So You Think You Want To...
establish a presence in a metaverse

This guide seeks to help you navigate metaverses. What are they? How can they help your brand? And what legal issues arise?

What is a metaverse?

Let us start by level setting the terminology. Although one of the hottest buzzwords for the last two years has been "The Metaverse," the term is factually misleading. There is no single metaverse product or place. Many metaverses exist and many more are being built. Different metaverses will have different priorities – for some that may be gaming or interactive media, some may focus on B2B solutions and others on social interactions. A more correct term is to refer to "a metaverse" or "metaverses," which may not roll of the tongue as easily as "The Metaverse" but is the more accurate term.

Since dominating the news headlines from the start of 2020, this ecosystem has been predicted to be the next trillion dollar industry, a claim that does not seem so far fetched when we see many of the world's biggest brands making announcements or investing in metaverses.

Coined in 1992 by science-fiction writer Neal Stephenson, the term "metaverse" refers to the concept of a highly immersive virtual world where people gather to socialise, play and work. It is meant to describe a convergence of an augmented physical reality and a physically persistent virtual space – a virtual world accessible through special technology.

A generally agreed-upon definition of the concept is a digital experience that blends VR, streaming video, mobile games, cryptocurrencies, social media, 5G, AI and email. In its current form, this new virtual world is not fully developed and is something that will grow over time with contributions and different perspectives being created by various companies and platforms.

Yet, despite the concept still being developed, it is already a thriving economy with people earning and spending money in this new ecosystem. For businesses, having a presence on metaverses is tantamount to having a social media presence, and with predictions that the popularity of metaverse ecosystems will only continue to grow, it is no surprise that brands are keen to jump on the bandwagon.

What are NFTs?

An NFT (non-fungible token) is a unique, non-interchangeable cryptographic token. NFTs are recorded and traded via blockchain technology which tracks and certifies asset ownership. NFTs are minted through smart contracts that assign ownership and manage the transferability of the NFT from one holder to the next.

While the smart contract underpinning it might provide a buyer with a permanent digital receipt of an NFT, the rights granted and attached to an NFT depend on the particular smart contract and these can vary widely. A key point to note is that the terms underpinning each smart contract don't typically assign any IP rights. At most, they tend to grant purchasers a non-exclusive licence to use digital versions of the underlying work for non-commercial purposes. The takeaway? Ownership of the copyright does not transfer automatically to the purchaser of an NFT. As with all copyright assignments, ownership will only transfer if expressly provided for and agreed to by the author of the original work.

