Proskauer

Part II: When You Jump Chains, Do NFTs Stay the Same? Ordinals on the Bitcoin Blockchain

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As discussed in **Part I** of this series, Ordinals are a pioneering new method of utilizing the Bitcoin blockchain that will usher in new and innovative use cases on Bitcoin. As promised, in **Part II** we will discuss the implications for creators and owners.

Implications of Ordinal NFTs for Creators and Owners

As with most crypto innovation, capable users quickly flocked to the shiny new object. Copies of popular Ethereum NFT projects began appearing on the Bitcoin blockchain after the Ordinals launch. For example, a clone of CryptoPunks, named Ordinal Punks, popped up and is reportedly gaining traction. Further, the owner of Bored Ape Yacht Club ("BAYC") #1626 permanently removed the NFT from its spot as one of the most valuable in the space by "burning" it, then inscribing the NFT on Bitcoin using Ordinals. While the owner of BAYC #1626 effectively deleted – or symbolically transferred – the NFT, it appears that some NFT creators are not purists and are willing to experiment on Bitcoin. For example, Yuga Labs, the creator behind the Bored Ape Yacht Club Ethereum-based NFT phenomenon, announced that it would release a NFT project called TwelveFold on the Bitcoin blockchain.

In our December article we asked: what do hard forks mean for my NFTs? In this article we ask a similar question: how does a copy of an NFT on completely different chain (Bitcoin, not Ethereum), affect value and licenses?

A number of questions arise. Does the holder of the copycat Ordinal on Bitcoin require a license corresponding to the Ethereum NFT? What happens to the Ethereum NFT purchaser's rights granted to it under the license, which may or may not include a commercial right to exploit and sublicense? Does an Ordinal inscription of an Ethereum NFT fall under a purchaser's general non-commercial use and public display rights that are generally given to purchasers on NFT marketplaces? Does the original Ethereum NFT holder hold one set of rights and the holder of the copycat on Ordinals possess any rights that may be in conflict with the original NFT holder's? Generally speaking, would the value of the NFT be affected if two identical copies exist on two different blockchains? Does the NFT owner or project have a say in which blockchain to recognize? Has any IP infringement occurred?

These rights are not insignificant, as the holder, depending on the license grant, is typically permitted to display or otherwise use the NFT in a non-commercial manner, and, in some cases, may even be able to commercially exploit, or grant a person(s) the right to commercially exploit, the NFT. Understanding what bundle of rights, and whether others share that bundle, is helpful to valuing the NFT and its underlying IP, as well as brand building.

As with everything in the constantly-evolving cryptosphere, there will be variability in how licensing agreements these issues. Certain licensing agreements may offer clues for how this issue may be handled. For instance, the terms of one NFT marketplace, Rarible's Standard Collectibles Sale and License Agreement (the "Raribles Agreement"), indicates that it only recognizes NFTs on Ethereum:

"Collectible" means the combination of: (A) **an Ethereum-based NFT** having a Uniform Resource Identifier ("URI") identifying an appropriately configured JSON file conforming to the ERC-721 Metadata JSON Schema, ERC-1155 Metadata URI JSON Schema or a similar JSON schema, as applicable (such JSON file, the " Collectible ID"); and (B) the Collectible Metadata specified by such Collectible ID."

[While the Rarible's Agreement only recognizes Ethereum-based NFTs, the Agreement does recognize NFTs on each chain after a hard fork]:

"Collector" of a Collectible means at each time, the person who lawfully holds exclusive title to and ownership of the NFT included in such Collectible, for so long as such person continues to hold such title to and ownership of such NFT. All references to "Collector" include the Collector's lawful permitted successors and assigns. In the event of an Ethereum Persistent Fork creating copies of the Collectibles at the same addresses at which they were then held on Ethereum, the scope of the term "Collector," and all licenses granted to and other rights of a Collector under these Terms, shall be deemed expanded to include each person who lawfully holds exclusive title to and ownership of the copies of such NFTs that are included on the Ethereum Persistent Fork. **The parties acknowledge and agree that, as a result of the preceding sentence, in an Ethereum Persistent Fork, the aggregate number of the Collectibles may be increased, which could have an adverse effect on the value of each Collectible or the aggregate value of the total Collectibles.**

This raises a second question, what would be the effect be if the Rarible's Agreement (or any other similar terms of service on an NFT marketplace) was modified to permit an increase in the aggregate number of collectibles as a result of a new enablement on a new protocol, similar to how Rarible's treats a hard fork?

Like Rarible's, Yuga Labs, a Web3 developer of NFTs – including CryptoPunks and BAYCs – provides a warranty disclaimer that each CryptoPunk NFT exists only by virtue of the ownership record on the *Ethereum Blockchain*:

EACH CRYPTOPUNK NFT IS AN **INTANGIBLE DIGITAL ASSET THAT EXISTS ONLY BY VIRTUE OF THE OWNERSHIP RECORD MAINTAINED ON THE ETHEREUM BLOCKCHAIN**. ANY TRANSFER OF OWNERSHIP THAT MIGHT OCCUR IN ANY UNIQUE DIGITAL ASSET OCCURS ON THE DECENTRALIZED LEDGER WITHIN THE ETHEREUM BLOCKCHAIN, WHICH YUGA LABS DOES NOT CONTROL.

