Developments in Web3 for the Creative Industries

A Research Report for the Australia Council for the Arts

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Part 5: Legal Considerations

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Part 5: Legal Considerations

Blockchains and smart contracts should, in theory, reduce the administrative burden on creative practitioners by automating processes. Unfortunately, legal issues do not disappear by selling works as non-fungible tokens (NFTs) and it could take many years to achieve legal clarity let alone arrive at easier legal processes. As discussed in the preceding parts of this report, NFTs are assets that can be traded in a peer-to-peer fashion because blockchains enable us to agree on who owns what. While this confers proof of ownership of an NFT token, it does not deal directly with transferring or licensing the *intellectual* property rights in digital assets associated with the NFT (like images or videos), or any *personal* or *real* property associated with the NFT (like physical prints or 3D printed sculptures).

An assumed benefit of NFTs is that they can enable people to purchase a song or artwork and have exploitation rights over that work, including the ability to use it as a profile picture or make merchandise or derivative works from it. Legal experts have argued that, in general, existing laws can apply to NFTs and digital and physical assets that are transferred using NFTs. For example, intellectual property laws give exclusive rights to the owner of the intellectual property and make it unlawful to use those rights without their permission. NFT buyers therefore need to ascertain what licence rights they are purchasing from the owner, if any. NFT creators who want to give NFT owners permission to use their work need to take affirmative steps to make it clear what owners can and can't do. Unless these considerations are explicitly addressed, none of this is obvious from the metadata associated with an NFT token.

Like all property, copyright can be transferred from the owner to another person or legal entity. However, scholars at Cornell University and IC3 have written that transfer of copyright is not likely to be established through a smart contract under US law, as a transfer of ownership of the copyrights needs to be in writing and signed by both parties to be legally enforceable (Grimmelmann et al., 2022). The same applies under Australian copyright law. Moreover, transfer of copyright – otherwise known as an assignment – can open a new suite of problems related to downstream transfers (see Grimmelmann et al., 2022).

It is worth noting that there are many other ways in which the law can intersect with NFTs. NFT tokens themselves have been recognised as digital assets – specifically, as personal property – in UK and Singapore courts, however we have yet to see a similar test case here in Australia. Further complicating these considerations is the fact the legal implications of personal or real property transferred via an NFT (such as prints or 3D printed sculptures) have yet to be fully considered. For example, whether the material component (like the print) can be split from the NFT and sold separately remains an open question. Questions also remain around whether NFTs can be considered a security, and therefore trigger existing financial regulations when they are minted and sold. We are also starting to see NFTs used as procedural tools in legal processes (e.g., Shumba, 2022).

These questions are open and multiplying and covering all of them is beyond the scope of this report. Instead, we aim to provide a snapshot of current legal concerns and questions that creative practitioners and intermediaries may want to consider as they engage with web3 technologies. We focus on intellectual property, resale royalties, and consumer protection, as these are the immediate concerns of most artists. However, NFTs and other tokens do come into contact with securities law and tax law, which creators and buyers may need to investigate.

5.1 What is Intellectual Property?

Intellectual property (IP) refers to "creations of the mind" (WIPO, n.d., para. 1), including literary and artistic works, as well as designs, names, and symbols used in commerce. Intellectual property laws exist to incentivise creations of the mind. Without these laws, anyone could copy a creation of the mind and exploit it for commercial gain, to the detriment of the author (or creator). This would effectively de-incentivise the making of creations of the mind.

The distinct areas of IP law that NFT creators and buyers need to be mindful of include copyright, designs, trade marks, and patents.[1]

Copyright provides authors and IP owners (of any creative work, not just literary works) with economic rights over the expression of their work (it can't just be an idea). These rights mean the authors/IP owners can prohibit or authorise the reproduction, adaptation, performance, recording, translation, and broadcasting of a work. In addition, authors have moral rights that protect the integrity of their work and provide the author with rights over attribution, including anonymity and pseudonymity. In Australia, the *Copyright Act 1968* (Cth) stipulates the laws relating to copyright. Under the *Copyright Act*, original works receive copyright protection at the point of creation, making it unlawful to use another's copyright protected work without the author/owner's permission, regardless of whether a copyright attribution is present. Unless copyright has been assigned (transferred) or licensed (given permission to use), it resides with the author/s. Employment or work for hire are two instances where the copyright owner and author may not be the same. For example, employers hold copyright of works created by employees and freelance contracts may have specific IP clauses which determine that the copyright of works is held by the client, rather than the creator.

Design rights protect the overall visual appearance of a product. This visual appearance can be made up of multiple visual features (e.g., shapes, colours, configuration, patterns, ornamentation). The design right applies to a product that "has physical and tangible form, is manufactured or handmade, [and] is produced on a commercial scale" (IP Australia, 2020a, para. 2). Design rights are particularly important when it comes to fashion NFTs.

Enterprises that wish to distinguish their goods or services from those of other companies may apply for a **trade mark**. Unlike copyright, trade mark signs generally need to be registered to be enforceable (although other areas of law can be used to support trade mark-related claims, like passing off and misleading and deceptive conduct). Importantly, a trade mark can be applied to "a letter, number, word, phrase, sound, smell, shape, logo, picture, movement, aspect of packaging, or a combination of these" (IP Australia, 2019, para. 1).

Patents provide a means to protect the IP of an invention. The patent application includes technical information about the invention and patents are kept on a register. To register a patent, the "invention must be new, useful and inventive or innovative" (IP Australia, 2020b, para. 1). It is important to note that a patent may not be granted if the invention has been demonstrated, sold, or discussed in public before the patent application was lodged (IP Australia, 2020b). Confidentiality agreements can be used to support conversations regarding the invention with employees or business partners prior to lodging the patent application.

