

Protecting IP and Limiting Liability When Licensing IP for Digital Art and NFTs

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Many things are being tokenized, but the growth of NFTs for digital art is booming. This, in part, is due to the recent headline news that Beeple's iconic digital art work was sold at auction by Christie's for \$69 million. Other digital art is being created to leverage pre-existing IP and physical art. This boom is creating great opportunities for IP owners who want to license their IP for use in NFTs. However, for those just entering the space, there are many things to consider given some of the unique aspects of NFTs and digital art. The IP owners that may capitalize on this NFT boom can include:

- brands that have famous trademarks, logos, and other brand identifiers;
- game companies that have unique characters or game art
- book, movie and other publishers that have unique characters and other IP;
- artists who created have physical or digital works;
- other IP owners

When IP licensing rights for use in digital art and other NFTs, it is important to be clear what is and what is not being licensed. The scope of the license should be limited to particular purposes. Various other limitations may also be appropriate. For example, a creator may grant rights to create a specified number of NFTs associated with a copyrighted work, in order to maintain the scarcity (and associated value) of the NFT based on such work.

Other examples to consider include imposing limitations on:

- modifications of the IP or the art in which it is included;
- what can be combined with the IP-based art; and
- where and how the NFTs are distributed.

Considerations relevant to each of these potential limitations is set forth below. Limitations on Modifications and Combinations In some cases, licensors may wish to limit or exercise control over modifications of the IP as used in the art and/or modification of the IP-based art itself. Also, it may be advisable to consider limitations on what can be combined with that art. To understand the potential need for limitations on modifications and combinations, it is important to understand the range of options that exist with certain forms of NFTs (e.g. digital art). Failure to consider these options may result in granting rights that are too broad and permit your IP to be modified or combined with other content in ways that you may not want associated with your IP.

Layered Art

For example, one cool feature of NFT-based digital art technology is layered art. This technology enables a single work to include multiple layers of art, each created by a different artist. Each layer may be tokenized and owned by a different entity. And the work as a whole can also be tokenized and that token can be owned by yet a different entity. Due to this feature of digital art, you should consider the scope of the license you grant to prevent art based on your IP from being associated with works that you find undesirable. For example, without appropriate limitations, your licensee may create one layer of such a work based on your IP, while other layers may include offensive materials or other content that you would not want associated with your IP.

Programmable Art

Another interesting genre of digital art is programmable art. Programmable art may be autonomous or not. In either case, the art is programmed to change based on certain triggers. In a simple case, the work may have two fixed layers and the art may change from one layer to the other based on some fixed event. In this simple example, one layer may be presented during the day and the other at night. In this scenario, there are two fixed layers that are alternately displayed. However, programmable art can be much more complex and can morph a single image in various, sometime random ways. In some cases, programmability can modify or distort the image. This, too, could lead to some undesired representations of your IP.

Generative Art

Yet another form of digital art is referred to as generative art. Generative art uses AI or other algorithms to create or modify art. In some cases, an artist specifies some of the inputs or starting points for the art, then the algorithm takes over. Depending on the effect of the algorithm, if generative art is based on your IP as an input, this too could lead to some undesired representations of your IP.

Collaborative Art

Another form of digital art that is becoming more popular is collaborative art. This is a form of art where many individuals contribute to a single piece of art. Layered art (discussed above) is one way collaborative art is being created. However, in some cases the art is much more openly collaborative in a crowd-sourced manner. See for example Dada. Due to the open nature of contributions to collaborative art, this too could lead to unintended consequences for your IP if the licensee contributes to such a work with art based on your IP. Without sufficient knowledge of the digital art landscape, and the ever evolving tools and techniques, it is difficult to effectively draft licenses that protect your IP from undesirable modifications or combinations. When licensing your IP for digital art

or other NFTs, it is important to understand the potential ramifications of these and other technologies. Simply granting a license to use your IP in one or more NFTs can be risky. While that may seem like a limited license, without other appropriate limitations, it may be a lot broader than you intend. Depending on the intended use, licensors should consider including language in their license to protect against potentially undesired outcomes.

License Revenue Models

Another unique and advantageous aspect of many NFTs is the ability for creator and/or licensor to collect a fee not just when the NFT is originally sold but each time it is resold as well. This capability can be implemented through smart contracts. Smart contracts typically comprise autonomous code that is associated with a token and manage the sale and resale of the token. They can be programmed to automatically transfer a portion of the sale and resale to a designated digital wallet. To take advantage of this capability, licensors should make sure the license is properly worded to cover a royalty or revenue share for the initial sale and each resale.

Liability avoidance

While the upside of licensing IP for NFTs is appealing, there can be potential liabilities as well. For example, various potential legal liabilities may arise based on how and where the NFT is sold. Most of the well known NFT platforms are mindful of and address these issues. However, without appropriate limitations, licensees may use alternative distribution methods that are not necessarily regulatory-compliant

Securities Laws – Fractional Ownership and Pooling

Most NFTs that are associated with a single work and individually sold are not likely to be deemed a security under U.S. securities laws. However, various sales techniques are being used that may implicate securities laws. One technique is fractional ownership. In this scenario, ownership of a single work (or group of works) is represented by multiple tokens with different owners. This enables many people to share ownership of a single work. Depending on how this fractional ownership is structured this could constitute a pooled interest. According to another technique, multiple artists may pool together a collection of their independent works, tokenize that collection and share in the proceeds from sale and resale of the token. In both of these scenarios, depending on how the fractionalization or pooling of interests is structured, securities law issues may arise. The seminal case on whether a token offering is subject to securities law is the *Howey* case. This case dealt with a pooling of assets (orange groves) and a sharing of the collective proceeds. Whether the foregoing techniques raise securities law issues must be decided on a case-by-case basis, considering the totality of facts and circumstances of the particular offering. However, prudent licensors can include language in their licenses to NFT creators that can help prevent or mitigate any such liability.

Money Laundering and Sanctions Circumvention

It is well known that high value art has been used in money laundering schemes and to circumvent sanctions. The record sums being obtained for some NFTs has caught the attention of FinCEN and OFAC. These entities administer the anti-money laundering and sanctions circumvention laws governing these activities. IP owners should consider provisions in their licenses to address these possibilities. Requirements for a licensee to ensure compliance with all applicable laws and to indemnify the licensor in the event of breach are common in IP licenses. These requirements are

recommended. However, in some cases, it may be prudent for licensors to understand and limit where licensed NFTs will be sold and/or to include language in their licenses to exercise a certain level of control to prevent unwanted scenarios. A certain level of diligence on the distribution methods and/or platforms through which a sale of the licensed work will be sold is advisable. Conclusion The digital art and NFTs markets are, fascinating, growing and will undoubtedly continue to evolve. Many fortunes already have been made. Many more likely will be made. But as with any other big opportunity there do come some potential risks and liabilities. The foregoing are just some of the legal issues that should be considered when licensing IP to capitalize on these trends while avoiding or minimizing liability.

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