Podcast Transcript

NFTs and the Future of Digital Brands

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Kattman: NFTs, Web 3, the metaverse. These terms have become all but inescapable over the last few years. So what is an NFT? And how can a digital token affect your business's IP and brand, both in the metaverse and the real world? I'm Amy Kattman, and you're listening to BakerHosts.

On today's episode, we're diving headfirst into the metaverse to discuss all things IP and NFTs, including how they could be crucial to your brand. Our guests today are Jerry Ferguson, a partner in our Digital Assets and Data Management Group and the New York Digital Assets and Data Management Leader, and Dr. Scott Duke Kominers, who is a professor at Harvard Business School where he teaches courses on Web 3 and marketplace design, and also a research partner at a16z crypto. Welcome to the show, Jerry and Scott.

Ferguson: Hi Amy. Thanks for having us on. I'm really looking forward to talking with Scott today about NFTs. I always feel smarter after a conversation with Scott.

Kominers: And thanks so much for having me as well. I always learn a ton from talking to Jerry. I'm really excited to be here.

Kattman: That makes three of us. Scott, from a technical perspective, what is an NFT, and what are some different ways in which they can be used?

Kominers: Awesome. So an NFT is fundamentally a digital record of ownership, typically stored on a public ledger called a blockchain. And you can think of them a little bit like a digital deed, right? Fundamentally, a deed is a piece of paper, or now often already a digital record, that grants the holder ownership of a given piece of

property. Maybe it is a house. Maybe it is a car or something of the sort. In the same way, NFTs are digital records that can be associated to other assets, whether they're digital assets like images or other media or even physical assets. But an NFT, it sort of lives in a software network, and often ownership of an NFT is publicly accessible and verifiable. So you can see who owns each one, which means that you can actually build software features and even physical tie-ins on top of them.

So for example, if I've created a stop-motion animation of like a cool raccoon, maybe he is a little cartoony raccoon, who jumps over a fence and then takes out a guitar and starts rocking out or something, I can create that animation and then associate it to an NFT. So I mint, that is the process of creating an NFT. I mint an NFT associated to this animation and now I can post the NFT for sale on any various different online marketplaces. And someone like Jerry, if they liked my animation, could come by and acquire the NFT. They can buy it from me or from whoever holds it currently, and now he owns the digital deed encoding the NFT. He owns the asset and is interpreted as the owner of the animation as well.

So, some NFTs are used just in this way. They're in effect like a, just a token for transacting. They just have this digital deed functionality, but maybe Jerry buys my animated raccoon and like, really likes it. And one day he calls me and says hey, Scott, this raccoon of yours is really awesome. I feel like I could see it on T-shirts. I feel like I could see it all over the internet. Maybe there should be an online game. And I'm wow, you're totally right, and so I create a new series of NFTs. We'll call them the really awesome raccoons, so new set of NFTs, each one associated to a different image of a raccoon in that same style, and that can sort of serve as the foundation of a whole product ecosystem. Maybe we'll call it the Raccooniverse. And how do we do that?

Well, I start issuing new products and features to people who hold the NFT. So maybe if you log in to an online metaverse platform and you are the holder of the NFT, it is attached to your, what is called a crypto wallet, which is like your access to a lot of different crypto assets. You connect your crypto wallet to the metaverse platform. You can see that you have a really awesome raccoon, and now suddenly your metaverse character can dress up as a raccoon. You can basically press a button, and it will load your raccoon character on top of yourself, and you can be a raccoon in various metaverse worlds. Or maybe I hold like a real rock concert, rocking out with the raccoons or something. And everybody who has one of these NFTs can use that NFT as an entry ticket. So they can basically prove that they own a really awesome raccoon, and now they get to attend the concert.

Ferguson: I think an important point too, Scott, is that this whole exercise you're describing, this brand-building exercise, what we're seeing is that established brands can have a real head start.

Kominers: Yeah. So, indeed. So there is a sense in which what these NFTs are doing in some sense is creating physical assets in digital space, if that makes any sense, right? In the same way that physical property you own, like it is tangible, and you

can do things with it. You can take a book or wear your really awesome raccoons T-shirt from place to place, here same thing, right? Like, if you hold an NFT, it can, in principle, have a lot of different uses in many different digital contexts, and so one thing it is doing is giving established brands a beachhead into digital space. People can take their fandom and excitement about a brand and start to display that through a variety of new digital assets built around NFTs.

Ferguson: You hear many brand owners describing their brand as a lifestyle brand, and they are really developing a community of followers of their brand in a very conscious and intentional way. And what I hear you doing is kind of describing how that brand-building strategy can be extended in a metaverse and an NFT environment.

Kominers: Exactly. It is very much the way to think about it. You know, when you have an NFT, especially since most of them are on these public ledgers, they in effect create naturally a network among all of the holders, right? All the really awesome raccoons holders can find each other and interact, and so really these digital assets can become part of their lifestyle, their public identity online and also enable them to form community with other enthusiasts. Just as if you're fans of the same sports team or band or something you might bond with other people you see at a sporting event or a concert, here you can bond with the people who are representing their raccoons digitally. And people use it as their profile pictures or feature it in other social media or who wear their, wear an image or 3D realization attached to their NFT and digital metaverse platforms in worlds.