The Coalition of Automated Legal Applications (COALA) is an international group of legal practitioners, legal scholars, artists, and technologists working on blockchain-related legal issues. COALA is currently developing NFT legal standards aimed at addressing the legal uncertainties that surround NFTs, including how to associate licensing terms into a token, and how to enable people to verify that they have authorisation to use a work. COALA's work includes technical experimentation to create an immutable link between an NFT and licence terms that can be adopted by any platform.

If this effort achieves its goal, it is entirely possible that web3 – including NFTs – will make legal administration easier for creators and NFT owners in the future when current uncertainties have been resolved. For now, artists should approach intellectual property as a matter of risk assessment, including seeking legal counsel where necessary. A useful starting point is the "Can't Be Evil" NFT licences released by A16Z in August 2022. The licences aim to fulfil three objectives: "(1) to help NFT creators protect (or release) their intellectual property (IP) rights; (2) to grant NFT holders a baseline of rights that are irrevocable, enforceable, and easy to understand; and (3) to

[1] There are other subsets of IP for more specific applications, e.g., plant breeders' rights.

help creators, holders, and their communities unleash the creative and economic potential of their projects with a clear understanding of the IP framework in which they can work" (Jennings & Dixon, 2022, para. 4).

In the next section we provide a brief look at some of the intellectual property issues artists are facing in relation to NFTs, giving examples where possible. We have organised these according to common motivations for undertaking NFT projects and focused on IP. The final section looks specifically at resale royalties, meaning the ability to receive a share of sales that occur after the initial sale.

5.2 Intellectual Property and NFTs

5.2.1 An Artist or Estate Chooses to Sell a Collector's Item

The creators of an NFT project should be mindful that buyers may have incorrect assumptions about what they are entitled to do with the artwork associated with their NFT token. One now infamous example where buyers misunderstood the intellectual property attributes of an NFT was Spice Decentralised Autonomous Organisation's (DAO) purchase of the script bible of Alejandro Jodorowsky's 1970s film version of the sci-fi novel *Dune*, which never made it to production. The DAO assumed the transfer in ownership of the NFT was also a transfer of associated copyright and intended to produce an animated version. Only after they had made the purchase did Spice DAO realise the copyright owner was author Frank Herbert's estate, which had licensed the exclusive film rights to the producers of the 2021 film production of *Dune*. In addition, as Caroline Foley points out, the DAO would also have needed copyright from Jodorowsky to use the intellectual property in such an adaptation (Foley, 2022).

Spice DAO's experience is a cautionary tale, which legal commentators use to encourage buyers to check any rights associated with the NFT. But it is not always obvious where a buyer should look. Marketplaces like OpenSea state in their terms of service that NFTs may be subject to terms between buyers and sellers and to check third party links to creator's website for such 'purchase terms'. OpenSea (2021) makes it clear that it is not party to such terms, but that it will take down content in accordance with the US Digital Millennium Copyright Act (DMCA), which provides a procedure for reporting copyright infringements. Given, however, that users are habituated to ignoring terms of service during everyday online activities, and with terms of service subject to change, there remain doubts as to how binding such terms might be.

For a buyer, if the rights are not specified by the creator (on their website, for instance), then it is safest to assume that the author of the work retains copyright de facto until IP expires (Department of Infrastructure, Transport, Regional Development, Communications and the Arts, 2019). As is the case if you buy a physical print of an artwork, the owner of the NFT may display the work but cannot make further copies to sell or produce merchandise based on the NFT (such as selling a line of t-shirts with the work screen-printed on it). For instance, NBA TopShots (2022, sec. 4) state that purchasers of its NFTs acquire a "non-exclusive, nontransferable, royalty-free license to use, copy, and display the Art" for personal, non-profit purposes or to display on marketplaces and other apps if ownership is cryptographically proven.

5.2.2 A Musician Wants to Release a Music NFT

In 2021, American rapper Jay-Z sued his former collaborator Damon Dash for attempting to sell an NFT of Jay-Z's debut album *Reasonable Doubt*. Jay-Z and Dash each own one-third of the record label that owns the copyright to the album and Jay-Z claimed that Dash was attempting to sell the copyright of the album through the sale of the NFT, which he had no right to do. Dash countered that he was attempting to sell his share in the record label (see more Guest Work Agency, 2021).

There are often multiple rights-holders in a single song, such as band members, song writers, and record label producers. As the *Reasonable Doubt* NFT example illustrates, artists or bands who are signed to a label often hand over the master rights of their songs, including rights to future

works. If an artist or band wants to release an NFT they need to carefully look at who they need permission from – obtaining licenses where necessary – to mint the NFT. Profits from the NFT may need to be split between rights holders. It's possible some existing label contracts do not extend to artworks that a musical artist intends to release as digital art NFTs, and some artists have rights that fall outside the label contract, such as over merchandise, that might give them scope to issue NFTs independently of the label. Artists who are unsigned and have complete control over their works will have fewer hurdles, while those who are considering signing to a label may want to include specific wording about whether the minting and selling of NFTs falls within the scope of their contract.

5.2.3 A Company Behind an NFT Project Wants to Build its Brand by Allowing Token Holders to Use the Image in Their Own Commercial Enterprises

One of the most famous NFT projects*, Bored Apes Yacht Club* (*BAYC*), seeks to harness the enterprising efforts of its community by encouraging members to earn income by using the image of a '*Bored Ape*' they own for commercial purposes. Yuga Labs, the creators of *BAYC*, grants owners "unlimited, worldwide license to use, copy, and display the purchased Art for the purpose of creating derivative works based upon the Art ('Commercial Use')", including the ability to create merchandise products displaying copies of the art as long as it is done in a way where there can be cryptographic proof of ownership "to ensure that only the actual owner can display the Art" (*Bored Ape Yacht Club*, n.d., para. 3). Bored Ape Wear, for instance, produces street wear that displays *Bored Apes* owned by the *BAYC* founders. A quick search on Etsy retrieves floor rug designs featuring Bored Apes, although there's no way to establish whether the sellers on Etsy own the NFTs of the apes printed on the rugs (bringing new meaning to the term 'rug pull').