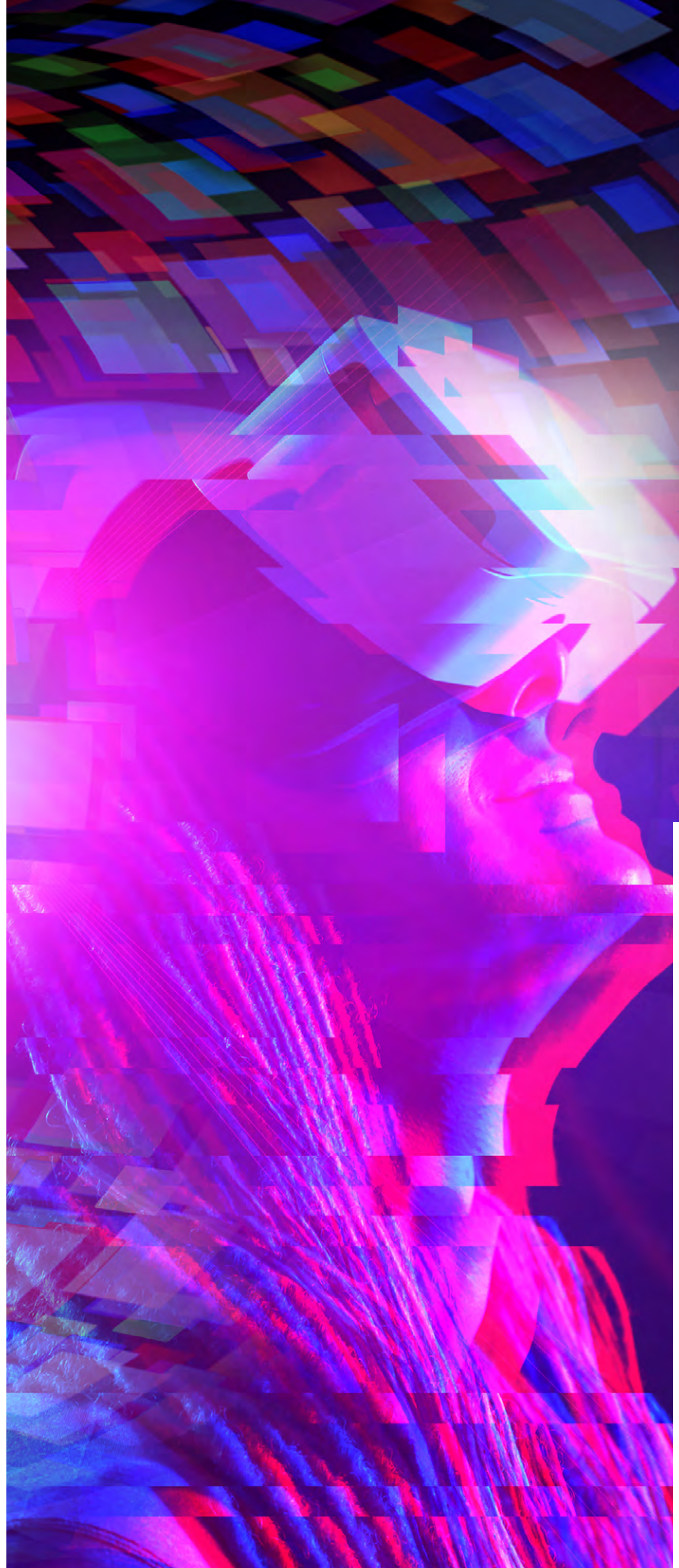
What NFTs have established though, is ownership of a verified version of a digital asset, for example - digital art. Historically there was no way to separate the "owner" of a digital artwork from someone who just saved a copy to their desktop. NFTs look to solve this problem by giving parties something they can agree represents ownership of a verified version of the digital asset. In doing so, NFTs create scarcity of digital images and other works which may otherwise be freely available online, and provide a digital "deed" or authenticated receipt.

NFTs can provide more than a digital deed, though. Because NFTs are programmable, it's possible to endow NFTs with features that enable them to expand their purpose over time, or even to provide direct utility to their holders. In other words, NFTs can do things — or let their owners do things — in both digital spaces and the physical world. NFTs can function like membership cards or tickets, providing access to events, exclusive merchandise, and special discounts — all of this gives NFT holders value over and above simple ownership — and provides creators with a vector to build a highly engaged community around their brands. Depending on the chosen use of an NFT, holders of NFTs might be, for example an investor, a member of a club, a brand shareholder, and a participant in a loyalty program all at once.

In terms of creating or establishing the "value" of an NFT project, marketing, "fandom", and community plays a crucial role. A token's worth comes from users' shared agreement — and this means that the community a brand builds around NFTs determines the NFTs' underlying value.

What's next for NFTs? The NFT market reached a staggering 41 billion US dollars in 2021. There are different schools of thought as to how the NFT market will fare longer term. Some have called time on NFTs saying we've reached peak saturation and the bubble is bursting. Others are projecting the NFT market to grow by almost 150 billion by 2026. We have also seen key legal, regulatory and commercial issues emerge over the past year or so. From alleged copyright and trademark infringement, hacking and theft, to environmental and anti-money laundering concerns. We will continue to monitor related cases and regulatory enforcement, as well as how regulators around the world respond to the challenges posed by NFTs as they develop.

We don't hold a crystal ball, but what we can see is that there's still interest in NFTs, and that the interest has developed from earlier use cases of digital art, to an increasing number of consumer, fashion and luxury goods brands exploring the space. With growing interest in metaverses too, we've not seen the end of NFTs just yet.



How are brands engaging with metaverse users?

Metaverses provide new and exciting ways to interact with customers and to showcase a brand's products, creativity and sense of identity. Brands have been keen to embrace this new medium and the opportunities it gives rise to, which include:

- **New advertising channels** such as collaborating with existing gaming platforms to feature their brand or their products within the gaming environment or creating customized games specifically for their target consumer.
- **New forms of interactive engagement with customers** such as virtual events, for example virtual fashion shows.
- **New virtual goods** such as digital goods sold as NFTs and fashion collections or branded skins for avatars.
- **New sales environments** for the full omnichannel experience, such as virtual retail stores that replicate the "in-store" experience for consumers by leveraging off the visualization capabilities of AR and VR. Such stores can facilitate the purchase of both virtual and physical goods by the consumer.

