

Center for
Cultural
Innovation

NFTs, Smart Contracts, & DAOs: A Resource for Creatives

A report to help creatives capture the opportunities of blockchain technologies, while protecting themselves from legal risk

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INTRODUCTION

At the Center for Cultural Innovation (CCI), our mission is to support individuals in the arts—artists, culture bearers, and creative entrepreneurs—to realize greater self-determination. Across our various programs, we support thousands of individuals in the arts, and are deeply familiar with the struggles they face every day to secure the social and economic protections they need. Moreover, we understand that artists' economic security depends on their ability to own and control their work, and that blockchain technologies could be a path to growing artists' ownership rights...or further eroding them.

In particular, CCI serves many individuals from marginalized communities, including BIPOC, disabled, and immigrant communities. When we started seeing many BIPOC artists moving into the blockchain space several years ago, we started building our own expertise in this area. That's why we commissioned Alex Glancy at Gundzik Heeger LLP (GGH LLP) to author this report exploring the legal challenges artists face on the blockchain.

Amy Whitaker, NYU Professor and CCI AmbitioUS Ally, says that "blockchain is the future of creative labor," where every artist is an "early investor" in their own work with the opportunity to "own the upside."¹ As we enter this future, creatives will need expanded education about the legal issues arising with the blockchain.

To support creatives as they engage with this new technology, this report seeks to provide information in the legal areas of copyright, business entities, securities, contracts, and trademark, as applied to these emerging tools. Ultimately, we hope this report serves as a resource to help creatives capture the opportunities of blockchain technologies, while protecting themselves from the risks.

**"Blockchain is the future of
creative labor"** – Amy Whitaker, NYU

Professor and CCI AmbitioUS Ally

¹ Amy Whitaker, *Blockchain is the future of creative labor*, TED: TEDx (Jun. 5, 2018), https://www.ted.com/talks/amy_whitaker_blockchain_is_the_future_of_creative_labor.

GLOSSARY OF TERMS

Blockchain. A record of transactions distributed across a network.

Contract. Agreement between two or more parties, whether orally or in writing, based on a meeting of the minds.

Copyright. A type of intellectual property that protects original works of authorship.

DAO. Decentralized autonomous organization. DAOs are emerging forms of organizing people and resources using blockchain technology.

NFT. Non-fungible token. NFTs have at least two components: (1) the cryptographic token and (2) an asset associated with the token.

Smart Contract. Self-executing computer code that is stored on the blockchain and receives data that triggers actions based on conditions programmed in the code.

Trademark. A type of intellectual property that protects words, symbols, or other devices that function as brand signifiers.

MEET OUR CAST OF CHARACTERS

Creatives in all disciplines have been getting involved in the blockchain for a variety of reasons. To illustrate concepts throughout this report, consider the stories of three individual creatives who interact with the blockchain in different ways.

First, meet Abe. Abe is an emerging fine artist. Abe is represented by a gallery in New York and promotes himself online through his website and social media. Abe's main goal right now is to increase the exposure of his work by creating digital collectibles. Abe

would be thrilled if these collectibles supplemented his income.

Second, meet Dee. Dee is an animator. Dee is interested in NFTs to explore generative art as a medium. Dee has created a collection of NFTs called CryptoRats, which consists of cartoon rats, each with its own personal characteristics. Dee is excited about creating a community around the CryptoRats.

Finally, meet Crystal. Crystal is a freelance graphic designer who is passionate about technology and cryptocurrency, participating in a number of DAOs. Crystal's main goal right now is to get involved with DAO communities with the hope of building wealth through cryptocurrency and crypto investment opportunities.

Stay on the lookout for these characters' appearances in this report.

COPYRIGHT LAW, CONTRACT ISSUES, AND NON-FUNGIBLE TOKENS (NFTs)

This section introduces what copyright means for creators and how it is important to understanding NFTs. Please note that this discussion applies to U.S. based artists, although the basics of copyright law are similar across many countries.

COPYRIGHT AND LICENSES

What is copyright?

If you create an original work², you own a bundle of rights that are together called your "copyright." Amid the burst of technological innovation, traditional copyright law still very much applies to creative content associated with NFTs.

² The works of authorship must be "fixed in a tangible medium" and have a minimal degree of creativity. The U.S. Copyright Act was written to anticipate new technologies and applies to any medium of expression, whether now known or later developed. See 17 U.S.C. § 102.

Copyright consists of rights of exclusion: to exclude other people from doing certain things with your work. The copyright owner is the only person with the rights to reproduce, display, prepare derivative works based upon, perform publicly, and distribute copies of the work. The copyright owner can separate these rights from each other, handing some to one party or another, conditioning their use, and keeping some for themselves.

Copyright vests automatically under U.S. law when you create an original work in any medium, including digital, print, music, and film. Copyright begins at the time of creation and lasts for one's life plus 70 years afterwards. There are some benefits to formal registration of copyright with the U.S. Copyright Office, but registration is not necessary to receive these basic rights under the law. Copyright registration is a simple, relatively low-cost way to protect your work and makes it easier to get money if someone ever improperly uses or steals your work.³

Why does copyright matter to my economic wellbeing?

Your copyright is rich with value, both economic and personal. It is a jewel that you can trade, divide up, sell, regenerate, and build upon. And as you rise in prominence through your career, your copyright will ideally increase in its monetary value, perhaps during your lifetime or after you die. Copyright in the United States goes all the way back to the U.S. constitution. The principle behind the copyright system is that it is important to reward people for promoting the progress of science and arts.