NFT projects that wish to permit commercial use of the associated image can give permission to the owner of the NFT by way of a licence to use it for a profit-making enterprise such as merchandise. In the case of *BAYC*, Yuga Labs states it is granting an unlimited worldwide licence to use, copy, display and create derivative works, not that it is transferring copyright to the owner.

CryptoKitties, the first project to use the ERC721 standard, issued owners of *CryptoKitties* the "NFT Licence", (CryptoKitties, n.d.) which allows, among other things, the owner of a '*Crypto Kitty'* to profit from merchandise that uses the image of their *Kitty* up to USD$100,000. The licence states the owner can even get a tattoo of the *Kitty*, although it doesn't say whether the owner would need to remove it if they sold the *Kitty*.

If an artist wishes their NFT work to be available for others to use, then another licensing option is to adopt a Creative Commons licence standard. Creative Commons is an organisation that has produced six copyright licence standards to choose from that allow certain usage rights to the public. These 'legal tools' encourage reuse or remixing and make it easier to discover works on the web. However, a Creative Commons licence is a public licence that applies to anyone, meaning anyone can copy and use the artwork under the conditions of the Creative Commons licence attached to it regardless of whether they own the NFT. Creative Common licences are therefore insufficient for projects that wish to grant a bespoke licence to the current owner of the NFT.

There is also the question of how to 'attach' the licence terms to the NFT. Given the limited space for the metadata associated with an NFT, licence terms tend to either be covered by NFT platforms in their general website terms or can sometimes be seen in the description that accompanies an NFT listing (e.g., the Krista Kim example referred to by Guest Work Agency, 2021).

5.2.4 A Well-Known Brand Asks an Artist to Collaborate with Them and Create an NFT

There are growing examples of artists collaborating with well-known brands in creating NFTs (Batycka, 2022; Digital Nation Staff, 2022). In cases where an artist is hired by a brand to create an NFT, there will likely be a contract between the artist and the brand's company that has been initiated by the brand. The artist may negotiate to retain copyright over the work they create and

share in the sale or resale profits rather than earn a set fee, particularly if the artist's reputation is helping to sell the NFT.

Big brands are likely to own trade marks (as discussed above), which protect their brand under trade mark legislation. For example, Hermes has claimed that artist Mason Rothschild produced the equivalent of fake Birkin bags for the metaverse by releasing NFTs featuring the bag without their permission (Guest Work Agency, 2022). This example raises questions over whether the NFT's value is derived from association with the brand and whether companies with trade marks will need to start enforcing their rights when it comes to NFTs.

5.2.5 An Illustrator Is Employed by a Games Lab That Is Creating NFTs As In-Game Purchases

A game involves multiple layers of copyright protection. The illustrator and/or animator may be the owner of copyright in the moving image (the 'cinematograph film'), the sound producer in the 'sound recording', and the writer over any text-based elements (the 'literary work'). The game engine software may also be treated as a 'literary work' under copyright law, and it could also be protected by a patent. Typically, if the artist, animator, sound producer, or writer is employed by a games lab then the intellectual property will belong to their employer. Where they are sub-contracted to the games' lab for a specific project, the contract between an artist (sound producer or writer) and a games lab will likely specify how the copyright in various layers of the game will be carved up, much like a film production. It is also possible that the game engine software licence that is granted to the games lab to create the game will also have terms relating to required credit lines for the game engine provider and even royalty payment requirements based on the number of games sold.

While in-game purchases such as buying avatars and skins well predate NFTs, game developers are considering whether to back their in-game purchases with NFT technology (see section 5.2.3). However, like other types of other NFTs linked to copyright-protected subject matter (e.g., artworks or music), the degree of exploitation the gamer has ultimately depends on the scope of the licence granted by the owner of the intellectual property in the in-game asset. This is likely to be the game developer. In other words, the intellectual property in the in-game asset is likely to still be owned by the game developer, with the gamer given a licence to use that intellectual property in certain specific ways, unless the terms of the game provide otherwise. We have yet to see a game which assigns or transfers intellectual property in in-game assets to purchasers (*Illuvium*, discussed in Part 2 section 2.4, does not).

If an NFT project founder were to commission an artist to produce a visual image or animation, they would need to negotiate with the artist prior to commencing to establish intellectual property arrangements. Typically, this would involve a written contract that would specify who owns what IP (particularly if it is based on an existing storyboard, script bible, etc.). The majority of NFT platforms and standards to date assume there is a single author of a work, which can complicate matters where such collaborations occur (see Kushnir, 2021 for a detailed discussion).

5.2.6 An Artist Is Selling an NFT as a Digital Certificate to Accompany a Physical Sculpture or Painting

If the artist is selling a digital image of an artwork separate to the physical artwork itself (see *Lost Tablets* in Part 2 section 2.1), then this is similar to selling a print of an artwork, or an editioned photograph.

In cases where the NFT functions as a digital receipt of the purchase of a physical artwork, questions around whether the NFT can prove the physical artwork is authentic may arise. While the record of the purchase transaction on the blockchain is shared and immutable, there is still a technological challenge to linking the NFT and the physical artwork in a way that can be proven. For example, a physical painting may contain a label on the back which includes the token ID, but someone could remove the label and replace it with a false token ID.

Richie O'Gorman (aka GhostAgent) described his early attempt at physical NFT artworks:

> *I started doing a project, I call it Skeuomorphic provenance loop. I wanted to make an NFT you give to someone. I was surrounded by ceramicists so I started making these ceramic containers and I would put the private key in there. Obviously, there's a flaw in that whole concept because someone knows the key. Me, who put it in there. Then I went down the rabbit hole of Shamir's secret sharing and Multi-sig.* (O'Gorman, interview)

There are many companies that have been working on developing the technology to link physical assets – including but not limited to artworks – to NFTs (e.g., Forctis, n.d.; Verisart, n.d.). Technologies currently being suggested include barcodes and QR codes, RFID and NFC tags or chips, holograms, DNA tags, security inks, and (diamond) dust identity. Companies like Mattereum issue an Asset Passport that comes with certifier-backed warranties and provides the possibility for dispute resolution. Companies like Kong, in turn, are focused on hardware components, creating microchips that contain a private key (called HaLo and SiLo tags), which provide strong guarantees of authenticity and enable a physical object's history to be reliably factored into its value. These innovations are critical considerations in relation to the opportunities for enhanced provenance provided by web3 technologies, as discussed in Part 4 section 4.3.