The timing of the emergence of this more dynamic and immersive online experience utilising AR and VR and better graphics, has coincided with the need for consumers to resort to online sales due to the pandemic. This coincidental collision has propelled both the development of the technology and the expansion of the metaverse ecosystem perhaps at a quicker rate than might otherwise had been the case.

What are the legal issues that metaverse participation can give rise to?

Below we touch on some matters that need to be considered when developing and adopting a metaverse strategy.

Collaboration

Consumer goods & retail metaverse initiatives will typically involve the company collaborating with one or more third party providers.

In particular, brands wanting to launch a metaverse platform initiative are very unlikely to be developing their own platforms. Brands will tend to want to leverage existing platforms and their significant user base to maximize consumer engagement. Indeed, much of the existing metaverse activity we have seen to date involves companies working with leading existing gaming, console and social media platforms, with more limited activity involving newer and decentralized platforms. Accordingly, where the platform's terms of use already accommodate the proposed initiative, the brand will need to ensure that the proposed campaign or initiative is compliant with the platform's terms. Alternatively, the company will need to enter into a specific strategic partnership agreement with the platform.

Many metaverse and NFT initiatives also involve brands partnering with an agency, designer, artist or influencer which will require the brand to put in place commercial agreements with those individuals or organisations.

If the initiative includes creating NFTs, the brand will also typically work with a NFT minting platform or marketplace to create the NFTs and make these available for sale. Again, the brand will need to review and comply with the relevant platform terms or put a bespoke agreement in place with the marketplace, depending on the marketplace or platform provider selected.

IP protection

With the convergence of new technologies as well as the opportunities for collaboration between partners, metaverse ecosystems create a new landscape for IP owners to navigate.

One of the big questions for IP owners is whether their existing trademark registrations adequately cover new uses in metaverses, or whether further trademark applications should be filed in order to broaden out protection.

On the whole, a sophisticated brand portfolio should offer relatively good protection in relation to new uses in metaverse ecosystems, but we do advise a portfolio audit in order to identify any gaps, particularly in relation to house and top tier trademarks. For the top tier marks for any brands, in most jurisdictions there will likely be merit in filing further trademark applications in order to expressly cover some of the anticipated virtual uses in metaverse activations. How these specifications will be drafted will naturally depend on the approach of the IP offices in each jurisdiction, and caution will need to be exercised, particularly in jurisdictions where intent to use is necessary. But a clever and thought through filing program should extend brand protection and enable IP owners to better protect their new anticipated brand uses, and more effectively enforce against third party encroachment on their rights in metaverses.

