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NFTs: The Harbinger of Property Rights in the Metaverse?

By Ryan M. Cooney and Janet Fries

Non-fungible tokens ("NFTs") continue to dominate the crypto-zeitgeist. It is beyond dispute that they are currently a major economic and cultural force. In 2021, sales surged to approximately $25 billion. They have been featured in high profile television commercials during the Olympics and the Super Bowl. And Nike recently purchased the NFT developer RTFKT Studios, signaling its intention to be a dominant provider of digital fashion in the metaverse.

Despite all this, it remains unclear what legal rights are conveyed with the purchase of an NFT. The academic consensus is that, absent a "smart contract" that expressly includes intellectual property ("IP") rights, purchasing an NFT does not convey any copyrights or trademark rights. Yet, the creation of an NFT (called "minting") is almost certainly limited by recognized IP and other legal principles. These issues have begun to percolate up through the courts.

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This article explores lingering, undefined NFT questions through the lens of several pending lawsuits. While many articles just describe the facts of each case, this article focuses on the most interesting legal arguments that each makes. It also identifies how decisions by these courts may form the basis of property rights within the metaverse. And ultimately, it questions whether the emergence of such lawsuits undermines blockchain as a decentralized institution.

This article assumes a base level of NFT and blockchain knowledge.

First, Do Copyright Holders Have the Exclusive Right to Mint NFTs of Their Works?

A case involving a 60-foot long mural titled "Lightning" and known as the "Guernica" of India (referencing Pablo Picasso's famous mural depicting the Spanish civil war) may lead to an answer. When a gallery in New York, TamarindArt LLC ("Tamarind"), announced that it planned to issue NFTs based on Lightning, it received a cease and desist letter from the administrators of Maqbook Fida Husain's estate, the artist who created the mural. Now Tamarind is seeking a declaratory judgment that, pursuant to the terms of its purchase agreement with the artist, it can proceed with minting NFTs without infringing any copyrights held by the estate.[1]

The complaint provides language from the 2002 bill of sale and an agreement from 2003, both executed by the artist and Tamarind. The quoted provisions indicate that Tamarind acquired "all rights including the copyrights" and contemplated "digital" works, but the complete documents are not attached as exhibits, so we do not know if there are other provisions that might undercut this grant of rights; for example, there could be a reversion of rights or perhaps there is a term that has an expiration date.

This case tees up an important question: Does copyright law determine who can mint NFTs? While most would agree that an NFT itself does not convey a copyright (unless that is explicitly agreed to in writing by the parties), minting an NFT based on a copyrighted work may well violate a copyright owner's exclusive rights, which include reproduction, distribution, adaptation (including the creation of derivative works), public display and public performance. Currently, that question has no definitive answer.

A court will ultimately have to decide whether NFTs fall within one of these defined exclusive rights. Should it be fully litigated, Tamarind could present such an opportunity, so this case is certainly one to watch.

Second, do Trademark Holders Have the Exclusive Right to Mint NFTs Depicting Their Marks?

Several prominent trademark holders are arguing that they have the exclusive right to commercialize NFTs that depict or otherwise implicate their marks. Brand holders seeking protection against unauthorized NFT sales under this theory would not require courts to expand existing doctrines (as may be the case with copyright law). As one such argument goes, when NFT producers reference a protected trademark in their drops, consumers may mistakenly believe that the mark owner is involved with the NFT project, likely causing consumers to be confused as to the origin of the NFTs – thus adversely affecting the mark holder's brand. As both a copyright and trademark holder in "Pulp Fiction," Miramax is one of several parties making this claim in recent lawsuits.

Another is Hermès, owner of the Birkin Bag mark.[2] Hermès recently sued the "METABIRKIN NFT" project creator for trademark infringement, dilution, and false designation of origin. Besides incorporating the name "Birkin" into the NFTs, the subject digital art depicts the Birkin handbag design, although in candy colors and covered in fur. At its core, Hermès argues that the NFT creator "is stealing the goodwill in Hermès' famous intellectual property to create and sell his own line of products."

Nike is making similar arguments against a company called StockX, which runs an online aftermarket resale platform.[3] As part of its NFT business model, StockX is creating digital versions of physical Nike sneakers that it holds in its "vault" (i.e., physical warehouse). StockX claims that these digital versions merely function as a traceable digital receipt, because consumers can cash them in for the physical product held in storage. The corresponding NFT is then burned (i.e., removed) from the blockchain. Further, according to StockX, the NFTs serve an authentication function. Nike rejects these characterizations and contends that these NFTs are in fact "new virtual products" because they are bundled with additional (but unspecified) StockX services and benefits.

From Nike's perspective, StockX is capitalizing on its IP while simultaneously diluting the strength of its brand. For its part, StockX counters that Nike is simply attempting to interfere in the "lawful secondary market for the sale of its sneakers" and that this project is protected by the doctrines of first sale and nominative fair use.

