

ONCE UPON A TIME IN NFT: BLOCKCHAIN, COPYRIGHT, AND THE RIGHT OF FIRST SALE DOCTRINE[♦]

KATYA FISHER, ESQ.^{*}

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.¹ 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 two million dollars in 2015.² The purchase included contractual terms stating that the album could not be commercially exploited by the subsequent owner until the year 2103.³

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

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^{*} Katya Fisher, Esq. is an attorney representing international businesses and entrepreneurs with a specific focus on media and technologies such as blockchain, cybersecurity, cryptocurrency, and A.I. A graduate of New York University and Benjamin N. Cardozo School of Law, Katya is a former Howard M. Squadron Fellow at the University of Oxford's Programme in Comparative Media Law and Policy and has been selected to Super Lawyers as a "Rising Star" in Corporate Law in 2014, 2015, 2016, 2017, and 2018. She is licensed in the state of New York and before the U.S. Tax Court. The author would like to thank Freeman Lewin for his research and editorial assistance.

¹ Tshepo Mokoena, *Wu-Tang Clan: Unique Copy of Album Will Be Sold by Online Auction*, GUARDIAN (Jan. 8, 2015), <https://www.theguardian.com/music/2015/jan/08/wu-tang-clan-once-upon-time-shaolin-auction-paddle8>.

² Ben Sisario, *How Much Is Martin Shkreli's One-of-a-Kind Wu-Tang Album Worth?*, N.Y. TIMES (Mar. 9, 2018), <https://www.nytimes.com/2018/03/09/business/media/martin-shkreli-wu-tang-clan.html>.

³ Shawn Christ, *Wu-Tang Clan Issue Statement to Clarify 'Once Upon a Time in Shaolin' Release*, MUSIC TIMES (Mar. 6, 2015), <https://www.musictimes.com/articles/30821/20150306/wu-tang-clan-statement-once-upon-time-shaolin-release.htm>.

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*⁴

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 technology is best described as a database maintained by a distributed network of computers. Public permissioned blockchains allow information to be recorded and distributed among multiple parties on a decentralized ledger. Once the information is verified and stored on a blockchain network, it becomes tamper-resistant, resilient, and non-repudiable.⁵ 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

⁴ The RZA & Cilvaringz, *Since Time Immemorial*, SHLUZAY, <http://scluzay.com/conceptus> (last visited Apr. 4, 2019) (emphasis added).

⁵ See ARVIND NARAYANAN ET AL., BITCOIN AND CRYPTOCURRENCY TECHNOLOGIES: A COMPREHENSIVE INTRODUCTION (2016).

taken place, and nobody can challenge the legitimacy of the transfer.”⁶

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.⁷ 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, regulation has yet to catch up with these recent technological advances. Questions are 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. 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. And thus, while NFTs provide the potential to fully own digital property, there remain issues associated with the recordation of these works on a blockchain, which necessarily requires continuous replication.

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. 17 U.S.C. § 109 provides that it is legal to resell or otherwise dispose of physical copies of copyrighted works. As a result of the first-sale doctrine, the sale of an oil painting from your private collection, for instance, does not require that you obtain permission from 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.⁸ A recent case, *Capitol Records LLC v. ReDigi Inc.*, confirmed the 2001 opinion.⁹

ReDigi Inc. had operated a website that allowed its users to resell their legally obtained digital music files to other users. ReDigi’s platform required users to download a software that verified 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.

⁶ Marc Andreessen, *Why Bitcoin Matters*, N.Y. TIMES (Jan. 21, 2014), <https://dealbook.nytimes.com/2014/01/21/why-bitcoin-matters>.

⁷ See, e.g., *The Plentiful Virtues of Digital Scarcity*, WACHSMAN, <https://wachsman.com/the-plentiful-virtues-of-digital-scarcity> (last visited May 21, 2019).

⁸ U.S. COPYRIGHT OFFICE, DMCA SECTION 104 REPORT (2001).

⁹ *Capitol Records LLC v. ReDigi Inc.*, 934 F. Supp. 2d 640 (S.D.N.Y. 2013).