BAYCs includes a similar provision in the Ownership section. As such, under these terms, Yuga Labs has de facto designated Ethereum as its blockchain of choice. However, whereas Rarible's licensing agreement may result in doubling the amount of "Collectibles" in the event of a fork, Yuga Labs, a Web3 developer of NFTs, reserves the right to designate which fork is valid for their notable Cryptopunks:

The License applies only to the CryptoPunk NFT on the blockchain that Yuga, in its sole discretion, may designate, which designation shall apply retroactively. Thus, for example, if a fork or other event purports to result in duplicate CryptoPunk NFTs, only the non-fungible token recorded on the blockchain designated by Yuga Labs will be eligible to receive the benefit of the License. Any license purportedly granted hereunder to the owner of a non-fungible token recorded on a blockchain not designated by YugaLabs is void ab initio.

Thus, in addition to stating that CryptoPunks exist by virtue of the digital asset record on *Ethereum*, Yuga labs may designate the blockchain where CryptoPunks exist. In terms of forking, Yuga Labs' approach is similar to venture capital firm a16z's approach, which provided five template NFT licenses, each providing for the industry-recognized chain post-fork, merge or duplication.

Transfer and Sublicensing. The licenses granted in these Terms are non-transferrable, except that if you lawfully transfer ownership of your Project NFT, the license to the NFT Media in Section 1.1 to you shall terminate upon the effective date of such transfer, and such licenses will be assigned to the new owner of the Project NFT associated with such NFT Media. As a condition to sales, transfers or similar transactions of the Project NFTs, the transferee agrees upon the acquisition of the Project NFT that (a) the transferee is not a Restricted Party and (b) the transferee accepts these Terms. Further, if you choose to sublicense any of your licensed rights set forth in Section 1.1 above, you are only permitted to do so if any such sublicensees agree (i) that they are not Restricted Parties, (ii) to the same covenant not to assert as set forth in the second to last sentence of Section 1.2, and (iii) that if your licensed rights in Section 1.1 are transferred (such as because you sell your Project NFT), then any such sublicenses you have granted in such licensed rights will automatically terminate. **Because virtually all public blockchains are licensed under open source licenses, it is possible that the blockchain may fork, merge, or duplicate the original blockchain that initially recorded ownership of your Project NFT. In such case, any rights granted under these Terms to owners of any Project NFT will only be granted to the lawful owners of such Project NFT whose ownership is recorded on the mainnet version of the blockchain that is generally recognized and predominantly supported in the blockchain industry as the legitimate successor of the original blockchain (as determined in our sole discretion).**

However, under this version of the a16z NFT license, a16z does not specify that the only valid ownership ledger is on Ethereum, so arguably the licensing agreement may be used with respect to an Ordinal inscribed on the Bitcoin blockchain. Further, Bitcoin is neither a fork from, a merge into, nor a duplication of Ethereum, and the license is silent on NFT copies; however, the clear emphasis is that IP licenses will only be granted to the lawful owners of a project on a "blockchain that is generally recognized and predominantly supported as the legitimate successor of the original blockchain" as determined in the sole discretion of the Creator. It is an open question whether this language would give holders comfort if the argument could be made that their licenses are protected against copycats on a completely separate chain, like Bitcoin.

Alternatively, as a creator may reserve the right to upgrade the NFT's smart contract in the case of a fork, reserve the right to declare future restrictions on the NFTs use, or stay silent altogether, a creator may also decide to jump entirely to a separate chain. In the absence of a licensing agreement or specific guidelines, *Archer v. Coinbase, Inc.*, 53 Cal. App. 5th 266 (2020), provides some clarity as to how new chains may be handled. In *Archer*, a user claimed that a cryptocurrency exchange was required to provide him access to all forked versions of the Bitcoin in his exchange account. The California state court disagreed, reasoning that the exchange's user agreement did not obligate the exchange to support all forks. The court also found that Coinbase's refusal to support a new form of forked cryptocurrency was not action amounting to conversion as Coinbase did not host the forked cryptocurrency in the first instance, and thus could not have deprived the plaintiff of a property right or exercised dominion over the forked cryptocurrency. Consequently, digital asset trading platforms (token, NFT, or otherwise) tend to expressly reserve the ability to determine which forks they support or otherwise reserve the broad right to place future restrictions on transactions.

It remains to be seen whether Bitcoin will become a widely popular chain for NFT enthusiastic and projects. In any event, the revolutionary capabilities enabled by Ordinals bring up novel questions surrounding NFTs and licensing agreements, so NFT issuers and marketplaces should consider what effect Ordinals might have on their business models and also reexamine relevant terms as needed to take into account any future NFT-enabled blockchains.

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