

Copyright Concerns For NFT Buyers, Sellers In Music Industry

By **Carly Kessler** (April 20, 2021)

A nonfungible token, or NFT, is a unique digital token that acts as a nonduplicable digital certificate of ownership for essentially any kind of asset — including music, tickets and fan merchandise. Most NFTs use the Ethereum blockchain to record transactions.

NFTs are recorded on a public digital ledger the same way that crypto coins are, but the two are not alike. NFTs are nonfungible and unique — they cannot be replaced or replicated — whereas crypto coins are fungible, meaning that every Bitcoin or Ether is interchangeable with another.



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So what exactly is an NFT asset? In the last few months, most NFTs have been associated with digital art. But recently, the music industry has become a front-runner in the NFT space. And whether NFTs are here to stay or not, they are garnering a lot of attention and being used in nontraditional ways.

For example, NFTs are allowing recording artists more control and transparency by providing fans greater access to, and investment in, their favorite musicians.

But this does not come without limitation or risk. It is important for buyers and sellers to be careful when transacting in this new marketplace. Sellers should be aware of what intellectual property rights they own — in a recording, for example — before offering it for sale as an NFT, and buyers should be aware of what they are actually purchasing.

It is also important for intellectual property practitioners to know and understand the landscape as legal issues, especially those involving copyright, are bound to arise. Below are some things to consider before venturing into an NFT marketplace.

Copyrights and NFTs: Things to Keep in Mind When Transacting

It is important for buyers and sellers to understand how copyright law applies to NFTs. The Copyright Act of 1976 grants authors of original works, such as literary, musical or artistic works, five rights:

- To make copies of their work;
- To distribute copies of their work;
- To perform their work publicly;
- To display their work publicly; and
- To make derivative works.

A copyright in a work, such as a recording, becomes the property of the creator at the moment the work is put into a fixed form, i.e., when it becomes sufficiently permanent so that it can be perceived, reproduced or otherwise communicated.

While a creator does not need to register his or her work to obtain a copyright, doing so provides a stronger basis to enforce the copyright against infringers and typically can provide higher rewards for a creator whose work has been infringed, i.e., statutory damages.

Sellers should only offer the sale of NFTs in which they own the copyright. A seller may own the copyright because he or she is the creator, or by virtue of a license or transfer of copyright.

Buyers should keep in mind that a transfer of copyright interests in an NFT is not automatic. Typically, copyright will not transfer to someone just because he or she owns or purchases an NFT. Usually, an author retains his or her copyright and the ability to enforce copyright protection in the underlying work even if he or she sells the NFT.

However, in some cases, the parties may use smart contracts, whereby NFT purchasers can buy a portion of an NFT's copyright and thereby receive royalties.

The NFT space is evolving rapidly and will likely test many areas of law, including copyright. IP practitioners, along with buyers and sellers, should consider the following.

Recognize what rights your client has with respect to the NFT he or she wants to sell.

For example, if a recording artist wants to sell his or her work as an NFT, does he or she own both the composition and recording copyrights in the song? If not, his or her right to sell the work could be limited. Also, practitioners should consider whether other IP — for instance, the copyright in artwork associated with an album — may be implicated in the sale and whether their client has the right to sell it.

Review the terms and conditions.

Purchasing an NFT does not automatically transfer rights, like copyright, to a buyer, although it may. By way of example, the NFT marketplace Bluebox[1] provides buyers an opportunity to own a 1% interest in a song's sound recording copyright.

On the other hand, terms may limit what a buyer can do with the NFT. For example, another NFT marketplace, YellowHeart,[2] hosted the sale of Kings of Leon's new album as an NFT. Some buyers received a full digital album download, a limited edition vinyl and collectible album artwork.

But the terms included several clauses restricting what a buyer could do with the art associated with the NFT — for instance, there was a prohibition on using it in movies, videos or any other forms of media.

Buyers also had to acknowledge that Yellowheart "owns all legal right, title and interest in and to the [artwork and merchandise associated with the NFT], and all intellectual property rights therein."

Also, buyers and sellers should be sure to review the NFT platform's terms on resale royalties. One benefit of many NFT marketplaces is the ability for a creator or licensor to collect fees not just when the NFT is first sold, but each time it is resold. However, automated resale royalties may only work if the NFT is resold using the same platform.