How is copyright shared with others?

The rights comprising your copyright can be transferred or licensed. Generally, it is in the

copyright owner's best interest to avoid transfers of copyright if given the choice and instead license only specific rights in proportion to the potential revenue streams or other sources of value. However, creatives' leverage to reserve their rights and grant only limited licenses varies depending on industry standards and bargaining power. In the context of NFTs, where creatives have the opportunity to set the license terms for their works, creatives should understand how licenses work and approach the design thoughtfully. We will dive into licenses later in this report.

How is copyright treated across industries?

Copyright is at the core of the creative industries. At a high level, the music, film, and visual arts industries have different standard ways to deal with copyright that result in different patterns of wealth creation. For those who are interested, these are briefly summarized below.

Music: In the music industry, songs carry two different copyrights: one in the songwriting and one in the music recording. Any person or company that plays a song commercially must secure a license for both of those copyrights, in exchange for paying royalties. In the music industry, full copyright transfer is rather common, except in the case of fully independent music artists. For example, record labels generally require the recording artists to transfer copyrights of recordings to the labels.

Film: In the film industry, typically the production company owns the copyright in a film and earns money by licensing the copyright to distributors and networks. In exchange for their creative labor, some actors, writers, directors, and other collaborators may secure royalty streams from any income that the production

³ For more information on how to register, you may visit the website of the U.S. Copyright Office.
<https://www.copyright.gov/>

company earns; however, they do not own the copyright in any aspect of the film.

Visual Arts: In the visual arts, in contrast to music and film, most often the artist reserves (i.e., does not transfer) the copyright when selling an artwork to a collector. By reserving the copyright, the artist is able to create subsequent print editions or enter into art licensing deals without seeking consent of the collector. In the visual arts, royalty structures are less common than in music or film. NFTs have shined a new light on the exciting potential of resale royalties,⁴ although for decades U.S. artists have been advocating for resale royalties with varying success rates.⁵

Off the blockchain, how do I know if I'm transferring or licensing my copyright?

Licenses are all around creatives all the time. Licenses may be contained in a

freelancer agreement, terms of service, or even implied through conduct when you casually grant non-exclusive permissions in your work. If you are putting work out into the world, then you are granting permissions of some kind. For example, by selling a painting to a collector, the artist is granting permission for the collector to display the image on a wall for personal enjoyment.

It's key to know the following legal rule: Transfer of copyright can only be accomplished in writing signed by the copyright owner.

Because of the tremendous value a copyright has for an artist, the law requires the formality and ceremony of a written and signed document in order for the artist to transfer any of their exclusive rights. So where there is no writing signed by the artist stating that it is a transfer, then the artist has granted merely a non-exclusive license.

Social Media Use: License Terms that are Not Favorable to Creatives

Many creatives grant copyright licenses every day through engaging on social media. The average user has dismally weak bargaining power over terms of service of social media platforms (simply clicking a box to "Accept All Terms"), and as a result, inadvertently grants very broad rights in content posted.

For example, in Instagram's Terms of Use, each user gives Instagram a license to "host, use, distribute, modify, run, copy, publicly perform or display, translate, and create derivative works of" the user's uploaded content.⁶ This is a non-exclusive license of all uses and is transferable and sublicensable by Instagram to others.

⁴ Lauren van Haften-Schick & Amy Whitaker, *From the Artist's Contract to the blockchain ledger: new forms of artists' funding using equity and resale royalties*, J Cult Econ 46, 287–315 (2022). <https://doi.org/10.1007/s10824-022-09445-8>

⁵ Tiernan Morgan & Lauren Purje, *An Illustrated Guide to Artists Resale Royalties (aka 'Droit de Suite')*, Hyperallergic (Oct. 24, 2014). <https://hyperallergic.com/153681/an-illustrated-guide-to-artist-resale-royalties-aka-droit-de-suite/>.

⁶ Terms of Use, https://help.instagram.com/581066165581870/?helpref=uf_share (last visited Mar. 22, 2023).

On the blockchain, is the sale of an NFT a transfer or license of my copyright in the creative work?

It's a license in the vast majority of cases. The "sale" of an NFT is a sale of a token as well as a license to some rights from the creator's copyright in the content associated with the token.

Legally speaking, minting an NFT involves attaching a license to display a piece of creative work, such as a visual image, song, or literary piece, to a certificate of ownership, which is represented by the NFT.⁷ The terms of the license depend on the minting platform and the creator's own license terms, if permitted to add their own by the platform.

The terms of service of minting platforms contain their own license language, and vary substantially. It's important to understand the NFT marketplace terms of service in order to verify the treatment of copyright and the nature of the license granted. As discussed above, transfer of copyright would require a signed writing by the copyright owner and is not widespread practice by NFT marketplaces. Even if it were, NFT platform terms of service may or may not be enough of a "signed writing" to effectuate a transfer of copyright; it depends on the context, and the law is still very much in flux around how transfers of copyright may be enacted through token sales. If a creator does want to transfer copyright, then they should consider signing a traditional legal agreement with the purchaser.