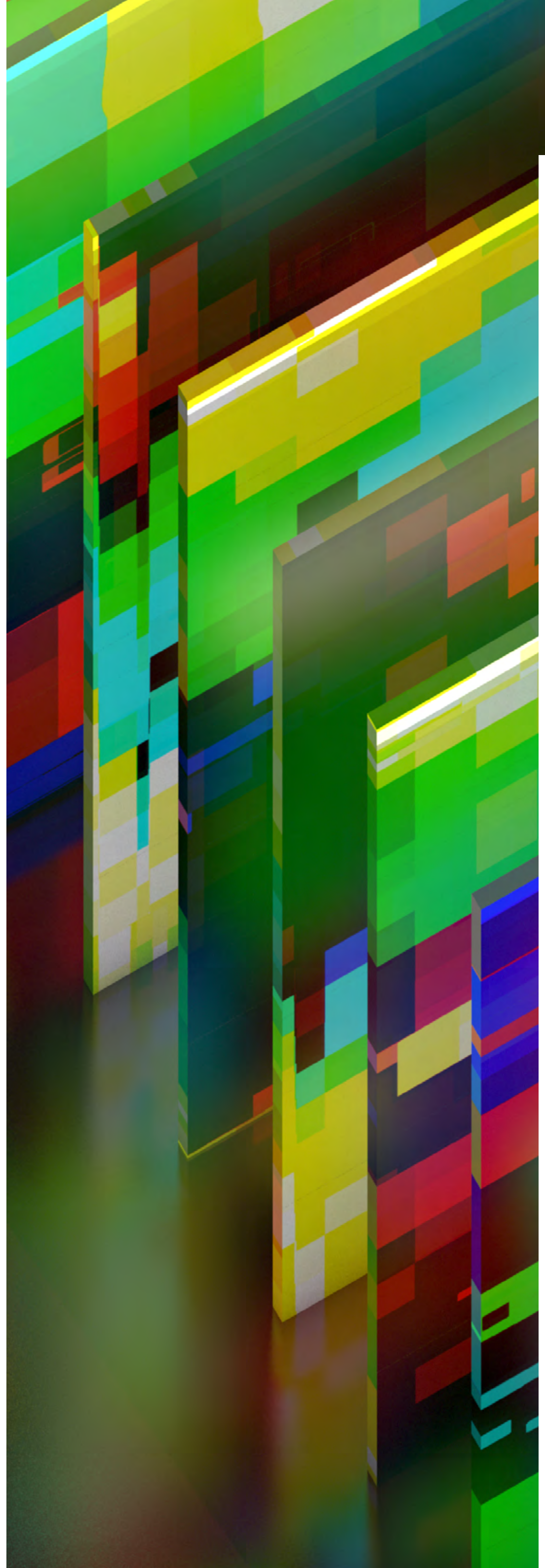
IP enforcement

As with the arrival of the internet, the new landscape of the metaverse ecosystem has attracted a number of players who are seeking to free ride on the coat tails of established brands.

This brings with it a number of complications in relation to IP enforcement, not least due to the approach of many to consider uses in metaverse ecosystems and as NFTs as "art" or "expression" as opposed to commercial use.

In a number of high profile trademark infringement cases relating to NFTs and metaverse use, we have seen defendants argue that their use is simply in the form of art or expression, and therefore falls outside the remit of trademark infringement. This argument will hold more water where trademark protection is not directly on point (e.g., in the EU where a brand owner is relying on a mark with a reputation in relation to dissimilar goods, and so has to show that the use is without due cause) or in jurisdictions such as the United States where freedom of expression is so fundamentally enshrined in legislation and case law. But with appropriate IP protection this argument will often fall away, as it also should where uses more clearly veer to commercial appropriation of third party IP rights. And in relation to copyright claims, in jurisdictions where there is no broad fair use doctrine this argument will often fall at initial hurdles for failing to fall into more limited exceptions to infringement.

But it is fair to say that the enforcement landscape is complicated in relation to metaverse ecosystems, and not only for the above art versus commerce divide. Brands will often find it difficult to identify infringement uses in far corners of metaverses, though online monitoring providers are offering more sophisticated services all the time. And even if infringing acts are identified, in the case of decentralized metaverses in particular it may be very difficult to effectively enforce any IP rights, both because of a lack of any clear metaverse terms or take down system, as well as due to more fundamental barriers in terms of even identifying who is using the IP and who is responsible for the metaverse space. However, as with all IP infringements, our advice remains to continue to monitor as far as possible and to enforce in appropriate cases where the situation allows – as we have seen before in the offline world, brands who fail to take any action at all against infringing uses often suffer severe misappropriation and brand devaluation, so it's all about making your IP a less appealing target for infringers.



Consumer protection

One of the most important parts of any online platform is of course its users, who will for the most part be consumers.

Creating an environment that is trusted and safe for the participants in a metaverse will need to be considered by brands when either developing their own worlds or, more likely at the initial stage, when partnering with and agreeing terms with metaverse providers.

Trust will be essential – for both consumers and regulators – and metaverse operators must ensure transparency and consistency in what they are providing to consumers. Moreover, to ensure mass appeal, brands will need to make sure that everything that is consumer-facing is spelled out in simple and easy-to-understand language, as many of the terms will be unfamiliar to most.

How the metaverse ecosystem will be regulated for the protection of consumers is very much a developing area. Regulation of areas such as information requirements, advertising law and marketing, particularly advertising to children, are likely to change. Sales of digital assets (particularly digital goods sold as NFTs) bring an added layer of complexity with, for example, financial services advertising requirements around cryptocurrencies.

It is also clear that there are hurdles to comply with regarding common consumer rights in a metaverse:

- What is the consumer purchasing? Are they purchasing digital content or a service, and has this information been clearly communicated to them?
- What remedies will a consumer have if an item or experience they purchase in a metaverse is defective, and how does one determine what "defective" means?

A key area for brands to focus on initially will be preparing fit for purpose purchase flows and consumer terms for metaverse transactions.