As discussed in Part 3 section 3.3 of this report, NFTs also offer potential for tracing provenance and resale royalties (discussed further below) in the context of First Nations artworks (Copyright Agency, 2019; Rennie, 2020).

5.2.7 A DAO Wants to Commission an Artist to Create Artworks for an NFT Project

If undertaking an NFT project, a DAO needs to consider who is liable for any potential legal action that may arise in the future, including intellectual property or consumer protection disputes related to any NFT collection that it issues to its members or sells for income. An artwork can only give rise to intellectual property rights where the author of that work is a person. A person, in this instance, could be a natural person, or an incorporated entity, like a private company (in Australia, a Pty Ltd), a public company limited by shares or guarantee (in Australia, an Ltd), or a statutory incorporation (such as RMIT University). What this means for DAOs is that intellectual property can be owned jointly by individual members of the DAO, but not by the DAO itself. In other words, the DAO itself cannot enter into legally binding contracts, and cannot enforce what it buys and sells in a court of law, including intellectual property. It also means each member is responsible for the actions of the others (being jointly and severally liable). Furthermore, joint ownership or a licence to an artwork requires all members to consent to its use. In practice, this can be time consuming and unwieldly, leading to all sorts of problems, such as it not being clear who has the right to do what with that artwork, especially if this is not addressed before the artwork is created.

Some DAOs are registered in jurisdictions where specific laws have been adopted that allow limited liability for DAOs, such as Malta and the State of Wyoming in the US (Wright, 2021). However, both the Malta and State of Wyoming DAO models are different and have received criticism for being complicated and only capturing certain types of DAO structures. At the time of writing, Australia has no legal framework for DAOs, which means DAOs are not recognised as legal entities that can enter into legally binding contracts. This means a DAO could not legally enforce a licence it may have been granted for use of an artwork for the DAO, nor could it legally enforce an assignment (i.e. the sale or transfer) of the copyright in an artwork. One indication this may be changing is the 2021 Senate Select Committee on Australia as a Technology and Financial Centre, which stated COALA's DAO model law "could be used as a starting point for developing a law in Australia" (Commonwealth of Australia, 2021, p. 78).

5.2.8 An Artist Creates a Generative NFT Project Where the 'Image' Is Created and the NFT Is Minted at the Time of Purchase

Further uncertainty surrounds generative artwork NFTs that are created in whole or in part by software (Graves, 2022), as copyright protection does not necessarily extend to works created by non-human entities (Guadamuz, 2017).

A judge in Australia ruled in 2021 that an artificial intelligence (AI) system could be an inventor for the purposes of the Australian *Patents Act 1990* (Cth). The case found that, under patent law, there is no requirement for a human author as there is for copyright and moral rights (Caligiuri & Tobin, 2021). This ruling, however, has since been overruled. The current Australian approach is consistent with the United Kingdom and the United States (Guest Work Agency, 2022).

It is also worth noting that a number of projects listed on artblocks.io, a generative NFT platform, have chosen Creative Commons licenses. It is as yet unclear how such licenses would be construed.

5.2.9 An Artist 'Outs' a Copycat NFT Using their Twitter Account

Artists are increasingly finding that their digital artworks or images of their artworks have been minted as NFTs and/or listed for sale on NFT platforms without their permission. (An example of these dynamics in the context of cultural intermediaries like museums with open access collection is discussed above in Part 3 section 3.3.1.1).

The 'calling out' approach on social media, particularly Instagram and Twitter, continues to be a cheap but risky avenue that is frequently being used by artists to address NFT copycat situations.

To help combat this issue, digital art platform DeviantArt (Team, 2021) has created a free copy-detecting AI to help alert artists to the minting of their work as NFTs.

5.2.10 A Museum Wants to Collect NFT Art

As discussed in Part 4 section 4.1, while there is evidence of 'traditional' cultural intermediaries like museums acquiring NFTs overseas, these practices remain nascent in Australia, with the National Gallery of Victoria an important exception to this rule. These practices are guided by collection policies, which may not yet facilitate the purchasing of NFTs. It is worth noting that the NGV's acquisition of NFTs have reportedly been under their responsive collecting policy (Coslovich, 2022).

5.2.11 A Museum Wants to Mint and Sell NFTs

As discussed in Part 4 section 3.3.1, several museums and galleries are minting and selling NFTs of works in their collection as a means of fundraising and merchandising. These practices raise questions regarding the rights to mint and sell NFTs of works they may have in their collection but not own copyright over. Minting and selling NFTs in this way would require permission from the copyright owner (e.g., the artist).

Museums currently undertaking such initiatives are typically doing so through third-party platforms or marketplaces, rather than building their own NFT platform or selling directly through the museum's website or online shop. For example, the British Museum is using LaCollection (see Chayka, 2022; Valeonti, 2022).

5.2.12 A Gallery Wants to Exhibit an NFT Collection

We have seen some galleries holding exhibitions (whether in physical galleries or in the metaverse) of NFT collections from a single collection, where it is the collector who is supplying the NFT for display, rather than the creator.

In Australia, copyright includes the exclusive right to reproduce and to communicate to the public (electronically by means of uploading to a website, for example), but it does not include an

exclusive right to display. So, in theory, the display of a physical artwork in a gallery does not infringe the copyright of the artist if it is displayed without permission from the artist. However, displaying the NFT artwork image on a screen in a gallery technically involves a *reproduction* of that work on the screen, so there remains a question regarding whether the copyright owner's rights (e.g., the artist's rights) have been infringed by having the NFT reproduced on a screen in a gallery without their permission. It therefore remains unclear whether an NFT collector has the right to provide a gallery with permission to display their NFT collection, or whether the NFT collector can hold their own exhibition with displays that reproduce the NFT artwork.