Ferguson: As a spin-off, the holders of the really awesome raccoons would be airdropped a raccoon hat that their avatar in metaverses could then start wearing.

Kominers: Exactly. And so in this way, the brand extends their footprint, right? So the story as we've told it now is like, again, I haven't actually invented this nor am I a particularly good cartoonist, so my raccoons would not be ones anyone would want to brand around if, even if I did try and draw them. But suppose I created the really awesome raccoon series. We have 10,000 people who have collected really awesome raccoons NFTs. I can then deliver to them various brand extensions and reward features and so forth, right? I can, as Jerry just said, airdrop a hat. Now everyone has a raccoon hat that they can wear in the metaverse. I can even, airdrop, by the way, it's sort of like email or direct deposit. People's crypto addresses are recorded publicly as well, and so you can send new digital assets to them. I could see every crypto address that has a really awesome raccoon NFT and directly send them an additional NFT for a metaverse hat or something like that.

I could also use a retail platform to give out real physical hats, and this has been done also. We've seen various brands enable holders of their NFTs to log on to their online store and claim a free hat to have shipped to them. And so it blends the relationship between the digital and the physical, right? You can own it. You can own a hat in the metaverse that matches up with a hat that you wear around in the street, and in that way your attachment to the brand reinforces in both spheres.

Kattman: Scott, how do NFTs create value? And in particular, why do people pay potentially large amounts of money for them?

Kominers: And I should emphasize that some NFTs people pay large amounts of money for, but many of them, in fact, I think probably by mass, the majority of them at this point are actually ones that are more like relatively inexpensive collectibles. Think of them as like the types of souvenirs you might get when traveling or attending a concert, or something like that. But the key is, first of all, we've talked about sort of two different categories of uses of NFTs. One of them is just as like digital deeds for ownership, and sometimes people might have willingness to pay to just own something, right?

If I make a cool animation, and Jerry wants to support me as the creator, maybe he will buy the NFT of my animation. He becomes one of my animation collectors, or similarly we've seen NFTs used associated with various digital collectibles. And just like in other collectible categories, right, sometimes people just pay sometimes very large amounts of money to own something just for the sake of collecting it. It is rare. It is unique, and it sort of resonates with them. They think it is special. And so one reason is simply, just like you might pay money for some other piece of property, you might pay money for an NFT because you want to own it and its associated assets. But meanwhile, in this digital brand NFT category we've been talking about, it is a little bit like entering into a community, right?

My co-author Steve Kaczynski and I have written that an NFT is sort of simultaneously like a membership in a community, right? You're sort of buying into a community of brand enthusiasts, and it is also a little bit like a rewards program, right? Jerry and I were talking about you can airdrop a hat. You can get more assets or more functionality. Maybe you get into a free concert or something by virtue of owning the NFT. So if you have a really awesome raccoon, you're on the ground floor of the Raccooniverse, like you're there when we launched the brand. And so you collect everything, the first edition really awesome raccoons hat. You went to the original rocking out with the raccoons concert. Like, you sort of get to be part of the brand's evolution, and the community of enthusiasts that participate in that evolution and help guide the brand as it grows up.

And so, you can easily imagine that at least for some brands. First of all, people really want that attachment and they really, they love it. They love the aesthetic. They love, they are, like they identify as a raccoon. I am in, like all in on really awesome raccoons. And moreover, you can imagine that that in the end delivers lots of different forms of value over time, what is referred to in the NFT world as utility, right? It is not just that you own this token for the sake of having an image of a raccoon, but rather you own this token for the whole stream of value that being in the really awesome raccoons delivers for the hats, the concerts, the community, all of these different things that you can get out of being a part of the brand.

Ferguson: And what I would like to emphasize, I agree with every single point you just made, Scott. But what I'd like to emphasize, where I'm seeing a lot of excitement among my clients that own established and successful brands in the physical world, is the opportunities that the blockchain technology and Web 3 create for usable and wearable assets…

Kominers: Yes.

Ferguson: …in virtual worlds.

Kominers: The interoperability is really central here, right? The cool thing about NFTs and public blockchains is that they're sort of standardized software layers that many different platforms can plug into and work with at once. So instead of just being able, think about if you create data on a Web 2 social media platform, it just lives in the platform. It is not like the other platforms can reference it and use it. Here, NFTs are more like physical possessions. That digital hat is more like a physical hat in that you can wear it anywhere. You can, any sort of platform that has a way to access your NFT ownership can manifest a version of that hat.