Data protection

Privacy and cybersecurity is already a compliance challenge for brands active in existing online environments. Entering a metaverse will only add extra layers of complexity.

Consumers will be using a wide range of other technologies to interact with a metaverse, for example: potentially their unique NFTs and other avatars as entry points to a metaverse; VR headsets (which can collect more biometric sensitive data, like eye tracking data) and even haptic gloves that help you feel in the virtual world. Any action in a metaverse can produce even more data, for example, when users spend money to customize their avatars or even how their eyes move when they look around a metaverse shopping environment. These actions can be very valuable behavioral data for targeted marketing purposes. The more data that is collected and used in a metaverse, the more data that data controllers will be responsible for and the greater the need to protect it. In the web of partnerships that the metaverse is currently, a key initial consideration for brands will be creating privacy notices and policies for new metaverse related activities and working out how best to present these to users in compliance with existing laws.

Negotiating data protection terms in agreements with technology partners in connection with a particular metaverse activity are also likely to be initial areas of focus. Identifying the data controller is important and, given the many parties involved in a metaverse, it may be the case that multiple data controllers exist in the environment and agreements will need to reflect this appropriately.

Looking towards the future, and a move to a singular decentralized metaverse, other more complex challenges arise. There are many key questions that will need to be considered in this multi-layered global virtual world. Some potential areas for consideration include:

- Whether existing forms of consent will be fit for purpose in an immersive virtual world.
- Whether there will need to be consensus on information security standards for the metaverse given the increased cyber risk.
- If a metaverse is blockchain based, decentralized and transactions can't be altered. How then do you effectively ensure compliance with data subject rights, such as the right of erasure?

