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NFTs: Beyond Digital Art and Collectibles

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The first major boom of non-fungible tokens (NFTs) began in March 2021 when digital artist Mike Winkelmann, professionally known as Beeple, partnered with famed auction house Christie's and sold an NFT of his work titled *Everydays – The First 5000 Days* for $69M USD. In early May, the NFT market recorded a peak of $170M USD over a seven-day period. While this first boom of NFTs has largely been driven by digital art and collectibles, such as NBA Top Shot and CryptoPunks, the next wave of the NFT market could be catalyzed by other interesting uses. These uses can have disruptive effects on a variety of traditional industries and markets ranging from entertainment to sports to intellectual property. This article focuses on the uses that have the most potential to endure as a fixture in different industries and the possible implications of such use cases. (For a primer on blockchain technology and NFTs, please see our article from March 31, 2021, *NFTs: A Primer on the Trending Crypto Phenomenon*.)

Entertainment: Royalties

Traditional recording and performance contracts contain royalty clauses, which are often administered by one party and audited infrequently by the counterparty. This necessitates a level of trust between the two parties and involves intermediaries to calculate the royalties collected, owed, and distributed. With smart contracts, an emerging technology enabled by blockchain, the royalty distribution process can be streamlined and automated.

A smart contract is a computer code that is stored on a blockchain-based platform and automatically executes all or parts of an agreement when certain predetermined conditions are met. In other words, a smart contract functions as an "if/then" statement – if all conditions precedent programmed into the smart contract are met, then the contract is activated, and the transaction is completed (presumably through the release of money to the receiver).

In the entertainment industry, the parties entitled to royalties on a piece of creative work can record and validate their claims on the blockchain through NFTs, which act as a digital certificate of authentication. Smart contracts can then be set up and connected to digital streaming platforms, such as Spotify and Netflix, such that for every stream of the creative work, the corresponding royalty is accurately split among the contributors and automatically released to them. Smart contracts for automated payments already have precedent in the insurance industry, where French insurance company, AXA, has launched Fizzy, which uses smart contracts connected to global air traffic databases to trigger insurance payments to the insured whenever a delay of over two hours occurs. In April 2017, Spotify acquired Mediachain, a blockchain startup that developed a protocol for registering, identifying, and tracking creative works across the Internet, a year after Spotify reached a settlement over unmatched and unpaid song royalties.

Beyond distributing royalties to the original contributors of creative work, NFTs can also be used to fractionalize ownership of royalty streams, presenting new avenues of income for creators. In early June 2021, Anthony Martini, manager of musician Lil Dicky and CEO of music royalties marketplace Royalty Exchange, announced that he would be selling his share of the publishing royalty stream for Lil Dicky's 2015 hit "Save Dat Money" as an NFT on Royalty Exchange. This is an interesting take on the recent trend of music catalogue sales by musicians, as Martini is similarly cashing out his future royalties at present value. However, as the NFT sale of the royalty stream will contain a smart contract, any subsequent resale of the NFT will entitle Martini to a portion of those transactions as well – a potentially lucrative proposition for Martini if the value of the royalty stream grows. In return, the buyer will be entitled to a passive income stream through the royalties.

Sports: Ticket Authentication

Sports teams (and other entertainment events) have struggled with preventing the counterfeiting of tickets for many years. Whether it is websites set up to appear like official box offices of a sports team or individuals purporting to offer tickets for resale, it can be nearly impossible at times for fans to know whether they are purchasing an authentic ticket just by looking at it. In the end, a fan's disappointment from being turned away at the gate harms the team's relationship with its fanbase.

Leveraging the authentication capability of NFTs can potentially revolutionize ticket sales. With an NFT to certify that a ticket, whether from a primary or resale marketplace, is authentic, customers can gain confidence in their purchases knowing that counterfeiters would not be able to replicate the immutability of NFTs. This would also create a more competitive and accessible ticket marketplace – for sellers, they can list at competitive prices knowing that there are no counterfeiters undercutting the prices with fake tickets, and for buyers, they can compare ticket options from different vendors knowing that they will be purchasing exactly what they intend to buy.

Furthermore, again through smart contracts, the use of NFTs in ticket sales can also increase the benefit to the primary ticketer. A smart contract can be programmed into every primary ticket sale, such that if the ticket is then resold on a secondary marketplace, the smart contract is automatically executed to give a portion of the profits to the primary ticketer. This would open up a lucrative revenue stream for sports teams through the resale market from which it was previously difficult to benefit.

Intellectual Property: Patent Marketplace

For all of the discussions about the legal considerations of intellectual property (IP) rights surrounding NFTs, it is perhaps ironic that NFTs may soon help to unlock greater value for a key type of IP: patents. In April 2021, IBM, one of the world's leaders in patent ownership, announced plans to work with IPwe, an IP specialist firm. According to IBM's announcement, this would allow the company to tokenize patents as NFTs in order to create an infrastructure for storing patent records on a blockchain-based network and to develop a marketplace in which patent holders can more easily sell, trade, commercialize, or otherwise monetize their patents, which would bring new liquidity to the asset class.

As patents already require authentication through the government's patent system, converting the physical patent certificate into an NFT would be simple. A marketplace would then allow users to search for descriptions and/or metadata associated with each patent, and the patent holder's contact information stored on the blockchain would help interested buyers facilitate a transaction, such as a licence or a sale, eliminating the resources needed to track down and contact the seller. The patent NFTs can even use smart contracts to determine a set price for a licence or purchase, such that any buyer satisfied with the conditions can pay and immediately unlock the rights to the patent without either parties ever having to interact directly.

While patents are currently regulated jurisdictionally around the world, a blockchain-based patent marketplace using NFTs can reduce the geographical barriers between patent systems using as simple a tool as a search query. The ease of access to patents globally can help aspiring inventors accelerate the innovative process by building upon others' patented inventions through licences.

Legal Considerations

Despite these promising uses for NFTs, the industry remains unpredictable due to the absence of legislation anywhere in the world. In June 2018, the Canadian Securities Administrators (CSA) wrote in their Staff Notice 46-308, under use case 14, that where "tokens are not fungible or interchangeable and each token has unique characteristics that result in the purchaser exercising their personal preferences to value it as a mode of entertainment or as a collectible item," the possible implication under securities law is that "the value of the token may be based on its unique characteristics, and not on the effort of others," and therefore, it does not satisfy the broad definition of a security. However, as the uses of NFTs diversify from collectibles, each instance will likely produce more clarity on the applicable regulatory guidance.

Furthermore, with NFTs enabling automated transfers of property, rights, and money, buyers and sellers should make sure they fully understand the terms of the transaction, as the immutability of NFTs also means that these transactions cannot be reversed or rectified without considerable effort and resources. The use of smart contracts also means that the seller may have remaining rights after the transaction that could affect the buyer's rights. In any of the scenarios described above, you should consult a professional to ensure that you understand what you are buying or selling and what rights you have after the transaction.

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