Capitol Records LLC sued ReDigi, claiming that ReDigi had violated Capitol Records' reproduction rights in the musical works. The Second Circuit ruled in favor of Capital Records, stating that since it was impossible to transfer a digital file without making a copy, such a transfer would be subject to a copyright owner's ongoing reproduction right, as opposed to the distribution right limited by the first-sale doctrine.¹⁰

There are, of course, legitimate reasons as to why the first-sale doctrine is limited to distribution, as opposed to reproduction. Disseminated content relies on financial revenue streams through reproduction. 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.¹¹ The distinction made between tangible and intangible may be 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 a 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.¹² Transferring a right on a nonexclusive basis does not require a written agreement.¹³ A transfer of copyright ownership can be recorded with the Copyright Office.¹⁴ 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.¹⁵

¹⁰ *Id.*

¹¹ See R. Anthony Reese, *The First Sale Doctrine in the Era of Digital Networks*, SOC. SCI. RES. NETWORK (Nov. 30, 2003), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=463620.

¹² 17 U.S.C. § 204(a) (2018).

¹³ 17 U.S.C. § 101 relieves a non-exclusive license from the operation of 17 U.S.C. § 204(a). The grant of a non-exclusive license can be oral or inferred through conduct.

¹⁴ 17 U.S.C. § 205(a).

¹⁵ See *In re Peregrine Entm't Ltd.*, 116 B.R. 194 (C.D. Cal. 1990) (holding that the only way to perfect a security interest in copyrighted works was to record the security interest with the U.S. Copyright Office).

To that end, the value of an NFT may be further impacted by its status in bankruptcy. In the traditional art market, lending money against tangible art is big business. In 2017, Deloitte estimated that the art lending business was worth between seventeen billion and twenty billion dollars.¹⁶ Many of the loans are arranged using art as the only collateral. In these transactions, ownership is established through perfection, which is established through a simple process of filing a Uniform Commercial Code-1 financing statement with the Secretary of State of the jurisdiction where the borrower or entity resides or is organized.¹⁷ Perfection, and thereby notice, is necessary because it establishes the lender's position in the order of parties who may have an interest in the art in the event of, say, a bankruptcy.¹⁸

While the U.C.C. Article 9 was intended to govern transactions of security interests in personal property, including general intangibles, mainly trademarks, copyrights, and patents, a lender seeking to perfect his or her ownership over an I.P. owner's copyright must look to federal law. This is because U.C.C. Section 9-109(c) provides that Article 9 does not apply to a security interest subject to a federal statute "to the extent that a statute, regulation, or treaty of the United States preempts this article."¹⁹ Copyrights are the subject of such statutes and may therefore not fall under Article 9 protections.

Indeed, in *In re Avalon Software Inc.*, the court cited to a string of cases and held that a security interest in a copyright is only perfected when filed with the Copyright Office.²⁰ Further, the court held that ultimate perfection depends on the registration of the product.²¹ However, this proposition has been rejected by the Ninth Circuit in *In re World Auxiliary Power Co.* to the extent that it extends to unregistered copyrights.²² There, the court agreed that security interests in registered copyrights can only be perfected by filing with the Copyright Office, but maintained that the perfection of unregistered copyrights is governed by state law. Thus, a U.C.C. filing is not insufficient to perfect a security interest in a copyright unless the security at issue pertains to a registered copyright.

Perfection of security interests in registered copyrights through federal filing raises a myriad of logistical issues inherent to the

¹⁶ Anna Louie Sussman, *Why the Ultra-Wealthy Borrow Billions, Using their Precious Art Collections*, ARTSY (Aug. 23, 2018, 6:01 PM), <https://www.artsy.net/article/artsy-editorial-art-loans-popular-ultra-wealthy-good-economic-times-bad>.

¹⁷ See U.C.C. § 9-301 (AM. LAW INST. & UNIF. LAW COMM'N 2010) (setting out a comprehensive scheme for the regulation of security interests in personal property).

¹⁸ Naturally, possession trumps filing. Therefore, in the case of art-secured transactions, lenders normally move the art to art storage facilities.

¹⁹ U.C.C. § 9-109(c).

²⁰ *In re Avalon Software Inc.*, 209 B.R. 517 (Bankr. D. Ariz. 1997).

²¹ *Id.* at 522.

²² *In re World Auxiliary Power Co.*, 303 F.3d 1120, 1128 (9th Cir. 2002).

copyright registration and filing system. These issues, related to timing, recordation, and deposit, are made worse when considering that federal courts may disagree with the holding in *In re World Auxiliary Power Co.* Therefore, at least for now, the marketability of NFTs' viable pieces for use in the art-secured loan market may be greatly hampered by current legal uncertainty and logistical challenges.

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 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 consider, for this and a number of other reasons, registering NFT-based works with the U.S. Copyright Office in order to preserve their valuable rights.