A potential innovation in this space is the new 'rentable' Ethereum NFT standard (S, 2022), however this would not provide a solution for the display and exhibition of existing NFTs that do not use this standard.

5.2.13 Indigenous Cultural and Intellectual Property Issues Raised by NFTs

The Indigenous cultural and intellectual property issues which NFTs may raise are yet to be examined in detail. Indigenous cultural and intellectual property (ICIP) is based on Indigenous peoples' right to self-determination. According to Terri Janke (1997), ICIP rights are Indigenous peoples' rights to their heritage and culture.

In April 2022, a discussion paper, *First Nations' Culture in the Metaverse*, written by Bibi Barba, Dr Vanessa Lee-Ah Mat, Angelina Gomez, and Joni Pirovich, was released. The paper noted the need to advocate for international protection of ICIP embedded within cultural content in the metaverse:

> There should be recognition and respect for the principle that only First Nations people as protectors of their land, waters and air, of spiritual and sacred objects, can share their stories, or give others permission for a specific use (ensuring transparency and no exploitation in use) to share their stories, through words, song, dance and art. (Barba et. al., 2022, p. 11)

We believe the area of ICIP issues and NFTs requires further community consultation.

5.3 NFTs that Enable the Producer to Share in the Profits of Secondary Sales

One of the most common reasons NFTs have been championed as changing the status quo for creators is because of their ability to distribute royalties to the creator(s) when the NFT is resold. This is particularly accurate for creators based in jurisdictions which do not have legislation in place for an artist's resale royalty, like the US, Canada, New Zealand, Japan, Switzerland, and Greater China. For creators based in jurisdictions which do have a legislated resale royalty requirement, like Australia, the UK, and the European Union, this reason for championing NFTs may not be as pressing.

To date, little analysis has been undertaken to determine whether the resale of NFTs falls within the remit of existing resale royalties legislation or falls outside of it by virtue of their novel form and methods of sale. This section specifically considers how the resale of NFTs by Australian creators interacts with the existing Federal resale royalties legislation, the *Resale Royalty Right for Visual Artists Act 2009* (Cth). It also considers the automated royalties payment process which *some* NFTs adopt by virtue of smart contract technology, and how this operates in practice *vis a vis* the

Copyright Agency,[2] whose role is to administer payments due to Australian artists and artists' estates under the *Resale Royalty Right for Visual Artists Ac*t.

5.3.1 Background to Resale Royalties

Resale royalty or *droit de suite* laws were first brought into effect in France more than 100 years ago. Since then, over 75 countries have followed suit, propelled by their endorsement in Article 14ter of the *Berne Convention for the Protection of Literary and Artistic Works* in 1948,[3] and the European Parliament's directive 2001/84/EC in 2001.

Notwithstanding this widespread adoption, the components and mechanics of each of the legislative schemes vary. For example, a royalty rate of 5% of the total resale price is required in Australia, whereas in Brazil the royalty rate is set at 5% of any gain in value. In European Union countries, the royalty rate varies depending on the sale price of the work. Each jurisdiction also has different thresholds for the minimum sale price, which triggers the payment of a resale royalty and maintains different obligations in terms of who is liable for the payment – the seller, the buyer, or the sales agent (see van Haaften-Schick & Whitaker, 2022).

In jurisdictions which have not legislated for a resale royalty scheme, creators are left to implement a resale royalty requirement by way of private contract.[4] These jurisdictions include the US, Canada, New Zealand, Japan, Switzerland, and Greater China. Although they are a mere handful in comparison to the number of jurisdictions that currently have a legislative scheme in place, the US accounts for the bulk of global art sales at 43%, followed by Greater China at 20% (McAndrew, 2022).

There have been numerous attempts to legislate for resale royalties in the US in particular. Such attempts have been primarily criticised on the basis of its conflict with the US Constitution and the US *Copyright Act 1976*, and more generally on the basis of economic principles i.e., that in having to allocate a percentage of an artwork's resale value to the creator, collectors will be less incentivised to resell artworks and the art market will suffer as a result (for a concise history of US attempts to legislate for artist's resale royalties, see Tarsis, 2022). The resulting gap that has been left open by the US legislature has had a direct influence on the development of alternative resale royalty distribution strategies when it comes to NFTs.

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[2] The Copyright Agency is an independent not-for-profit organisation that has been appointed by the Federal Government to act as Australia's collecting society for all written works, imagery, and survey plans. The Copyright Agency also collects and pay royalties to creators and advocate for their rights.

[3] Article 14ter (Berne Convention for the Protection of Literary and Artistic Works (as Amended on September 28, 1979), 1979) provides:

> (1) The author, or after his death the persons or institutions authorized by national legislation, shall, with respect to original works of art and original manuscripts of writers and composers, enjoy the inalienable right to an interest in any sale of the work subsequent to the first transfer by the author of the work.
>
> (2) The protection provided by the preceding paragraph may be claimed in a country of the Union only if legislation in the country to which the author belongs so permits, and to the extent permitted by the country where this protection is claimed.
>
> (3) The procedure for collection and the amounts shall be matters for determination by national legislation.

[4] A key historical precedent for the inclusion of an artist's resale royalty in a contract is the *Artist Reserved Rights Transfer and Sale Agreement*, a template contract form drafted by lawyer Bob Projansky together with art curator and dealer Seth Siegelaub in 1971. This contract includes a term that an artist can claim 15% of the increase of the value of a work when it is resold at auction or privately. Although the contract was rarely used by artists in practice, it is still considered "a watershed experiment in artists' legal and economic rights" (van Haaften-Schick & Whitaker, 2022, p. 5).

