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Generations Winter 2022 - NFTs Art Collectors: Caveat Emptor Applies

On March 11, 2021, a digital artist named Mike Winkelmann, known professionally as "Beeple," sold a non-fungible token, or NFT, associated with a digital collage of his images for $69 million. The most expensive NFT art (or crypto art) ever sold to an individual buyer, Beeple's "Everydays: the First 5000 Days" will likely be remembered as the first major NFT art sale to break through into the mainstream, bringing the concept of NFT art sales to the masses.

On its face, Beeple's sale of his digital art linked to an NFT was made in a form with which we are all familiar—an artist created a work of art and sold it to a third party at an auction through a reputable auction house. There are major differences, however, between the sale of a physical work of art and the sale of an NFT associated with digital art, centering on what the parties own once the purchase is finalized.

An NFT is a string of data embedded in a public ledger known as a blockchain. In the case of crypto art, the NFT is digitally linked to a particular piece of digital art that is typically stored separately from the NFT itself. An NFT is akin to a certificate of authenticity signifying ownership of a digital work of art. Unlike a physical painting, an NFT does not embody a work of art. Instead, the typical NFT being sold through most digital art platforms simply points to a file comprising a digital image that visually depicts the associated digital artwork.

For centuries, tokenized forms of ownership in the forms of deeds, certificates of title and bills of sale have been accepted as proof of ownership of assets. To be effective, these tokens described with detail the underlying assets they represented. For example, a deed will describe the specific metes and bounds of the underlying real property. The metes and bounds are immutable in the real world, and no identical real property can ever exist. Similarly, an NFT will describe an underlying digital asset by pointing to a digital location in which the underlying asset is stored. Unlike real property, however, the digital assets referenced by most NFTs may not exist forever in the locations specified in the NFTs, and duplicates of the digital assets can easily be created.

Digital files associated with an NFT can be stored in three different ways: (1) with the NFT token on the same blockchain (NFT-embedded storage), (2) on a different blockchain or decentralized storage (off-chain decentralized storage) or (3) in a private or centralized server (centralized storage). NFT-embedded storage is the most desirable for a purchaser of an NFT because it ensures that the digital artwork will be accessible as long as the NFT exists. Unfortunately, the cost of embedding digital artwork within the blockchain on the most popular blockchains (e.g., Ethereum) is far too high to make NFT-embedded storage practicable. Most digital artists have opted for off-chain decentralized storage networks, such as the InterPlanetary File System (IPFS) peer-to-peer network, for their digital art. This form of storage requires payment of an ongoing "pinning" fee to ensure persistent availability of the digital artwork; otherwise, an NFT might be linked to a nonaccessible location within the IPFS network. Finally, many NFT platforms offer their own private, decentralized storage for digital art minted on their platforms. While convenient and easy to use, the reliability of these platforms for long-term storage of digital images is uncertain. If the platform is no longer in business five or 10 years from now, how will the owner of the NFT linked with the artwork access the artwork?

Given this background, the question arises: What is it exactly that a purchaser actually acquires when purchasing crypto art? The traditional purchaser of artwork acquires the right to possess the physical representation of the work, display the work for personal use and enjoyment, and sell the work to a buyer. The traditional purchase of artwork does not include any rights to reproduce the artwork (in digital or any other form), distribute or display a copy of the work, or make any derivative works (for commercial or other purposes). Those rights are retained by the artist through the term of copyright in the work (i.e., generally, the life of the artist plus 70 years), unless the purchaser acquires those rights by direct negotiation with the artist.

Ownership with respect to digital art means something entirely different. Unlike a painting, digital art, which is embodied in the form of a digital file, is easily reproduced at little cost. The copy is indistinguishable from the original. So, physical possession of a file embodying digital artwork means very little, since other people can possess identical files. Without a written agreement from the owner of the copyright (usually the artist), the holder of a digital file has little more than an implied license to display the embedded image of the artwork for personal use, and nothing prohibits the owner of the copyright from reproducing and distributing identical files containing representations of the same work of art.

If the purchaser of digital artwork receives only a copy of a file containing a representation of a work of art, the purchaser of an NFT receives even less, absent a written agreement. The owner of an NFT receives a verifiable digital certificate that points to a storage location that holds a file containing a representation of a specific work of art. As with traditional art sales, unless otherwise specified in the purchase contract, the copyright in the work associated with an NFT remains with the creator of the work, allowing the creator to make and sell derivative works. Because an NFT is just a token, a purchaser of an NFT acquires no substantive rights without also entering into an additional embedded license or associated written agreement. Absent such a license or other agreement, there is no assurance that the link from the NFT to the stored file embodying the work of art will continue to work in perpetuity.

Typically, the platform used to mint and transfer an NFT will offer standard terms of service through which the creator retains ownership of the underlying intellectual property rights in the artwork but grants the purchaser of the NFT a license to certain limited rights in the work (e.g., the right to display for personal use). The most popular platforms for the minting and selling of NFTs, OpenSea and Rarible, do not require licensing of any rights in their terms of use.

Shortly after his historic sale of the "First 5000 Days" NFT, Beeple was quoted in *The New York Times* as saying "just making a[n] NFT does not give it any value. There's going to be a moment whe[n] we realize we got a little crazy and assigned insane value to crap." Here, Beeple was not talking about the quality of the artwork associated with NFTs. Instead, he was talking about the nature of NFTs themselves. If a purchaser cannot establish with certainty the rights he or she is acquiring with digital art, the purchaser may be acquiring nothing more than bragging rights over a digital certificate that was created by an artist and transferred along a traceable, publicly available chain of transactions stored on an immutable blockchain.

In the current unregulated world of crypto art, it's still "caveat emptor." Buying an NFT is not the same as buying a painting to hang on a wall. When a purchaser acquires an NFT associated with a work of digital art, unless the purchaser also enters into an agreement providing otherwise, the purchaser is not acquiring the actual digital artwork or any rights to reproduce, distribute or display the artwork, except for personal use. The purchaser is not even guaranteed that a stored copy of the digital artwork will always be available. Before buying an NFT associated with digital art, a purchaser should conduct the same due diligence regarding authenticity, provenance and rights obtained in the transaction as would a purchaser of a physical work of art.

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