Abe's Awful Discovery

Abe creates a digital composition and attaches it to an NFT. He intends that collectors should only be able to use the image in the context of personal display in their smart wallet and reselling the NFT within a single NFT marketplace. But one day, Abe's friend Betty spots Abe's NFT artwork shown on an LCD screen in a different NYC gallery than the one that represents him. On top of that, it's being shown alongside artwork he finds to be poor quality compared to his work.

Abe has mixed emotions: he is excited that he's getting exposure in another gallery, but he's disappointed that he's being shown in a gallery without his permission or knowledge by an anonymous purchaser of his NFT. He had agreed to exclusive representation with his NY gallery, so now he's worried he may have breached his agreement. He also feels regret he hadn't prohibited gallery displays in his NFT license terms.

⁷ Some legal scholars question whether it is legally proper to attach tokens to rights and/or assets at all, and the legal understanding of that attachment will likely develop with time. See, e.g., Juliet M. Moringiello & Christopher K. Odinet, *The Property Law of Tokens*, 74 Fla. L. Rev. 607 (2022) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3928901.

HOW TO APPROACH LICENSES

Creatives should put thought up front into how they want to handle rights in the creative work attached to an NFT, research NFT marketplace terms of service, and if possible, unequivocally state terms for collectors (and if needed, courts) in their own written license. When you are able to design your own license terms, you will consider the questions highlighted in this section.

There are already a number of sample licenses and resources available online, some of which are cited at the end of this report. We hope that over time, standard licenses will emerge that are as simple to use as the Creative Commons licenses.

Below, we break down some of the key decision points, and discuss additional practical considerations for your license.⁸

Please note that in the discussion below, we reference two prominent NFT industry players—Bored Ape Yacht Club (BAYC) and Dapper Labs—that took vastly different approaches to licensing their NFT collections. BAYC grants a broad license, allowing owners of BAYC NFTs to make money on the copyright in a myriad of ways.⁹ In contrast, Dapper Labs’s NFT License 2.0 reserves far more rights and limits NFT owners’ ability to commercialize the copyright.¹⁰

Will you allow commercial uses of the work?

The right to distribute copies of works for profit is an exclusive right held by the copyright owner. As a result, you can decide whether you will permit your NFT buyers to make money off of the artwork contained in the NFT apart from reselling the NFT. Dapper Labs gets even more specific, allowing NFT holders to use the image for personal, non-commercial use, except for merchandising opportunities of up to \$100,000 in revenue.¹¹ In contrast, BAYC grants NFT holders an unlimited worldwide license with a broad array of commercial rights, and many BAYC owners have brought their BAYC NFTs into all kinds of media projects.¹² You can also decide whether the license is sublicensable or not.

If you are allowing commercial uses, then you should think about trademark rights in the collection as a whole.¹³ A breakdown of trademark law is beyond the scope of this report, but at a high-level, trademark protects brands in only those certain business categories where the brand is being used.

If a purchaser of an NFT uses the NFT artwork in a new line of business, then the NFT purchaser, rather than the NFT creator, could own trademark rights in that line of business. For example, the NFT creator might own trademark rights for its NFT collection in the business category of art and technology. But if the NFT purchaser uses the

⁸ If the artist wants to arrange a full transfer of copyright in a work tied to a NFT, this can get tricky because of the legal formalities of copyright transfers. For example, there is an unwaivable right to terminate transfers under the U.S. Copyright Act. The artist is better off devising a broad non-exclusive license unless otherwise requested by the buyer. See James Grimmelman & Yan Ji & Tyler Kell, *Copyright Vulnerabilities in NFTs*, Medium: IC3 (Mar. 21, 2022), <https://medium.com/initc3org/copyright-vulnerabilities-in-nfts-317e02d8ae26>.

⁹ See BAYC, *Terms & Conditions*, <https://boredapeyachtclub.com/#/terms> (last visited Feb. 22, 2023).

¹⁰ See NFT License, <https://www.nftlicense.org> (last visited Feb. 22, 2023).

¹¹ See NFT License, *supra* note 10.

¹² See BAYC, *supra* note 9.

¹³ For a thorough discussion of trademark rights in NFT collections, access this episode of Ipse Dixit podcast: Ipse Dixit, *NFT Notes 22: Christa Laser on NFTs & Intellectual Property* (Nov. 2, 2022), <https://shows.acast.com/ipse-dixit/episodes/nft-notes-22-christa-laser-on-nfts-intellectual-property>.

NFT artwork to create a fast food burger restaurant, then the NFT purchaser could become the owner of trademark rights in the restaurant business.

Will you allow modifications of the work?

The right to make derivative works (including modifications) is also an exclusive right held by the copyright owner. So you can decide whether you will permit your NFT buyers to modify or create derivative creations based on your work. Examples of derivative works could range from changing a color NFT to black and white, to creating an animated video based on a character contained in the NFT. The Dapper Labs license prohibits modifications.¹⁴ In contrast, BAYC broadly allows NFT owners to create derivative works.

Will you want resale royalties?

Resale royalties can be coded into smart contracts—more on that below—and they can also be written into license language as an extra way of establishing legal agreement. The license can describe in words the artist's intention for how smart contract technology will be used to administer resale royalties.

Are there other protections or prohibitions you want to include in the license?

You can also inject "moral rights" into your license. "Moral rights" is a legal concept that creators deserve protection from certain harms, even if there's not a monetary impact to them personally, such as misattribution of their work or destruction or mutilation of their work (regardless of who owns the work). It is an acknowledgement that the uniqueness of creative works makes them impossible to replace entirely with any amount of cash.