5.3.2 The Origins of NFT Resale Royalties

The distribution of resale royalties to creators has not always been a defining component of NFTs. When one of the early iterations of an NFT was created by artist Kevin McCoy and developer Anil Dash in Rhizome's Seven by Seven hackathon in New York in 2014, the premise behind the duo's prototype was how to give artists creating digital artworks the ability to assert ownership over the 'original' artwork, and "to offer artists a way to support and protect their creations" using the potential of then-nascent blockchain technology (Dash, 2021, para. 2).[5] The defining component of their so-called 'monetised graphics' was the blockchain-backed verification of the digital artwork. However, the potential for blockchain technology to go a step further in supporting artists by distributing resale royalties was not considered.

In November 2017, the Ethereum-based project *CryptoKitties* – which allows players to purchase, breed and sell virtual cats – was launched. The smart contract which deployed each *CryptoKitty* NFT was an early precursor of what was soon to become the ERC721 standard. Soon after, in December 2017, the NFT marketplace OpenSea was launched in direct response to the movement forming around the game. Envisioned as an 'eBay for NFTs', the marketplace supported NFTs which were based on this same early precursor to the ERC721 standard. In 2018 a number of other NFT marketplaces were founded, including SuperRare in Newark, Delaware and Nifty Gateway in San Francisco, whose first minting contracts were also based on precursors to the ERC721 standard.[6]

The ERC721 standard is a template-style smart contract which "provides basic functionality to track and transfer NFTs" (Ethereum, 2018, para. 2). It was first proposed by William Entriken, Dieter Shirley, Jacob Evans, and Nastassia Sachs in January 2018. In the summary of the standard, the authors explain that "[i]n general, all houses are distinct and no two kittens are alike. NFTs are *distinguishable* and you must track the ownership of each one separately" (Ethereum, 2018, para. 3). In other words, the motivation for developing the standard was in the tracking of NFTs. Resale royalties are not mentioned in the ERC721 standard.

For NFT platforms which deploy the ERC721 standard (or the ERC1155 standard for that matter) 'out of the box', the distribution of royalties is administered by the platform itself, not by the smart contract. To that end, cross-marketplace royalty enforcement has primarily been the result of inter-company agreements, such as that between OpenSea and Foundation (OpenSea, n.d.b). The royalty distribution process to date has been *centralised*, dependent entirely on the processes of the platform itself. As James Morgan (2021, para. 4), a co-founder of NFT platform and marketplace KnownOrigin, observed in July 2021:

> The vast majority of royalty implementations are different and do not conform to a standard, this leads to centralisation of tokens and royalty payouts, typically only applied when resale happens on the originating platform. This can also create an undesirable reliance on post-sale settlements in a non-obvious or obscure way. Not fulfilling one of the original and best value propositions for NFTs.

The administration of royalties at the platform level previously enabled OpenSea to withhold the payment of resale royalties for a number of weeks. Some have noted that the high costs of Ethereum gas fees have been part of the problem. As Christian Heidorn (n.d., para. 50) observes, "[t]his makes sense when you're paying out $100 in OpenSea royalties and paying $200 in gas to do so". In other words, delaying payments in order to payout in bulk allows OpenSea to save on

[5] We note that what was the first NFT is still debated. Some point to earlier iterations of text domain names minted in 2011 on the Namecoin blockchain, which was originally forked from bitcoin software.

[6] On the SuperRare website (Lauren, n.d., p. np), they note that their very first smart contract, the V1, was not the ERC721 standard. "SuperRare's first minting contracts, dubbed 'V1 contracts', were utilized from April 2018 to September 2019, up until the ERC721 NFT token standard was adopted".

gas fees. But some reported that OpenSea has withheld resale royalties longer than necessary. As Rami Al-Sabeq (2021, para. 5) stated:

> An artist by the name of Lance Ren was in a Clubhouse room discussing this particular issue when Jen Stein pinged the CEO of OpenSea into the room, Devin Finzer. He reportedly faced the group of angry users, and offered them his apologies in regards to the situation. According to Lance, Devin mentioned two reasons for the lack of forthcoming royalty payments: high gas fees and old architecture that has not scaled yet.

These issues raise the question of how *automated* the distribution of resale royalties for existing Ethereum-based NFTs really are. Indeed, built-in royalty standards in smart contracts are a surprisingly recent development.

5.3.3 A New Chapter for NFT Resale Royalties

A token standard for resale royalties built into the smart contract for NFTs was first introduced in September 2020. EIP 2981, created by Zach Burks, James Morgan, Blaine Malone, and James Seibel, was developed on the basis that:

> [w]ithout an agreed royalty payment standard, the NFT ecosystem will lack an effective means to collect royalties across all marketplaces and artists and other creators will not receive ongoing funding. This will hamper the growth and adoption of NFTs and demotivate NFT creators from minting new and innovative tokens. (Burks et al., 2020, para. 7)

EIP 2981 was designed to extend existing Ethereum smart contract standards, like ERC 721 and ERC 1155, to be compatible with token level royalty handling. To date, of the mainstream platforms, Rarible, NiftyGateway, Mintable, and OpenSea are now compatible with EIP 2981. However, even the standard itself notes that it is "a minimal, gas-efficient building block for further innovation in NFT royalty payments" (Burks et al., 2020, para. 2). This is because the standard only provides for the signalling of the royalty amount and the creator to whom the royalty should be paid. The deployment of the standard itself does not *automate* the payment of the resale royalty to the creator.

In March 2022, a proposal for "a standard for onchain Royalty Bearing NFTs" (highlander, n.d.), EIP 4910, was published. Created by John Wolpert, EIP 4910 is an extension of the ERC 721 standard that enables "the collection and distribution of royalties to BOTH creators and affiliates securely, immediately and irrevocably on-chain. EIP-4910 eliminates the risk of centralized platforms failing to pay royalties from secondary sales correctly or on time" (TreeTrunk, n.d). With the implementation of this new standard, the distribution of resale royalties is not entirely dependent on the lifespan of an NFT platform: "[i]f the platform that a creator is using to manage their NFTs disappears, their funds stay safely on the blockchain" (Harris, 2022, para. 15). From 8 November 2022, new collections launched on Open Sea will be able to set onchain enforcement of resale royalties using a tool that blocks marketplaces that don't support creator fees.

