

# Navigating Contractual Relationships in the NFT Market



## Overview of Common NFT Contractual Relationships

Participants in the fast-moving - but legally uncertain - non-fungible token (NFT) marketplace can maximize their business opportunities and mitigate risk by delineating their specific role early and clearly defining where their obligations begin and where their responsibilities end. Understanding and defining your role, and the role of your counterparties, is critical. Here are some of the key contractual relationships that NFT market participants can expect to encounter.

### 1. Seller Terms of Use

The artist who creates the underlying media content that is linked to the NFT (NFT Media) legally owns the intellectual property rights to the artwork. Unless the artist conveys these rights in selling the NFT, a buyer does not automatically receive the right to commercially exploit the artwork. The terms of use for the NFT sale will govern what an NFT buyer can and cannot do with the NFT and NFT Media.

### 2. Trading Platform Terms of Use and Agreements

Trading platforms where NFTs can be created, listed, sold or bought will have terms of use that govern the responsibilities and disclaimers of the NFT marketplace operator toward its customers. These terms of use will also apply between buyers and sellers of the NFTs featured on the trading platform. NFT trading platforms may also enter into specific agreements with NFT sellers or technical vendors.

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### 3. Technical Vendor Agreements

NFT sellers often hire technical vendors to perform NFT customizations and other deliverables on behalf of the seller, such as create or mint NFTs, process the NFT sale, or provide cloud accounts or decentralized storage solutions for hosting the NFT Media. These agreements may include certain work-for-hire provisions.

### 4. Cryptocurrency Payment Processor and Exchange Agreements

Cryptocurrency payment processors allow NFT sellers to accept cryptocurrency payments and convert those cryptocurrency payments to fiat currency. In some cases, these services may extend to exchange- and wallet-hosting services that allow NFT sellers to store cryptocurrencies, and even store NFTs, in hosted wallets. These agreements govern the use of cryptocurrency payment gateways, and cryptocurrency and NFT custody, for NFT sellers.

### 5. Intellectual Property Agreements Related to NFT Media

The artist of media that is used to create an NFT can modify the original media to create new NFT Media that is jointly owned by the artist and a second owner without encroaching on the sole copyright of the original artist. Agreements between the original copyright owner and any joint owners in the new NFT Media will govern this relationship.

### 6. Sale Agreements Related to Commercial Exploitation of NFTs

Third-party vendors may provide display and viewing opportunities for NFT owners, such as digital art frames that give NFTs a lifelike form and virtual land (e.g., digital malls) to show off NFTs. Opportunities for use of NFTs in the metaverse may also be offered by certain third-party vendors. Terms of use, and sometimes bespoke agreements, will govern relationships with these vendors.

## Key Issues to Address/Consider in NFT Contractual Relationships

Although NFTs are fraught with legal issues that have yet to be explored, the business opportunities in the NFT marketplace show no signs of slowing down. On the seller side, the main goal is often to secure future revenue from an NFT through initial sales and perpetual royalties. On the buyer side, the main goal is often to leverage the NFT for various consumptive or other benefits. On the third-party vendor side, the main goal is to extract the value of the deal without lingering obligations after performance is completed. These different interests mean, among other things, an increased focus on

negotiations over rights such as the underlying intellectual property rights of the seller, the resale rights limitations of the buyer and the controlled access by the third-party vendor. As these negotiations develop, there are some key contractual provisions to consider.

#### 1. Defining the 'Services'

Vendors should clearly define the scope of their services and avoid tertiary obligations past their services under use or service agreements. Terms and conditions for the sale of an NFT in the primary marketplace should align with consumer protection laws to prevent misleading a buyer into buying stolen work, a trademarked brand or a celebrity likeness.

#### 2. Perpetual Royalties

It is in the artist's and/or NFT seller's best commercial interest to receive future royalties from any subsequent sale(s) of the NFT in the secondary marketplace. After all, royalties can grow over time as the NFT appreciates in value in the secondary market. To the greatest extent practicable, royalty rights should be both articulated in contract terms and programmed into smart contracts code, to ensure that NFT artists and sellers receive royalties as designated.