Although U.S. law gives artists some moral rights during the artists' lifetime,¹⁵ moral rights generally do not apply to digital art or digital reproductions in the United States.

You can imbue moral rights concepts into your license. For example, the license could (1) require that the NFT image be credited with the artist's name in all displays of the image; (2) prohibit modifications that would alter the intended viewing experience of the art; or (3) affirmatively require the buyers to take actions to preserve the work.

More generally, licenses can be a place to lock your values into your art. For example, Dapper Labs prohibits hate speech connected with their NFTs.¹⁶ You can add any restrictions or obligations that are personally important to you.

¹⁴ See NFT License, *supra* note 10

¹⁵ See Visual Artists Rights Act of 1990, 17 U.S.C. § 106A.

¹⁶ See NFT License, *supra* note 10

Case Study: Seth Green's Stolen Ape

A thief of an NFT could interfere with license permissions unless clearly stated otherwise in a license policy. Consider the case of Seth Green's stolen Bored Ape. Green planned to create a TV show based on his Bored Ape, which he named Fred Simian. But right before the trailer debuted, Green's account was hacked and the NFT stolen. Under the law, the chain of title does not legitimately pass to the buyer of stolen property; however, the BAYC license was tied to the blockchain owner regardless of the legality of that ownership. As a result, Green no longer owned the NFT or the license to Fred Simian that was attached to it, and his plans to create a TV show based upon that license were interrupted. Artists can avoid this scenario by having the license specifically say that the legal system, not blockchain ledger, will control who holds the licensed rights in the event of a theft.

RESALE ROYALTIES

Will you want resale royalties?¹⁷

With resale royalties, the artist earns an amount of money equal to a percentage of the resale value of their work every time there is a sale. So for example, if an artist has secured a 15% resale royalty right and the first buyer resells the work for \$1,000,000, then the artist may earn \$150,000 from that resale (depending on the

specific formula). The calculations may vary from case to case.

Resale royalties recognize that artists deserve to benefit from the increase of value of their artworks over the long-term.¹⁸ Many artists are excluded from larger and higher paying art markets, especially early in their careers, so only receive low prices on direct sales. As works are then promoted and recognition eventually grows, in the traditional system it is the collectors who then benefit from much of the profit, not the

¹⁷ The concept of resale royalties is not new. Resale royalties for artists originated in France in 1920 and continue there to this day for sales of art meeting certain criteria. Although at least 59 nations around the world have some form of resale royalties in the law, the United States does not. California passed a resale royalty law in 1976, which was subsequently ruled unconstitutional. When Congress passed the Visual Artists Rights Act in 1990, early versions of the bill included a resale royalty right, but this was dropped from the final version. The only way for a U.S. based artist to obtain the right to resale royalties is through private contracts with collectors.

In the 1970s, Seth Siegelaub and Robert Projansky wrote The Artist's Reserved Rights Transfer and Sale Agreement (often referred to as the "Artist's Contract") that introduced resale royalty provisions to the public. In the Artist's Contract, the artist earns 15% on the *increase* of the value of the work since the last sale. In a lot of blockchain smart contracts, the percentage is earned on the sale price as a whole without considering the past price.

Since the '70s, artists have built upon that contract in many forms. For examples, see www.artistscontract.com (where an artist can customize online their own version of the artists contract, including linking the work to the blockchain if desired); Alex Strada's Artist Contract <https://alexstrada.com/Artist-Contract> (where resale of the work is mandatory after 10 years with proceeds to be reinvested in a new artwork made by an emerging female artist), and Kadist Foundation's The Artist's Reserved Rights Transfer and Sale Agreement <https://artistcontract.org> (where the resale royalty benefits a charitable organization).

¹⁸ For an example of an organization with an attunement towards these issues, see Souls Grown Deep, *Resale Royalty Award Program* (last visited Feb. 22, 2023), <https://www.soulsgrowndeep.org/foundation/resale-royalty-award-program>.

artists or their estates. An artist can specify that portions of resale royalties go to themselves, another person, a DAO community, a non-profit organization, and/or any other recipients with whom the creative desires to share money.¹⁹ Resale royalties are an important economic justice tool, especially to support and potentially redistribute wealth to artists of color, immigrants, or other creators who may be excluded from or exploited by the sector.

How are resale royalties implemented on the blockchain?

Resale royalties can be coded into smart contracts.²⁰ Implementing resale royalties is a great use of smart contract protocols, an exciting innovation for creators. Smart contract technology makes arranging for and collecting resale royalties on NFTs easy. Since NFTs are on the blockchain and purchases are effectuated through the blockchain, and the blockchain allows transparent viewing of transactions, the artist is able to automatically receive resale royalties when due. When minting a NFT, the artist is usually prompted to choose a resale royalty percentage if desired.²¹ The artist may also want to make sure resale royalties are written into license language as an extra way of establishing legal agreement

What is a smart contract?

Smart contracts are not legal contracts. Smart contracts are a technical protocol, most often used to program money to automatically change hands upon some

events. Those events, and the amounts of money to be transferred, are contained in an actual legal contract (even if that contract is unwritten or contained in terms of service). Through the use of smart contracts, certain aspects of the contract can be self-executing without any further action from either party.

