NFT projects), aims to create a standard license that grants NFT buyers certain IP rights in the NFT. In addition to personal use, the NFT License grants owners limited commercial use rights. The license also sets out a number of clear use restrictions, among others, prohibiting owners from using their NFT IP for promoting hatred, intolerance, violence or cruelty; promoting other third-party products or services; or producing movies, videos or other media. If NFT owners violate these provisions, the original creator of the NFT can terminate the agreement.

Practically, it might be difficult for a brand to repossess an actual NFT as a consequence of a purchase violating the underlying license. But since a brand's license agreements govern the NFT owner's rights with respect to the underlying assets of the NFT, drafting clear licenses that are presented to buyers and easily accessible becomes important for protecting a brand's IP. For example, the NFT License is drafted in plain language, and it also includes "Intro" and "FAQ" tabs that clearly explain what uses the license does and does not allow.

Somewhat controversially, platforms like OpenSea that allow the buying and selling of NFTs have also frozen the trading of NFTs that were reported as stolen. Given this precedent, it's also important for brands to review the terms of use of these platforms for the potential remedies they may provide against bad actors when deciding where their NFTs might be made available for sale. Of course, brands will also have to police each NFT platform for potential IP infringement. For example, Nike and Hermes have both filed federal lawsuits challenging the creation, marketing and sale of NFTs incorporating their trademarks and trade dress. These lawsuits have the potential to set the precedent for how laws will govern the use and enforcement of branding assets in Web3.

Finally, brands need to understand from a reputational standpoint that many have voiced environmental concerns associated with blockchain mining, which is the process used to validate new transactions (such as NFT sales) on the Ethereum blockchain. While Adidas' acquisition of a Bored Ape NFT went largely without scrutiny, that has not been the case for every brand. Like Adidas, MeUndies also purchased a Bored Ape NFT, but it faced swift customer backlash for the well-documented environmental impact of the Ethereum blockchain (which the Bored Ape Yacht Club uses), with criticism pointing out that the brand has frequently touted its sustainable and environmentally friendly practices. At a time when digital and sustainability present some of the biggest opportunities for growth (particularly for the fashion industry), brands must work to ensure that their digital efforts do not run contrary to their efforts in sustainability.

Crypto Conclusions

Web3 and the recent explosion in the popularity of NFTs present opportunity and promise for established brands to leverage their IP in new and exciting ways. While traditional approaches to IP adapted to the metaverse and NFTs present risks that are familiar to brands that have long worked to protect their IP IRL, crypto-native approaches that seek to engage the creators and community that represent the promise of Web3 will present brands with new risks. As brands experiment with crypto-native approaches, they must adopt strategies to mitigate the risks associated with granting intellectual property rights to NFT owners.

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6947 REV1 04-08-2022