Ensure that the NFT being purchased is authentic.

Ensuring that the NFT is what it claims to be includes researching and doing due diligence on the NFT. For instance, the Manhattan District Attorney's Office website suggests that

buyers perform a reverse image search on the NFT and that, if it appears on a number of NFT exchanges or markets, it may not be legitimate.[3]

Understand what is being purchased.

The asset being purchased is a piece of code on a blockchain that is linked to a product. Others can view the asset or have a copy of the underlying work.

Smart Contracts and Licensing: What to Anticipate

Most NFT platforms use smart contracts to transact the buying and selling of NFTs. A smart contract is a self-executing contract between parties whose terms are stored on a blockchain. Eliminating the need for intermediaries and other gatekeepers, these contracts authenticate a work and track its provenance and value as an NFT travels from one person to the next.

Smart contracts track an NFT's lifecycle and ownership. They work by following certain demands that are written into computer code on a blockchain — once predetermined conditions have been met, a computer will execute the actions it's told to complete.

These actions could include transferring copyright ownership from an NFT seller to its buyer. For example, Taylor Bennett,[4] the brother of Chance the Rapper, and the U.K. rapper Big Zuu sold copyrights in their newly released recordings using the Bluebox platform. Each NFT sold for 100 USD Coin, a digital currency pegged to the U.S. dollar. The NFT sales bought a purchaser a 1% split of the copyright in the sound recording.

NFT owners can track and withdraw their earnings directly from the Bluebox account, according to Bluebox's website. Zora,[5] another NFT marketplace offering audio NFTs, allows creators to set a creator share representing a percentage that the creator will receive on all future sales. Smart contracts are used to automatically pay creators.

Another potential benefit of NFTs to the music industry is the potential ability to track royalty payments and reduce the amount of so-called blackbox money that currently stands unclaimed. Blackbox royalties refer to a situation in which digital services providers, i.e., Spotify and Apple Music, are unable to track the songwriter or publisher to whom song royalties belong. Ultimately, the money remains stuck in a black hole with the royalties unclaimed. Blackbox royalties presently remain a significant issue in the music industry.

If the individual NFT platform builds royalty payments into its smart contracts, artists can receive payment automatically and with ease, potentially eliminating the need to track down artists.

NFTs are providing more autonomy to artists by allowing them to collect profits directly from buyers, and they could also streamline royalty payments. But this is not a perfect system, and issues could arise. For example, if there is a lawsuit concerning copyright in the recording, there could now be multiple players at stake, complicating the litigation.

Licensing could also become unwieldy. For example, if someone wants to license a song for use in a movie or TV show, he or she may need to obtain permission from multiple copyright holders, thereby burdening the process.

One solution could be to assign a manager to the NFT asset — similar to a manager-managed LLC in which a single person or group of people would hold voting or decision-

making responsibility. The managers could help control decisions relating to things like litigation or music clearances.

IP practitioners and those wanting to transact in the NFT space should take careful note of what the smart contract says.

Practitioners should keep in mind that if an artist sells his or her music as an NFT — assuming he or she has the right to do so — and wants to earn resale royalties on the work, the practitioner should ensure that the license contains the proper language such that the artist will not only receive revenue for the initial sale but also for each resale.

Separately, if an artist wants to control what a buyer can do with his or her work, the practitioner should ensure that the scope of the license is properly limited — in other words that restrictions are built into the license.

Conclusion

NFTs are being used in myriad new ways in the music industry, and the possibilities are inspiring. But there is still much to learn. Given the technology's infancy and novelty, buyers and sellers should conduct due diligence before entering this marketplace, including, among other things, reviewing the contract's terms and conditions, understanding which IP rights are or are not being transferred, and ensuring the authenticity of the NFT.

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[1] <https://auctions.bluebox.info/sales/run-in-place-0>.

[2] https://www.yellowheart.io/kol/terms_and_conditions.pdf.

[3] <https://www.manhattanda.org/nft-scams-and-frauds/#:~:text=Conduct%20due%20diligence%20on%20the,artist's%20own%20social%20media%2Fwebsite>.

[4] <https://bluebox.info/nft/>.

[5] <https://zora.engineering/protocol/smart-contracts>.