Oh, and one more riff off of Jerry's comment. The other thing that is key here is that people want to bring their brand affinities into digital space, right? People are spending more and more time online, especially since the start of the COVID-19 pandemic, and as a result, people care about bringing their, even their physical world affinities into digital spaces as well. And so one reason to acquire NFTs, especially from these established brands, is that you might just be a mega fan of that brand. And you want to present that as you walk through the digital world, right? You want to be showing that on social media, in metaverse platforms, maybe even in like your video conferencing software, and NFTs are a great way to enable that.

Kattman: Jerry, how might the rules governing intellectual property apply to NFTs and their associated media?

Ferguson: It is a great question, and I think there is a very significant misconception out there. I've been seeing it in a number of commentaries that somehow, we need new intellectual property rules for NFTs. I couldn't disagree more. The fundamental intellectual property rules that we've been relying for for centuries have taken us through the Industrial Revolution, the Transportation Revolution, the Internet Communications Revolution, and they're going to take us through Web 3. And the two fundamental categories of intellectual property rights that are really relevant in the discussion we're having are copyright and trademark.

The copyright is your right to protect your creative expression from someone else copying it and making, selling, something that is the same or substantially similar. And so to go back to our really awesome raccoon and the actual digital artwork that Scott created that is associated with the NFTs, that artwork is protectable as copyright. And anybody who is looking to make something that is the same or substantially similar is going to risk running afoul of those rights. Now this is a topic that gets very complicated. There are fair use rights. There are uses that

are commentary and therefore transformative. And that is really worth a separate podcast, Amy. But I think that important for here today, copyright is a very solid tool for protecting your creativity and remains so in the metaverse.

Trademark is what protects all the branding activity that Scott and I have been talking about, and it is fundamentally a consumer protection statute. The idea is, as Scott was just saying, someone who really feels brand loyalty and wants to present their relationship with the brand in a metaverse environment has the right to get something that is really associated with the brand owner and not be confused into buying something that they think is associated with the brand owner but really isn't. That's kind of trademark rights in a nutshell. And to the extent that what we're seeing now is so many NFT projects built around brand-building activity, the traditional protection of trademarks to protect consumers from a likelihood of confusion continues to be a very important and valuable tool.

I will say in trademark in particular, there is a concern that trademark rights might somehow undermine free speech rights under the First Amendment. And there is case law going back over 20, over 40 years now, saying that in a piece of artistic expression like a film, you really have to meet a higher standard than just showing confusion. You have to really show that the use of the trademark wasn't artistically relevant or that it was willfully misleading, that it was something that really kind of went beyond likely to cause confusion. This whole concept is before the Supreme Court right now and a decision that we're expecting by this summer. And so we should get some greater clarity about this.

But having recently listened to the Supreme Court debate on this issue, it was very clear to me that in trying to define First Amendment protection, several of the judges were making a distinction between kind of pure artistic expression like artwork, movies, books, and commercial products. So, I think in looking at how trademark rights are going to act within Web 3 and within metaverses, I think that it is critical to understand an NFT project and the nature of it. Is it just in our only project like the original raccoon image that Scott created? Or is it a whole series of raccoon images that a brand is being built around to create the Raccooniverse? In which case that sounds a lot more like a commercial product where a more traditional approach to trademarks is appropriate.

Kattman: As we close out today's discussion, what are some ongoing challenges for thinking about intellectual property and Web 3? Jerry, let's begin with you.

Ferguson: My number one message to brand owners is Web 3 is going to happen, and your consumers are going there whether you like it or not. And you as a brand owner need to apply the same diligence that you apply to protecting your assets in the physical world to virtual worlds, or you risk losing those rights. That is a fundamental feature of particularly trademark law, that when you don't protect your rights, you lose them. And what that means as a practical matter is making sure you have trademark registrations that cover your key trademarks in Class 9, which is where NFT-related products are generally registered. Just as you're currently probably policing the marketplace for infringing uses, you need to make sure that that infringing activity is also being monitored in the metaverse. And you

want to be thinking creatively about the brand extension opportunities. Because if you're not, there are others out there who may try and steal your thunder.

Kominers: And as, Jerry, just as you were saying, right? Like, brands have to think about their positioning in digital assets in the metaverse. And we're already seeing experimentation with all sorts of new intellectual property models around these digital assets as well, right? We're seeing some digital brand NFTs that grant their holders the right to use the IP associated to the imagery they control, they own, and we're seeing others even that are building along more like open-source software-like models.

And then yet others often, again, these more established brand NFT projects where the assets are really the assets alone and the IP still all resides with the parent brand. And so I think it is really important when you're building an NFT project to think about the, how the digital assets, the NFTs and anything associated with them, the utility functions, and all of what you're building. The identity and community features around that, how those interface with the intellectual property associated with the NFTs in the first place. You have to, you need a coherent intellectual property strategy as a brand when you go into the metaverse.

Kattman: Jerry and Scott, thanks for this valuable discussion today.

Ferguson: It's been a lot of fun. Thank you.

Kominers: Yes, thank you so much. This was really awesome.

Kattman: If you have any questions for Jerry, his contact information is in the show notes. As always, thanks for listening to BakerHosts.

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