Musicians have not been spared from NFT issues. The rapper Lil Yachty recently alleged trademark infringement against Opulous, a business that provides "a lucrative revenue stream for creators in the form of music copyright NFTs."[4] Lil Yachty also asserts his California state law rights of publicity, privacy, and unfair competition in alleging that the defendants inappropriately used his name and likeness to advertise the project's introductory NFT sale.

Lil Yachty and Nike demonstrate the potential utility of a trademark argument in the unauthorized NFT context. Even if the underlying work is not infringing (because of the first sale doctrine, for example), brand owners may still contend that the NFTs' promotion and advertising mention (and so implicate) the mark holder's rights.

To further increase this protection, trademark holders who are entering the NFT market could consider filing additional trademark applications extending their marks to include digital assets, including NFTs.

Third, What Non-IP Claims Are Plaintiffs Advancing to Halt "Unauthorized" NFTs?

Chain of title issues as between different blockchains will likely pose a battleground for NFT ownership. This issue is pending in a current suit called *Free Holdings v. McCoy* – which challenges the ownership of what is widely purported to be the first NFT, Quantum.[5]

Quantum was created in 2014 on the Namecoin blockchain by digital artist Kevin McCoy. The Namecoin blockchain requires its users to reclaim their records roughly annually. McCoy did not reclaim the record as required. The question is: what happened as a result?

McCoy argues that Quantum was burned from the blockchain. The plaintiff, a Canadian holding company, alleges that it "claimed" Quantum after McCoy allowed it to expire. In 2021, McCoy reminted Quantum on a different blockchain, which allegedly preserved the original Quantum token. McCoy subsequently sold Quantum through Sotheby's for US$1.472 million. The plaintiff challenges McCoy's ownership of Quantum.

This case could present an intriguing insight into how courts will determine ownership between two distinct blockchains, subject to their respective terms of service. Given that part of blockchain's promise was to provide definitive, decentralized proof of ownership, it is ironic that the federal court (perhaps the archetypical "institution") is being asked to make this determination. Time will tell whether the court answers the call. And if blockchain proves ownership only to the extent that a federal court is willing to recognize it, one might rightly question whether blockchain is in fact the game-changing innovation that many of its fans claim it to be.

Plaintiffs are also using corporate principles to defend against unauthorized NFT sales. Roc-A-Fella Records ("RAF") recently sued Damon Dash, partial owner of the label, after Dash attempted to mint and auction a NFT based on Jay-Z's debut album "Reasonable Doubt."[6] This NFT also purported to convey all of Dash's future royalty rights in the album to the purchaser. Royalty-transference promises aside, RAF alleges conversion, replevin, and unjust enrichment and asserts that Dash breached his fiduciary duty as a shareholder in a close corporation. The court did enjoin Dash from undertaking the auction as planned, though the case is still pending.

In all likelihood, some of these cases will settle without providing guidance. But even one court's determination could help answer pressing questions about NFTs and could have profound implications for both the blockchain and its utility for proving digital ownership in the metaverse.

Such questions include whether minting an NFT is an exclusive right of copyright owners, whether NFTs violate trademark holders' rights, and whether NFT minting runs afoul of general corporate law principles.

Ultimately, the courts' handling of these cases may determine whether blockchain lives up to its promise of providing decentralized proof of ownership or whether determination of ownership will remain with existing institutions and procedures. If the latter comes to pass, then ownership of NFTs in the metaverse may simply be governed by existing legal doctrines, as opposed to being treated in a novel manner or triggering a free for all. With luck, 2022 decisions may provide guardrails for NFTs by answering these important questions.

Notes

1. *TamarindArt v. Husain*, No. 1:22-cv-595 (S.D.N.Y. Jan. 21, 2022). *See also Miramax v. Tarantino, et. al*, No. 2:21-cv-08979-FMO-JC (C.D. Cal. Nov. 16, 2021), a lawsuit filed by the entertainment company that produced the Oscar-winning 1994 film "Pulp Fiction" against Quentin Tarantino, the director and co-author of the screenplay, after he announced plans to offer NFTs containing "previously unknown secrets" from the film.
2. *Hermes v. Rothschild*, No. 1:22-cv-00384 (S.D.N.Y. Jan. 14, 2022).
3. *Nike v. StockX*, No. 1:22-cv-00983 (S.D.N.Y. Feb. 3, 2022).
4. *McCollum v. Opulous, et. al.*, No. 2:22-cv-00587 (C.D. Cal. Jan. 27, 2022). The other plaintiffs in this case are Ditto Ltd. and Ditto's founder, Lee James Parsons.
5. *Free Holdings Inc. v. McCoy et. al.*, No. 1:22-cv-00881-LGS (S.D.N.Y. Feb. 1, 2022).
6. *Roc-A-Fella Records, Inc. v. Damon Dash et. al.*, No. 1:21-cv-05411-JPC (S.D.N.Y. Aug. 12, 2021).