

Copyright in the metaverse: thriving new fields of application for NFTs

14 November 2022

NFTs are set to become one of the cornerstones of the metaverse

NFTs enable companies to enter the virtual market of the metaverse in manifold ways. Not surprisingly, the existence of copyright-protected works in this virtual world comes with the need to reliably protect the associated legal interests. The legal framework gives rise to legal uncertainties that could hamper the effective use of NFTs. However, the legal risks that arise under copyright law can be considerably limited through careful design during the creation of NFTs and awareness of potential weaknesses in existing NFTs.

Highlights:

- Copyright will be one of the keys to the effective use of NFTs going forward. At present, though, NFT copyright regulation remains a grey area, with specific rules yet to be tailored to the technical specificities of NFTs.
- Acquiring an NFT of a copyright-protected work does not necessarily grant the acquirer the right to exploit that work. Through the careful design of NFTs at the minting stage, uncertainty can be prevented in this regard.
- Minting an NFT likely constitutes an act of exploitation under copyright law, which would entitle the authors of the original work to legal remedies if the NFT is minted without the author's consent.

The potential of NFTs and existing copyright-related challenges

Skyrocketing revenues and the promise of irrefutable authenticity have caused NFTs to stir up markets worldwide. Regularly touted as "*ground-breaking*" and "*revolutionary*", NFT projects have taken off, particularly with respect to the sale of digital art and other digital copyright-protected works. The CryptoPunks and Bored Ape NFTs which represent pixelated images of punks and portraits of cartoon apes are only a few examples of countless NFT projects that have astonished the general public.

In a period when the metaverse is purported to become an integral part of people's daily life, NFTs bear known and unknown opportunities for companies entering the virtual world. Being uniquely identifiable and providing transparency for any act of transfer, NFTs may serve as a reliable instrument to safeguard legal interests if used properly. Conversely, the metaverse will provide NFTs with thriving new fields of application, as NFTs are used as a medium of exchange, tickets to events, and most importantly, to track the ownership of various digital artworks.

Cutting to the core of NFTs and the subject of recent NFT lawsuits, copyrights will be one of the key aspects which determine their future effective use. The primary issues revolve around the question of *whether* and to *what extent*

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the acquirer of an NFT is entitled to *use the copyright protected work* associated with the NFT and how such use may look like in practice. Moreover, on an even more basic level, does *minting (creating)* an NFT of a copyright-protected work actually require the author's *consent*? These issues will not only persist in the metaverse, but they will gain significance considering that NFTs will be instrumental to the creation of digital twins of real-life objects in the virtual world.

First things first: what is an NFT?

An NFT (non-fungible token) can generally be defined as a unique cryptographic token that is recorded on a blockchain and which is directly linked either to a real-world object (such as artwork or real estate) or to a digital object (such as JPEGs, memes, gaming items, tweets, digital collages or online videos). The token carries unique, irreplaceable information and cannot be replicated. NFTs usually contain a digital medium or a link to a digital medium. From the legal perspective, these certificates (and NFTs in general) can be characterised as immaterial movable assets that the owner can dispose of in whatever way he/she chooses. In respect of digital artwork, it is crucial to understand that an NFT is not the artwork itself, but rather the NFT serves as proof of ownership or a certificate of authenticity of the copy of the artwork.

The process of taking a code and inserting it into a blockchain is called minting. During minting, the creator determines the basic properties of the NFT. A record of this type of token creation is then registered on the blockchain network. The NFT itself usually contains only basic details about the owner, a description and the location of the work in question. Once minted, NFTs can be sold through marketplaces.

Working in the grey: specific rules regulating NFTs are lacking

NFT regulation is still largely a grey area, and there is currently no EU-wide legal regulation nor established case law in force for NFTs specifically. Hence, when it comes to copyright issues, any legal review must fall back on the existing law regime which is not perfectly tailored to the issues raised. Nevertheless, by means of a conscientious approach, certain legal risks may be significantly limited or even prevented from the outset.

Assignment of usage rights: What is purchased?

One of the key legal aspects when referring to NFTs is what the buyer actually acquires together with the token, and how such purchase affects copyright in relation to the copyright-protected work.

In theory, four decisive roles emerge during the minting and trading process of NFTs associated with copyright-protected works, such as images or music compositions: the *creator* of the *NFT*; the *owner* of the *NFT*; the *owner* of the copyright-protected *work associated* with the *NFT*; and the *author* of the copyright-protected *work associated* with the *NFT*. These persons have often very different understandings and expectations when it comes to the rights associated with the *NFT* and, in particular, copyright issues relating to the *NFT*.

If the owner and the author of the copyright-protected work are the same person (e.g. the painter of the image), there is little room for discussion as to the entitlement of that person to create the *NFT* and dispose of it in any way he/she chooses. However, even under the assumption that the *NFT* was created and sold by the proper copyright holder, it is not as clear as it seems at face value which rights the subsequent owner of the *NFT* actually has purchased. The correct right answer depends on the terms implemented in the *NFT*. Seen through the lens of copyright law, the decisive questions depend on the assignment of usage rights with the copyright-protected work that is associated with the *NFT*.

NFT acquisition: what does the law say?

Frequently, NFTs do not provide any information regarding the scope and extent to which the associated copyright protected work may be exploited by the acquirer of the NFT. Statutory law provisions merely provide initial assistance as regards the determination of the usage rights assigned by the NFT sale.