5.3.4 Australian Resale Royalty Legislation

Australia's resale royalty legislation, the *Resale Royalty Right for Visual Artists Act 2009* (Cth), was first introduced in 2010. Since its inception, 2300 artists and artist's estates have received one or more resale royalties from more than 25,000 sales (Copyright Agency, 2022). The scheme has been lauded for its impact in remote and regional locations, and its benefits to Aboriginal and Torres Strait Islander artists and communities (Copyright Agency, 2022).

In December 2019, a post-implementation review was published that surveyed the first three years of the *Resale Royalty Right for Visual Artists Act*'s operation – *The Post-Implementation Review – Resale Royalty Right for Visual Artists Act 2009 and the Resale Royalty Scheme* (Department of Infrastructure, Transport, Regional Development, Communications and the Arts, 2019). One of the

review's key findings was that stakeholder views were polarised, and that the legislation "is generally considered positively by artists and visual arts peak organisations and negatively by art market professionals and art investors, with some exceptions in all stakeholder groups" (Department of Infrastructure, Transport, Regional Development, Communications and the Arts, 2019, p. 9). However, with a five-year lag in releasing the report's findings, its usefulness is limited (Fairley, 2020), and contains no mention of how blockchain technology may be affecting the application of the *Resale Royalty Right for Visual Artists Act* or the resale royalties administration scheme.

The *Resale Royalty Right for Visual Artists Act* establishes a right "to receive a resale royalty on the commercial resale of an artwork" (Department of Infrastructure, Transport, Regional Development, Communications and the Arts, 2019, sec. 6). The amount of that resale royalty is set at "5% of the sale price" (sec. 18). An "artwork" is defined as "an original work of visual art" and includes a non-exhaustive list of types of works of visual art, including "digital artworks" and "multimedia artworks" (sec. 7). The right is granted to artists who are living and to beneficiaries of artists who are no longer living (up to 70 years) where the artist satisfies the "residency test" at the time of the resale. Under the legislation, the "residency test" is broad, in that it not only captures Australian citizens and permanent residents of Australia, but it also captures "a national or citizen of a country prescribed as a reciprocating country" (sec. 14). To that end, the Copyright Agency (2015) is in the process of establishing reciprocal arrangements in France, Germany, and the UK.

The resale right is only triggered under the *Resale Royalty Right for Visual Artists Act* if the sale price of the artwork is above the threshold of $1000, or "if the sale price is paid in a foreign currency, the amount worked out using the exchange rate applicable at the time of the commercial resale that is equivalent to $1,000" (sec. 10). Section 20 provides that the seller and the seller's agent or art market professional are "jointly and severally liable". The section further provides that if there is no agent for the seller, the buyer's agent acting as art market professional is liable, and if there are no agents for either seller or buyer, then the buyers are liable.

Under the *Resale Royalty Right for Visual Artists Act*, the Copyright Agency "must use its best endeavours to collect the resale royalty payable under this Act, and, if necessary, enforce any resale royalty right held under this Act, on the commercial resale of the artwork on behalf of the holder or holders of the resale royalty right" (sec. 23). The collection scheme administered by the Copyright Agency requires the seller and the seller's agent to report all resales to the Copyright Agency, unless the price paid for the artwork is less than the threshold of $1000, or the sale is a private sale between individuals, where no art market professional is involved (Copyright Agency, 2015). The Copyright Agency takes an administrative fee of 15% of the royalty collected, which supports administration of the scheme on behalf of rights holders and beneficiaries.

Currently it is unclear whether the resale of NFTs created by Australian artists triggers the application of the resale royalty right under the *Resale Royalty Right for Visual Artists Act*, and whether the resale of NFTs must be reported to the Copyright Agency under the scheme. This is partly the result of the terminology used in the legislation, which has been drafted with more traditional forms of marketplaces for art in mind, like auction houses and galleries. In particular, it is not clear whether the definitions of "commercial resale" and "art market professional" accommodate the resale of NFTs. Section 8 of the *Resale Royalty Right for Visual Artists Act* defines the commercial resale of an artwork as follows:

> (1) There is a commercial resale of an artwork if:
>
> > (a) ownership of the artwork is transferred from one person to another for monetary consideration; and
> >
> > (b) the transfer is not the first transfer of ownership of the artwork; and
> >
> > (c) the transfer is not otherwise one of an excluded class.

(2) The transfer of ownership of an artwork from one individual to another in circumstances that do not involve an art market professional acting in that capacity, is an excluded class of transfer.

(3) Art market professional means:

(a) an auctioneer; or

(b) the owner or operator of an art gallery; or

(c) the owner or operator of a museum; or

(d) an art dealer; or

(e) a person otherwise involved in the business of dealing in artworks.

To date, Australian courts have not had the opportunity to consider the application of *the Resale Royalty Right for Visual Artists Act* in general, let alone Section 8.[7] However, the Revised Explanatory Memorandum for the Royalty Right for Visual Artists Bill (2009 (Cth), p. 5) does provide that "the definition of a commercial resale is limited to transfers of ownership for *monetary* consideration to assist with ease of administration". This could potentially be interpreted to mean that transfers of ownership for consideration in the form of cryptocurrency should be excluded.