#### 3. Rights in the NFT Media

##### a. Reproduction/Monetization


The right to exploit the NFT for commercial gain depends in large part on whether, and to what extent, the seller actually conveys the underlying intellectual property rights with the transfer of the NFT. The rights of NFT sellers and buyers should be explicitly defined in this regard. Key intellectual property issues to consider include rights in the media used to generate the new NFT Media as well as rights of the copyright owner(s) to use the NFT Media vis-à-vis NFT buyers, any other contract parties or other third parties that may have an interest in marketing the NFTs.

##### b. Display, View, Use

At the very least, the buyer of an NFT receives the basic bragging rights that come with owning an NFT. Basic NFT buyer rights should present ample opportunities for the buyer to enjoy the NFT, such as displaying it in a metaverse or using it in a gaming application. However, any rights beyond display, view and consumptive use should be carefully considered before being provided to NFT buyers.

##### c. Offensive/Inappropriate Content

While no clear distinction exists between art and adult content, some NFTs have already been taken down for allegations of inappropriateness, or sometimes even without an explanation as to why. If necessary, adult content should be carefully crafted



when incorporating it into an NFT. Additionally, NFT marketplaces and sellers should consider contract terms that grant protections from offensive and inappropriate content in an NFT that may cause business disruption or reputational damage.

#### 4. Smart Contracts

Smart contract coding and deployment will often be a core component of agreements related to NFTs. One key issue that parties should consider, and memorialize in contract terms, is whether or not the NFT smart contract will be programmed with a “kill switch” that allows the smart contract code to be altered or updated.

In certain circumstances, there may be advantages to programming the smart contract without a kill switch. For example, the absence of a kill switch may provide the market with a higher degree of confidence that the NFTs will not be altered post-sale. On the other hand, the ability to alter smart contracts code may offer certain advantages, especially as the technology continues to develop and new technical functionality becomes available. One particular area of relevance here relates to securing perpetual royalty features. As the open-source coding community continues to find creative ways to improve perpetual royalty functionality, NFT sellers may benefit from being able to implement smart contract upgrades to enhance these capabilities as new techniques are deployed, tested and validated.

Third-party audit rights are another area that should be considered. Providing for a third-party technical audit of the smart contract code will provide assurance that the code will function as intended. The cost of a third-party technical audit, and the costs of any work required to correct any identified deficiencies, is a point of contract negotiation. Similarly, the parties may have an interest in defining certain key smart contract functions and designating responsibilities and remedies in the event these functions are not implemented correctly.

#### 5. Data Privacy and Security

Data privacy issues should be carefully considered during NFT contract negotiations. At a minimum, contract terms should address privacy policies and compliance with applicable privacy laws. Depending on the nature of the transaction, additional data privacy issues may need to be incorporated, such as remedies for privacy violations and data breaches as well as related insurance and

indemnification. Security incidents and notification procedures should be clearly defined. In some cases, a separate data privacy and security addendum may be appropriate.

#### 6. Access to Sales/Customer Data or Other Valuable Data

In some cases, technical service agreements involving NFTs may result in the collection and generation of valuable data. In these instances, data privacy provisions will have to be integrated with provisions that govern the rights of the parties to access, use and claim ownership of certain data. This data may be especially valuable because the NFT market is so new and reliable market benchmarking data is not readily available. In some instances, one contract party may seek ownership of certain data while the other party may seek a limited license to use the data in a way that mutually benefits the parties. The parameters of these arrangements should be well evaluated and clearly defined in the contract terms. To the extent that a party is allowed to maintain and use data owned by the other party, the contract terms should articulate standards for anonymizing and/or de-identifying any data that could be considered personal data under applicable privacy laws.

#### 7. Digital Millennium Copyright Act

The Digital Millennium Copyright Act (DMCA) will provide certain remedies in scenarios where NFTs are created and sold using NFT Media in a manner that violates a third-party’s copyright. NFT marketplaces and other vendors involved in the minting and initial sale of NFTs should have a clear DMCA public notice as well as an internal DMCA response plan to combat intellectual property violations. DMCA notice procedures and a designated DMCA agent are also required and should be incorporated into terms of use.

#### 8. Standard Terms Are No Longer Standard

As with the cryptocurrency market, the unique aspects of the NFT market call for certain updates to contract clauses that typically govern things like termination, indemnification, limitation of liability and other concepts that are sometimes thought of as standard clauses. With respect to termination, market conditions may call for provisions that reflect the evolving balance of power between different market participants. Indemnification and limitation of liability provisions should address copyright/intellectual property, technical aspects of decentralized blockchain networks and other NFT-specific issues.

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