How and when money moves is one feature of legal contracts, but legal contracts also do much more. Legal contracts discuss conditions, licenses, governing law, and dispute resolution, topics which smart contracts have limited capacity to administer. Smart contract technology cannot be used to enforce many key aspects of legal agreements, and even if it could, it wouldn't necessarily always get it right, because courts always are interpreting the documents and records in front of them.

Smart contracts clearly have a practical impact, as they self-execute certain functions. And they are likely legally binding to the extent that they accurately reflect the shared intent of the parties; however, the legal field is still evaluating how smart contracts relate to existing contract law.²² A smart contract provides evidence of what parties intended, but will not contain the entire agreement. In theory, a court could overrule a smart contract protocol if the court found that the smart contract action did not reflect the parties' intended agreement. In the future, legal contracts may start to address the use and coding of smart contracts within them, but smart contracts are unlikely to be a replacement for traditional contracts.²³

¹⁹ See, e.g., Kadist Foundation's Artists Contract, *supra* note 17.

²⁰ The license language may also cover the role of smart contracts in administering resale royalties.

²¹ The resale royalty only applies to resales of the token. If the artwork attached to the NFT exists in the physical world as well, implementing resale royalties for that physical artwork would need to be addressed separately in writing.

²² Law professor Gregory Klass is wrestling with these issues. See, e.g., Gregory Klass, *How to Interpret a Vending Machine: Smart Contracts and Contract Law*, 7 Geo. L. Tech. Rev. (2022) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4045711.

²³ Klass, *supra* note 22

TECHNICAL ISSUES IN MINTING AND STORING NFTS

Where do I put my NFT license language?

Licenses may be written into the description box when minting an NFT. License language can be posted on the web page associated with the NFT collection on its own tab, or at the bottom near where the Terms of Use and Privacy Policy usually are located. A license does not need to be signed by the NFT collector for it to be binding on them; however, a court would want evidence that the NFT purchaser has seen and acknowledged the license terms.

Who is responsible for ensuring perpetual NFT storage?

Storage of the token and the content attached to that token are often in separate places. When the creative work is stored off of the blockchain, there is no guarantee that the token will be forever tied to the display of that copy of the creative work. A creator who wants to assure that the content will be available years down the line needs to anticipate who is responsible for storage, whether that is the creator or the NFT purchaser. Currently NFT sales contracts rarely specify who has the legal obligation to host data in a way that the work associated with the NFT will always be retrievable by the NFT owner.

Terms and Conditions Apply: Ownership in the Metaverse

We have said before that you are automatically the copyright holder in work you create. But if you create an asset on a metaverse platform, using that platform's software, and for display in that platform only, the asset you created is now tied to the platform's Terms of Use, and your rights are affected. Creatives may seek to review and share information about the pros and cons of different platforms' Terms of Use, and advocate to set standards. For example, the Metaverse Fashion Council, a community of designers in the metaverse, calls for platforms to become further connected and ensure that people—not the platforms, should directly own and control their names, avatars, land, animations, and looks.²⁴

Trademarks Available for Creatives

In addition to copyright, creatives may seek to protect their assets in the metaverse by relying on trademark protection to the extent possible, such as filing for trademark registrations for logos and images with the U.S. Patent and Trademark Office. Big brands are increasingly filing trademark applications and enforcing their rights across both the physical world and metaverse platforms, and individual creatives could do the same.

²⁴ Metaverse Fashion Council, 10 Keys to Metaverse Fashion, <https://www.linkedin.com/company/metaverse-fashion-council/about/> (last visited Mar. 22, 2023).

SECURITIES LAWS AND FRACTIONAL OWNERSHIP IN PROFIT-MAKING ACTIVITIES INVOLVING CREATIVE WORK

What is securities law?

Securities law governs any time that people invest value into projects with a risk of loss. The Securities and Exchange Commission (SEC) is the federal government agency in charge of securities regulation and enforcement. The SEC is charged with balancing, on the one hand, allowing projects to access the capital they need to thrive, and on the other hand, protecting the investing public. Creatives getting involved with Web3 will want to be aware of the high-level securities law issues.

What are the risks of minting tokens from a securities law perspective?

It's up for debate whether tokens are considered commodities or securities under the law. As of the date of this report, SEC leaders have taken the position that tokens of all kinds could be securities.²⁵ As one co-

director of the SEC Enforcement Division has said: "The innovative technology behind these virtual transactions does not exempt

securities offerings and trading platforms from the regulatory framework designed to protect investors and the integrity of the markets."²⁶

The SEC takes an interest when a token is acting like a "security" rather than a good or commodity. A security is usually a passive, profit-driven investment. In contrast, a good or commodity can itself be directly used, controlled, or enjoyed. Securities are a highly regulated area of the law—sales and resales are a lot more complicated, and sellers of securities take on substantial legal risk. Offer and sale of securities requires a good amount of legal compliance and carries consequences in the event of fraud or misrepresentation.