The definition of "art market professional" also poses a challenge to the application of NFT resales under the *Resale Royalty Right for Visual Artists Act*. As Birgit Clark and Courtenay Whitford (2021, p. 62) have suggested, "NFTs sold via online crypto market-places are unlikely to benefit from the Australian resale royalties regime unless sold by a gallery, museum, auctioneer or person otherwise in the business of art dealing". Notwithstanding their point of view, the Revised Explanatory Memorandum does suggest a somewhat wider interpretation of an "art market professional":

> The term 'person otherwise in the business of dealing in artworks' covers commercial operators whose primary business is not dealing in artworks *but who engage in the business of selling artwork on a fairly regular basis* [emphasis added], such as a café-owner who regularly displays art for sale on the café walls, or a specialist antique dealer who regularly deals in a mix of artworks and furniture. However, it does not capture businesses that only sell artworks on a very occasional or intermittent basis because of the increased difficulty in monitoring and administering the scheme if such sales were included, and the unreasonable additional regulatory burden this would place on such operators. (Revised Explanatory Memorandum, Resale Royal Right for Visual Artists Bill 2008 (Cth), p. 6)

It could well be said that in the present day, NFT platforms and marketplaces *are* in the business of selling digital artworks on a regular basis. As such, where an NFT is resold via an online marketplace, it is arguable that a commercial resale of an artwork has taken place for the purposes of the Act.

As for the question of whether the resale of NFTs must be reported to the Copyright Agency, or indeed, are captured in the Copyright Agency's Notice of Resale, no public guidance has been provided by the Copyright Agency to date. A review of the publicly available Notice of Resale records does not identify any NFT sales (Copyright Agency, n.d.).

[7] The Act has been referred to in one reported case to date, *Australian Competition and Consumer Commission v Birubi Art Pty Ltd* (in liq) (No 3) [2019] FCA 996 at [39]. In addition, section 6 of the recently introduced *Resale Royalty Right for Visual Artists Regulations 2021* (Cth) provides that a transfer of ownership of an artwork for less than $1,000 is an excluded class of transfer such that reporting of the transfer to the Copyright Agency is not required.

5.3.5 Copyright Agency and Desart

Notwithstanding the above-mentioned uncertainties with respect to the *Resale Royalty Right for Visual Artists Act* and the scheme, the Copyright Agency has made attempts to trial blockchain technology in Australia in other ways. In 2018, with support from the Federal Government and in collaboration with Desart, the peak body for central Australian Aboriginal art centres, the Copyright Agency launched a pilot blockchain designed to assist with the tracking of physical artworks originating from three remote central Australian Aboriginal art centres. The pilot was initiated in response to what then-CEO of the Copyright Agency Adam Suckling described as "the serious problem of art and craft merchandise being passed off as authentically Aboriginal and Torres Strait Islander" (Copyright Agency, 2018, para. 5). Reflecting back on the project last year, the Copyright Agency (2021, paras. 5-6) explained:

> We worked with select art centres and art market professionals involved in primary and secondary sales. We considered the operating environment and needs of all parties from the creation of the work through to the sales process. With an eye on what worked well and what could be improved, we reviewed blockchain and a variety of technologies that track supply chains. To test and build our understanding of blockchain, we developed an application on the Ethereum blockchain.
>
> Having completed our research and built a test visual arts blockchain, we found that blockchain technology is well developed and functioning effectively for digital uses like Bitcoin. In visual arts rights management, it can offer automation and efficiency; however, this needs more development in ensuring data integrity for physical works onto the blockchain. There are some very effective methods for uniquely tagging physical works, but more needs to be done on the associated business practices to ensure accuracy.

The Copyright Agency (2021, para. 7) also expressed their commitment to engaging with "all visual arts blockchain organisations" as part of their role in managing the resale royalty scheme.

5.3.6 Resale Entitlements for Australian NFT Artists

So where do these uncertainties around the interaction of the *Resale Royalty Right for Visual Artists Act* and the resale royalty scheme leave Australian artists who are creators of NFTs? While our research shows that Australian artists have been paid royalties for NFTs by NFT platforms and marketplaces, none of the artists interviewed had any interaction with the Copyright Agency or the scheme to date. Nor is it clear whether Australian-owned NFT platforms and marketplaces have contemplated their reporting obligations, let alone liabilities, under the legislation.

5.4 NFTs and Consumer Law

Consumers and businesses may also have protection in relation to the buying and selling of NFTs under consumer protection law. The *Competition and Consumer Act 2010* (Cth) contains a broad provision that provides that "a person must not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive" (sec. 18.1). This provision is commonly relied on where an instance of 'ripping off' has allegedly occurred.

A similar provision under US consumer law was relied on by the purchaser of a *Rare Pepe* NFT to file a legal claim against creator Matt Furie and his companies, including a DAO and the limited liability company that operates the DAO. According to case documents (United States District Court for the Central District of California Western Division, n.d.), "the *Pepe* NFT was touted in the advertisement as 'a piece of blockchain history, originally minted in 2016'. The advertisement explained that 500 of this *Pepe* NFT were 'issued', 400 were 'burned' (i.e., destroyed), '99 will remain in the PegzDAO', and only 'ONE is being auctioned here'". Relying on these representations, the purchaser placed a winning bid. 46 of the 99 remaining *Pepe* NFTs were then released, which the purchaser argued significantly devalued their *Pepe* NFT. This case

demonstrates that creators of NFT projects need to be careful not to change their approach after a sale, particularly if it disadvantages NFT owners.

Part 5 Summary

The law has always played catch up with technology. In this sense, the legal complexities of NFTs are not new. Just as web2.0 required law-making to deal with new problems in piracy, privacy, the right to be forgotten, intermediary (platform) liability, and online harm, so web3 is raising a new set of challenges and opportunities. These include questions about who has authorship when an artwork is created by a non-human entity (e.g., AI and generative art), how or whether licences can be transferred along with a token, and whether a DAO can own intellectual property. Some of the legal grey areas outlined above will only be resolved through the courts and legislature over time, and some may require amendments to existing laws before any certainty can be achieved. In the meantime, the onus is on creators and buyers to assess the risks and seek legal advice where necessary.

Disclaimer

The contents of this report, including Part 5, are not legal advice and should not be considered as such.

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