

Once Upon a Time in NFT: Blockchain, Copyright and the Right of First Sale Doctrine

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In 2014 the legendary hip hop group Wu-Tang Clan announced that it had recorded *Once Upon a Time in Shaolin*, a double album produced in secret over the course of six years. The album was limited to a single physical copy, stored in a secured vault, and auctioned through auction house Paddle8 for a winning bid of \$2,000,000 in 2015. The purchase included contractual terms stating that the album could not be commercially exploited by the subsequent owner until the year 2103.

The concept behind the creation was explained by Wu-Tang Clan as follows:

“History demonstrates that great musicians such as Bach, Beethoven and Mozart were held in profoundly high esteem. They were considered sublime artists and masters of exploring emotion. Their work forged windows into the most elusive elements of the human experience. And yet in our time, music is no longer perceived in the same way.

“Perhaps it is our cultural attitudes to modern music that have cast it as something to be consumed. The complacency of no holds barred access and the saturation wrought by technology’s erosion of challenges. Mass replication has fundamentally changed the way we view a piece of recorded music, while digital universality and vanishing physicality have broken our emotional bond with a piece of music as an artwork and a deeply personal treasure.

“By adopting an approach to music that traces its lineage back through The Enlightenment, the Baroque and the Renaissance, we hope to reawaken age old perceptions of music as truly monumental art. In doing so, we hope to inspire and intensify urgent debates about the future of music, both economically and in how our generation experiences it. We hope to steer those debates toward more radical solutions and provoke questions about the value and perception of music as a work of art in today’s world.”

*The RZA & Cilvaringz
Wu-Tang Clan*

Once Upon a Time in Shaolin demonstrates the clear delineation between how tangible and intangible property is treated and draws attention to some of the problems inherent in such treatment, particularly with respect to artistic works. Technology has, in many ways, changed the arts for the better. The RZA and Cilvaringz are right, however, in their assertion that digital dissemination has fundamentally contributed to the loss of emotional connection and a feeling of reverence, or “specialness”, toward a specific work.

A technology that may have a hand in changing all of that is blockchain (or, to be more inclusive, distributed ledger technology). Blockchain allows information to be recorded and distributed among multiple parties on a decentralized ledger. Once the information is verified and stored on the blockchain it is immutable. American entrepreneur Marc Andreessen described the practical consequence of such a technology best, stating that it is, “...for the first time, a way for one Internet user to transfer a unique piece of digital property to another Internet user, such that the transfer is guaranteed to be safe and secure, everyone knows that the transfer has taken place, and nobody can challenge the legitimacy of the transfer.”

One of the types of digital property developed and transferable using blockchain technology is the non-fungible token, or NFT. An NFT represents something unique and, along with providing verifiable authenticity and ownership, creates digital scarcity. NFTs are new and the best uses cases for them likely have yet to be developed. Thinking of *Once Upon a Time in Shaolin*, however, opens the imagination to possibilities for all forms of digital art.

As one might expect, however, regulation has yet to catch up with these recent technological advances. Questions abound with respect to blockchain technology in relation to securities, tax, intellectual property and other applicable laws.

One area of law in need of a technology-friendly upgrade, particularly with respect to NFTs and transfers of ownership via blockchain technology, is United States Copyright Law. For the very first time NFTs provide the potential to fully own digital property. While certain legal aspects of ownership with respect to tangible works of art fall under property law, it is copyright law that governs intangible rights.

Under U.S. copyright law a number of limitations exist with respect to copyright ownership. One of these limitations is known as the first-sale doctrine. Under 17 U.S.C. § 109 it is legal to resell or otherwise dispose of physical copies of copyrighted works. If you need to sell an oil painting from your private collection, for instance, you do not need to obtain the permission of the artist. Same goes for books, albums, memorabilia, etc.

Digital copies, however, are a different story. In 2001 the U.S. Copyright Office published an opinion stating that a digital first sale right could not exist due to the non-fungibility of digital works which are, by their very nature, copies. A recent case, *Capitol Records LLC v. ReDigi Inc.*, confirmed the 2001 opinion.

ReDigi Inc. had operated a website that allowed it users to resell their legally obtained digital music files to other users. ReDigi’s platform required users to download software that evaluated the original file had been lawfully purchased. Once a file was sold it was transferred in its entirety and the original owner no longer had access. Capitol Records sued ReDigi Inc., claiming that ReDigi had violated Capitol Records’ reproduction rights in the musical works. The Second Circuit ruled in favor of Capitol Records, stating that as it was impossible to transfer a digital file without making a copy, such transfer would be subject to a copyright owner’s ongoing reproduction right as opposed to the distribution right limited by the first-sale doctrine.

There are, of course, legitimate reasons as to why the first-sale doctrine is limited to distribution. Disseminated content relies on financial revenue streams through reproduction. At the same time this poses a challenge for the proliferation of NFTs. Although blockchain technology can help alleviate some of the concerns surrounding digital copies, such as provenance, the very act of a *copy* of a work being added onto a blockchain ledger renders a digital first sale impossible. Copyright law maintains that a work be tangible or physical in order to fall within the first-sale doctrine. The distinction made between tangible and intangible is antiquated but, absent legislation, is codified into the Copyright Act and therefore upheld by courts.

This is disconcerting not only for creators of NFTs but, more importantly, for purchasers. It is quite possible that, absent contractual language, a court would uphold certain rights of the NFT creator in the event of resale under 17 U.S.C. § 109, thereby negating some of the touted benefits of NFTs.

Under Copyright law any or all of a copyright owner's exclusive rights can be transferred. The transfer, however, generally must be made in writing and signed by the owner of the rights conveyed or the owner's authorized agent. Transferring a right on a nonexclusive basis does not require a written agreement. A transfer of copyright ownership can be recorded with the Copyright Office. Although recordation is not required to perfect a transfer it provides certain advantages such as priority between conflicting transfers and constructive notice to third parties. In addition, some courts have held that a security interest in a registered work must be recorded with the U.S. Copyright Office in order to perfect the creditor's interest.

Given the proliferation of new technologies such as blockchain and non-fungible tokens perhaps it is time for Congress to revisit 17 U.S.C. § 109. In the interim it is important, therefore, that buyers of NFTs be aware of these potential legal pitfalls and retain qualified legal counsel to review title and contractual terms of sale. In addition creators of NFTs should, for this and a number of other reasons, register the works with the U.S. Copyright Office in order to preserve valuable rights.