Most artists selling NFTs treat them not unlike selling a physical artwork; however, the SEC is investigating certain NFT collections as possibly being investment securities. The SEC is currently investigating Yuga Labs Inc., the creator of Bored Ape Yacht Club, for violating securities laws with

Dee's Demise

When selling their CryptoRats NFTs, Dee posted on their Discord channel: "BUY YOURSELF A CRYPTORAT AND GET RICH QUICK! EACH RAT IS ONLY .04ETH BUT I HAVE BIG PLANS FOR THESE RATS... WE'RE GOING TO THE MOON!" Dee received positive feedback for the artistic vision behind the CryptoRats. Dee has sold about 500 CryptoRats so far, but Dee recently got a new job and doesn't have time to devote to the project anymore. Dee transfers all of the cryptocurrency they had received into dollars and abruptly shuts down the Discord channel. Dee forgets about the project until several months later, when Dee receives notice that they are being investigated by U.S. authorities for allegedly coordinating a "rug pull," harming investors, and violating securities laws. Dee now has to spend a lot of money on defense attorneys that they don't have, and regrets not consulting with advisors prior to launching the project.

²⁵ See, e.g., S.E.C., *Remarks Before the Aspen Security Forum* (Aug. 3, 2021), <https://www.sec.gov/news/speech/gensler-aspen-security-forum-2021-08-03>.

²⁶ Press Release, S.E.C., SEC Issues Investigative Report Concluding DAO Tokens, A Digital Asset, Were Securities (Jul. 25, 2017), <https://www.sec.gov/news/press-release/2017-131>.

respect to its NFTs.²⁷ The SEC is concerned that consumers may be buying into NFT collections based on the promise of flipping NFTs for profit, without adequate disclosures of the risks involved, and relying in large part on the efforts of the NFT creators to promote the overarching brand to economic success.

What is fractional ownership?

Fractional ownership is a form of co-ownership. A great example is corporate stock: a company sells shares of stock to multiple people who receive certain economic and governance rights in exchange. Decentralized autonomous organizations (or DAOs, discussed in more detail below) are another example of fractional ownership.

Fractional ownership can also work with assets, where each owner shares the benefits and rights to use the asset. For example, someone could become a fractional owner of an art piece by buying a share in an

entity that owns solely that artwork, as is the business model of Masterworks.²⁸

Alternatively, the artist themselves could establish fractional equity in a physical artwork at the time of selling a physical artwork, keeping a portion of ownership for themselves.²⁹

Blockchain-based fractional ownership simply involves tokenizing the ownership interest—in effect, creating a virtual representation of the ownership as a token on a blockchain rather than a stock ledger. Blockchain-based investing platforms may call the ownership interests ‘coins’, ‘f-NFTs’, or ‘tokens’ instead of shares and may be more willing to accept cryptocurrency (e.g. bitcoin) instead of traditional fiat (e.g. U.S. dollars), but these are all just technical applications of the same legal principles. These fractionalized ownership interests are securities, and selling them via the blockchain is not in itself an exemption from securities laws.

Case Study: Masterworks

The company Masterworks buys physical artwork at auctions. For each piece of art Masterworks purchases, it creates a limited liability company to hold that artwork only. It then sells membership interests in each of these LLCs online. For example, someone could buy a 3% interest in one of Masterwork’s LLCs, which would represent (sort of) 3% ownership of that artwork. But Masterworks LLC owners get no right to look at or display the artwork. Instead, if Masterworks ever sells the artwork, the LLC owners get a portion of profits, if any (after Masterworks takes a fee). Masterworks offers a secondary market where users can buy and sell their shares in the art, but the market is only open to other Masterworks users. Masterworks treats its ownership interests as securities and sells them to the public in reliance on SEC Regulation A.

²⁷ Matt Robinson, Bored-Ape Creator Yuga Labs Faces SEC Probe Over Unregistered Offerings, Bloomberg (Oct. 11, 2022, 9:25 AM), <https://www.bloomberg.com/news/articles/2022-10-11/bored-ape-creator-yuga-labs-faces-sec-probe-over-unregistered-offerings>.

²⁸ See Masterworks, <https://www.masterworks.com> (last visited Mar. 22, 2023).

²⁹ Amy Whitaker & Roman Kraeussl, *Blockchain, Fractional Ownership, and the Future of Creative Work* (February 11, 2019). <http://dx.doi.org/10.2139/ssrn.3100389>.

What opportunities are there for artists to sell fractional ownerships?

Bearing in mind the need for compliance with securities laws, artists could experiment with ways to divide economic rights in a NFT in a manner that serves their goals, whether raising money, building a fan base, acknowledging stakeholders, or otherwise.

There have been a number of changes to the U.S. securities regulations in the past 10 years that have opened up the accessibility of investment fundraising, and, relatedly, fractional ownership of assets. The JOBS Act of 2016 made it easier for companies to advertise and sell retail investment securities to people across the U.S. via regulation crowdfunding³⁰ and Regulation A.³¹ The process has been clarified and in a

number of ways simplified, and crowdfunding can take place on crowdfunding portals such as WeFunder, StartEngine, and Republic.

Through fractionalizing ownership of their copyrighted material, artists may engage fans, collaborators, and their communities to partake in the proceeds of their work. For example, musician Lil Pump sold tokens where investors could invest in his song "Mona Lisa" and share in the royalties.³² Any creative could seek to replicate or innovate on this strategy to simultaneously fundraise and share revenue with others; however, they need to do so with the support of a lawyer experienced in securities laws.³³

Case Study: Lil Pump Mona Lisa Song f-NFTs.

The musician Lil Pump sold fractional interests in his song Mona Lisa so that fans could invest and receive a share in royalty streams. The investors purchased "f-NFTs," which were simply a way to record their LLC membership interest through the blockchain instead of on an old-fashioned ledger. This is an example where NFTs aren't magic or themselves legally innovative, but rather they are just a modern way of recording a careful use of the securities laws. Lil Pump sold the tokens in reliance on SEC Regulation CF through the crowdfunding website Republic.