For example, under both Austrian and Czech copyright law, usage rights are not automatically assigned by the transfer of ownership to the copyright protected work. Quite to the contrary from what one may expect, it is stipulated that usage rights are not assigned by the transfer of ownership in cases of doubt. Then again, Austrian as well as Czech copyright law provides that the scope and nature of the assignment of usage rights must be interpreted according to the purpose of the underlying contract, if they have not been expressly agreed upon. While it seems reasonable to assume that the sale of an NFT should entitle the acquirer to use the NFT and the associated copyright protected work in *some* way, it may be highly arguable in *what* manner exactly. For example, is the acquirer allowed to display the artwork, and what if this display requires the creation of a copy of the artwork as is usually necessary when displaying digital artworks (e.g. on the internet)? Should the acquirer be limited to the use for private purposes only or also be allowed to use it for commercial purposes? Considering that the use of copyright protected works without the properly assigned usage right may entitle the copyright holder to seek injunctive relief and/or damages, major uncertainties may arise for either of the parties concerned by the NFT sale.

Discretion is the better part of valour: licensing terms for NFTs

In order to prevent the uncertainties described above, the NFT creator should already consider at the time of the initial minting of an NFT whether and to what extent the acquirer of an NFT will be entitled to exploit a copyright-protected work that is associated with that NFT. To that end, it is advisable to define from the very beginning the conditions of the assignment and the scope of the usage rights to be assigned by means of licensing terms.

When drafting licensing terms for NFTs, it is especially important to take account of their technical particularities, the targeted purpose of the creation and the NFT sale. Since NFTs are digital tokens that cannot be amended afterwards but may be viewed by any participant of the (public) blockchain, an option is to incorporate the licensing terms directly in the NFT on the blockchain when it is minted – by means of a so-called smart contract. As the licensing terms may not be altered unnoticed once they are incorporated in the NFT, this option may ensure that the same usage rights will automatically be assigned by any subsequent sale of the NFT. Moreover, smart contracts are able to automatically execute certain functions as soon as the conditions set forth therein are fulfilled. This said, smart contracts may not only be used to effectively safeguard the incorporated licensing terms, but they may also set forth the obligation for the payment of royalties to the author upon each sale of the NFT.

Terms on the website

Alternatively, licensing terms may be stored elsewhere – terms and conditions published on the websites of the person creating the NFT being a popular choice – whereas the NFT as such only includes a hyperlink leading to this other location. From an economic point of view, this option seems to be preferable for more elaborated licensing terms, since the costs incurred by the minting process are inter alia dependent on the data size to be stored on the blockchain. Hence, the greater the length of the licensing terms, the greater the required storage is and the higher the minting costs will be. Nevertheless, it should be contemplated that the licensing terms as such may be alternated at any time and in theory unnoticed, for only the hyperlink having become part of the blockchain. This flexibility may constitute an advantage or an unintentional risk, depending on the specific project.

NFT License Systems

In light of this and the increasing awareness of possible vulnerabilities arising in context of NFTs associated with copyright protected works, a more recent approach on the market has been the launch of NFT license systems. Aiming at inhibiting entry barriers to the NFT market while reducing possible legal friction, such systems consist of *standardized* licensing terms, each identified by a specific abbreviation and providing for a pre-defined scope of usage rights to be assigned by the NFT sale. While the actual terms of the license agreement are stored and published on websites, incorporating the specific license abbreviation to the NFT should suffice to clarify the rights and obligations assigned to its owner. However, besides being drafted under the legal requirements of one specific country only (practically most often US law), the obvious drawback of standardized license terms is that they might not fit the specific demands of the planned NFT project and still being very limited in numbers, one might be condemned to wear a shoe that does not fit.

Stating the (not) obvious: possible copyright infringement by minting an NFT

Things notoriously become more complicated when more parties are involved. The same applies to cases where an NFT is created by someone who is neither the owner of the associated copyright-protected work nor its author, especially if the author has not consented to this act. According to common sense, it appears obviously unfair if the creator of an NFT draws a profit but the author of the associated work (who did not consent to the creation of the NFT in the first place) does not. From a copyright law perspective, however, the author of a copyright-protected work may only be entitled to legal remedies such as damages or injunctive relief if the work was exploited in a manner that is relevant under copyright law.

The first point that must be clarified is whether the act of minting an NFT constitutes an act of exploitation under copyright law. Unsurprisingly, there is no definitive answer. However, following the CJEU, a closer look at its previous decisions provide some guidance as to qualifying the act of minting such an NFT as an act of communication to the public, thus a type of usage acknowledged under Art 3 of EU-Directive 2001/29/EC.

This existing case law, however, draws several distinctions including whether the author consented to the publication of the copyright-protected work on the hyperlinked location or whether the NFT was minted with the intention of making a profit (which may be assumed where the NFT is offered against payment). Even though a conclusive evaluation cannot yet be made, the indications are strong pointing to the qualification of minting an NFT that incorporates the metadata of and a hyperlink to an associated copyright-protected work as an act of exploitation under copyright law. As a consequence, minting such NFTs may entitle the author of the copyright-protected work to legal remedies if the NFT was minted without the author's consent.

Careful design can limit uncertainties

NFTs and their *raison d'être* have been the subject of many heated discussions in the recent years. Nonetheless, NFTs have become one of the biggest movers in the art world and are set to become one of the major pillars of the metaverse(s). As the metaverse is a virtual world where users will spend part of their daily business and share experiences online, the incorporation of copyright-protected works into this world is as inevitable as the need to protect the legal rights relating to them. Since the current legal framework has not been evolving as quickly as the technical advancements, uncertainties remain. However, through careful design during the initial creation of an NFT and awareness of potential weaknesses relating to existing NFTs, such uncertainties may be limited considerably.

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