³⁰ For more information, consider starting with S.E.C., *Regulation Crowdfunding* (last visited Feb. 22, 2023), <https://www.investor.gov/introduction-investing/investing-basics/glossary/regulation-crowdfunding>.

³¹ For more information, consider starting with S.E.C., *Regulation A* (last visited Feb. 22, 2023), <https://www.investor.gov/introduction-investing/investing-basics/glossary/regulation#:~:text=Under%20the%20federal%20securities%20laws,the%20offering%20with%20the%20SEC.>

³² Mona Lisa by Lil Pump, <https://republic.com/lil-pump> (last visited Mar. 22, 2023).

³³ Promoters of NFTs could be liable in the event token-holders or the SEC accuse them of material misstatements or failure to comply with federal and state securities laws.

DAOS: OPPORTUNITIES AND RISKS FOR CREATIVES' INVOLVEMENT

Creatives have gotten involved in DAOs to be a part of building community and organizing resources. Along with this new interest, there are many legal questions that a DAO participant may want to be aware of, and some of these are presented as FAQs here.

What is a DAO?

A DAO is a manner of organizing groups of people using blockchain technology. DAO is an aspirational term, as most existing DAOs are neither decentralized nor autonomous. There are numerous exciting applications of DAOs: Protocol DAOs, Collector DAOs, Creator DAOs, and Social DAOs.³⁴

In many respects, advising about DAOs is highly similar to advising any startup venture. In the same way that smart

contracts are a protocol used to manage certain aspects of actual contracts, DAOs provide a technical management overlay and some aspirational guiding principles, but do not alter the corporate legal structures and securities laws operating in this field.

Are DAOs legal entities?

No, but one can form a legal entity for a DAO. Forming a legal entity is a way to insulate DAO participants' personal assets from liabilities caused by the business or their partners. Because of this important risk management benefit, DAOs are increasingly advised to choose a legal entity (also called a "legal wrapper" in the DAO world). In addition to limiting liability, forming a legal entity will make it easier for DAOs to contract with third parties, file or pay taxes, pay employees, open bank accounts, protect their intellectual property, hold or protect off-chain assets, and identify default governance rules under law, in case of ambiguity and dispute.

Crystal's Conundrum

Crystal recently joined a DAO called NerdyDAO. The goal of NerdyDAO is to collectively develop educational materials, like textbooks and online curricula, about crypto and blockchain. If NerdyDAO takes off, then the token holders would receive a share of profits from licensing the educational materials. Excited to put her design skills towards this project, Crystal joins NerdyDAO and pretty soon afterwards contributes an animated "map" of the metaverse.

Two months into the project, NerdyDAO publishes a textbook, including her map. But it turns out that NerdyDAO's contributing authors completely plagiarized an existing academic article. A news story breaks about the plagiarism. Crystal asks the NerdyDAO founders about the article, but the founders are unresponsive and don't answer her message for two months. The authors of the academic article then sue NerdyDAO for copyright infringement and name Crystal personally in the complaint. Crystal learns that NerdyDAO never formed an entity and is now even more worried she may be personally liable for copyright infringement.

³⁴ DAOs may be organized to acquire rights to creative content, such as when Spice DAO bought a copy of a rare 'Dune' book with the intent to create an animated series, among other things. Unfortunately, in the case of Spice DAO, the collaborators did not realize that purchasing a single copy of a book is not the same as buying the rights to make an animated series, so the effort failed. Such an effort is subject to compliance with securities laws. See Caroline Foley, *You Spent \$3.5m on What?! Spice DAO, Dune, NFTs and Copyright*, MinterEllison (Nov. 3, 2022) <https://www.minterellison.com/articles/spice-dao-dune-nfts-and-copyright>.

Before participating in a DAO, creatives could inquire about: (1) the DAO's legal entity, the membership classes of the DAO, and the decision-making processes coded into the DAO's structure (typically managed through smart contracts); (2) whether participating in the DAO will open up any potential personal liability; and (3) whether holding the DAO tokens will have tax consequences.

Those considering starting a DAO should consult with an attorney both about legal wrappers and securities law compliance. For example, securities concerns arise with large DAOs in which each token holder has a very limited ability to participate in governance and steer the results of the DAO. And even where there is a legal wrapper, founders of DAOs could be liable where the launch of the DAO and sale of interests in it were made through fraud or material misstatements, or without compliance with federal and state securities laws around the sale of securities.

Is there an optimal legal wrapper for DAOs for creatives?

For the reasons described above, choosing any legal wrapper may be better than nothing. The best legal wrapper will depend on the DAO's business plan and goals.

Creatives that are approaching their DAO involvement from the lens of economic and racial justice might consider creating the DAO as a cooperative, enabling workers, artists, and any other stakeholder classes to have voting and economic rights in the DAO.³⁵ Among other attributes, cooperatives are distinct because each member has only one vote, regardless of contributions, helping to democratize management. Economic rights are tied to participation of stakeholders on an

ongoing basis, rather than who can invest cash into the project. Transparency is also foundational to cooperatives and important to facilitate broad democratic decision-making.

Choosing to form a DAO as a cooperative gives the community some fundamental principles to organize around, consistent with other aspects of DAO intent and rooted in the long history of cooperatives. Austin Robey, member of the Friends with Benefits social DAO and founder of Ampled, a cooperatively owned musician-focused web platform,³⁶ writes: "while DAOs tend to be better at enabling collective ownership at scale, cooperatives, through their sober rejection of capitalist realism, are more likely to correctly address the root causes of inequity" and "the best framework for coordinating—and making a difference—may not be a choice between the two models, but a blend of both."³⁷

Examples of DAOs that are formed as cooperatives include ETHDenver, Flamingo DAO, Raid Guild, dOrg, Opolis, Common Lands, and SongADAO.

If I engage with a DAO, am I an employee? Who owns my creative contributions?

When contributing labor to a DAO, it is best to consider the DAO the same way that you would any other organization (even if the DAO doesn't think about itself that way). If you do work for the DAO, you may be considered an employee under state law. If you expect or would like to be paid for your participation in a DAO, look into a DAO that shares these values (including potentially cooperative DAOs) and be upfront in your expectations.

³⁵ The availability of cooperative entities varies by state. The Colorado Limited Cooperative Association has emerged as a popular entity type for DAOs, although other state cooperative statutes could also be a good fit.

³⁶ Ampled is a recipient of a CCI AmbitioUS grant.

³⁷ Austin Robey, *What Co-ops and DAOs Can Learn From Each Other*, FW3: Editorial (Jan. 13, 2022), <https://www.fwb.help/editorial/what-co-ops-and-daos-can-learn-from-each-other>.

Similarly, be conscious of the work you are creating and what rights in that work you are transferring or licensing to the DAO. Generally, if you contribute copyrighted works to a DAO, in the absence of an employment relationship or a specific IP assignment agreement or license policy, you remain the owner of those copyrighted works with an implied license to the DAO. But when participating in the DAO, be sure to check the DAO's white paper, terms of service, or other membership-related documents for IP-related legal terms of service.

ADVOCACY

Governments are in the early stages of considering whether and how to pass or update laws to account for new blockchain technologies. For example, CCI recently [submitted a public comment letter](#) to the U.S. Copyright Office and U.S. Patent and Trademark Office advocating for independent creatives' interests as the norms and standards in the blockchain continue to develop.³⁸ More opportunities are sure to emerge.

The thrust of CCI's advocacy has been focused on ensuring creatives have the information, resources, and collective power to assert ownership and control over their work. Creatives generally want to avoid hidden "gotchas" or errors that could be costly or difficult to mend down the line, and affordable legal advice is hard to come by. Specifically, we have argued:

Artists need better tools to understand and influence the ways NFT marketplace terms impact their intellectual property rights, including the ability to assess terms, determine licenses, as well as choose or change platforms

There is significant legal uncertainty regarding the ways copyright law and contract law overlap on the blockchain, which creates copyright management and enforcement challenges for creators and inconsistencies in enforcement

Small creators need education and technical assistance to help them protect and manage their intellectual property on the blockchain, in particular given the high barriers to informed entry in the market and the lack of trusted advisors, especially within marginalized communities

Despite the opportunities, we worry that overdependence on too-few platforms could potentially use their market power to strip artists of ownership of artwork, rights to reproduce, trademark, and other economic opportunities.

As the industry develops, solidarity among independent creatives is important. Creatives may collectively review and share notes on marketplace terms of service or which platforms are most friendly to creator control. NFT minting platforms could add prompts to design their own license terms when minting NFTs. Moreover, organizations supporting artists could help assess the best and worst NFT minting platforms, with an eye towards artist issues.

Overall, blockchain technologies offer big opportunities for arts workers to control and derive economic benefits from their work. However, lack of information and means to exert collective power may undermine their ability to help creators—especially creators from marginalized communities—achieve greater self-determination. We hope governments will consider these communities' needs in particular when considering new or updated laws.

³⁸ Letter from the Center for Cultural Innovation to the U.S. Patent and Trademark Office and U.S. Copyright Office (Feb. 3, 2023), <https://www.regulations.gov/comment/COLC-2022-0005-0027>.

CONCLUSION

As illustrated through this report's discussion of licensing, contracts, securities laws, and other legal concepts, there is a lot of learning to be done. Some of the tips we hope creatives take away from this report include:

For those minting NFTs:

- Carefully evaluate and compare NFT marketplaces terms of service
- Design your own license policy whenever possible, to take control of managing your IP rights, both economically and around control
- Consider including resale royalty provisions in smart contracts
- Register your copyrights with the U.S. Copyright Office to proactively prepare in the event of copyright infringement
- Consult with legal counsel around securities law risks of minting NFT collections

For those participating in DAOs:

- Ask questions of project founders regarding tax, employment, and ownership obligations when participating in blockchain-based projects
- As a project founder, consult with legal counsel about corporate entities and other startup legal matters

CCI plans to continue to monitor industry and legal developments in this space. If there are other case studies or stories you'd like us to be aware of, or corrections or developments since the publishing of this report, we would love to hear from you. Please [share your story here](#).

ADDITIONAL RESOURCES

Water & Music NFT Contract Builder - <https://contractbuilder.waterandmusic.com/>

"Can't Be Evil" NFT Licenses - <https://a16zcrypto.com/introducing-nft-licenses/>

IC3 IFT License - https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4169092

U.S. Copyright Office - <https://www.copyright.gov/>

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