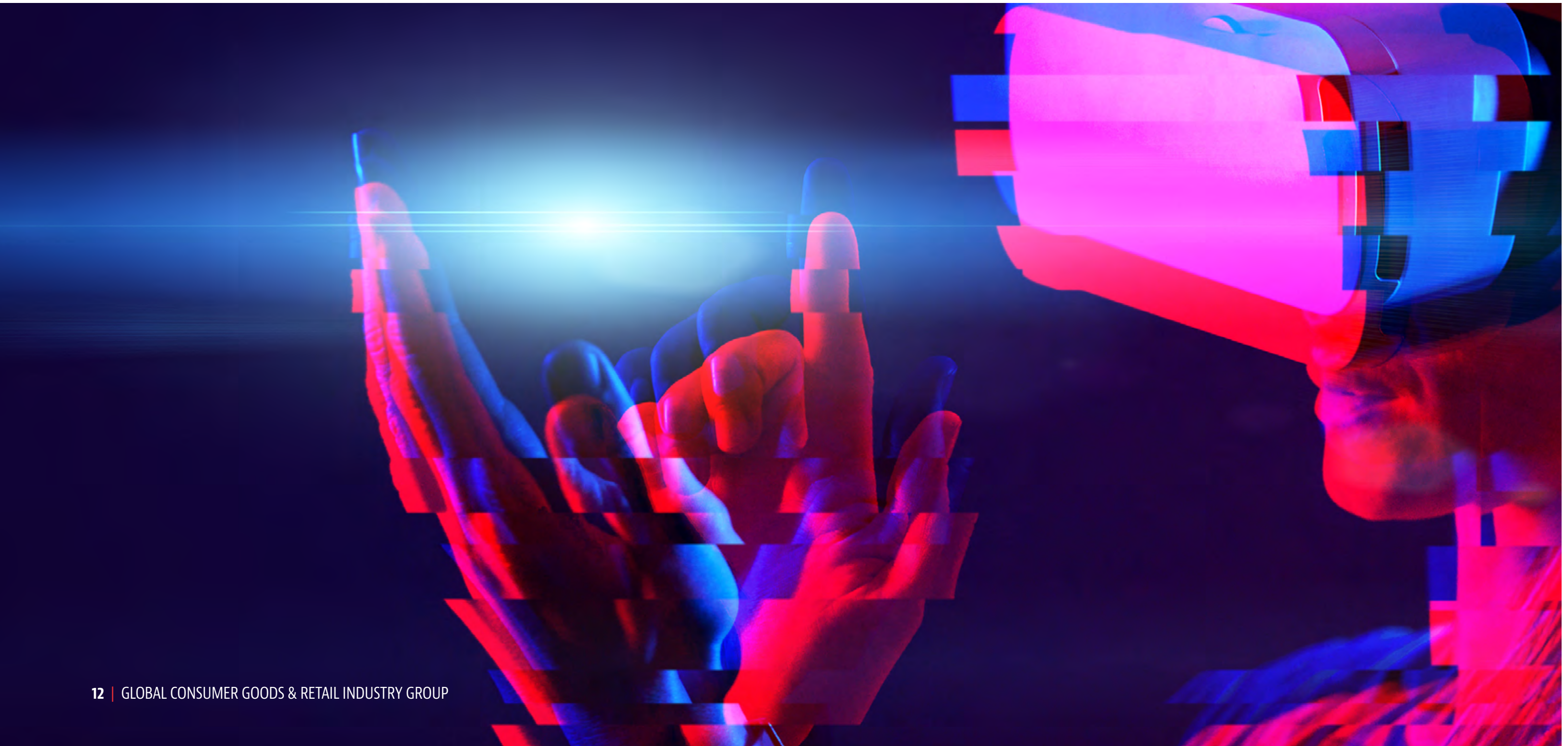
Nature of transactions

Transactions in metaverse ecosystems make the use of cryptocurrencies unavoidable. Hence, not only is it critical to dispose of the right cryptocurrency to pay, but, depending on the metaverse the transaction takes place in, the exchange of cryptocurrencies for NFTs is actually an exchange of two digital assets. As a consequence, any merchant and client transacting in a metaverse has to engage with exchange service providers or trading platforms to buy cryptocurrencies and trade NFTs.

Several risks arise in this context. First of all, cryptocurrencies do not always have a good reputation and merchants are mindful of their reputation. Hence, it is important to ensure that the cryptocurrencies bought and used are not related to unlawful activities and the merchant does not risk being accused of contributing to money laundering. Secondly, in some countries the legislation

adopted for digital assets might apply to an exchange of two digital assets (cryptocurrency for NFT). Thirdly, there is a lot of fraud related to cryptocurrencies and more generally to digital assets. Further, the transaction in the metaverse ecosystem will also trigger the application of general contract law depending on the legal qualification of the NFT and the rights it provides, and most likely consumer law will apply.

In all these situations, it is vital to know who the contracting parties are. Indeed, identity is of primary importance in the metaverse ecosystem. Since metaverses allow for the freedom to create fictitious avatars, it is challenging to know whether you are dealing with a child, a vulnerable person, a criminal, a competitor or some exposed person. The application of a certain number of legislations (consumer law, anti-money laundering, anti-corruption & bribery laws, etc.) require the identity of the person. This requirement of transparency has to be balanced against the right of the consumer to privacy and the preservation of their freedom to escape the real world and explore all the possibilities that metaverses offer.



Applicable laws and jurisdiction

As the metaverse ecosystem is ubiquitous, it will be challenging to decide what law applies and in which jurisdiction proceedings need to be held.

Further, transactions in metaverses will very probably increase conflicts of laws in jurisdictions, even more than the internet already does, as the interaction between participants is more immersive, easy-going and provides opportunities and a freedom the internet did not.

On a positive note, the rules on conflicts of law and jurisdiction as well as an important number of international treaties have already defined several factors that allow a situation to be linked to a country. These attachment factors very often provide sufficient flexibility for them to be applied in metaverses. Indeed, we already faced the ubiquity of the internet where initially a lot of people claimed that the law could not apply, but the judges still managed through interpretation and adaptation of existing principles to draw the internet towards the realms of the law and pin it down geographically. Hence, the challenges metaverses poses are not novel, but the intensity and the frequency of conflicts and of problems that need to be solved may increase.

On a more positive note, metaverses may crystallize the inefficiency and inadequacy of certain rules prompting us to think more prospectively about a possible evolution of the law. A good example is labor law. The metaverse ecosystem enables people to work for companies around the world. Let's not forget that in order to do business in metaverses, a person actually has to put a VR mask on and enter the metaverse. Hence, we are going to see the emergence of avatar-employees who spend their whole, or a substantial part, of their working time in metaverses.

Employers might want to establish their offices in jurisdictions that procure them certain advantages but are not necessarily overprotective of an employee.

Employees, on the other hand, may want to live in greener and more affordable countries but still benefit from the same standard of protection they are used to. As a secondary criteria, the applicable law to the contract will be the place where the employee normally exercises their activities. This is complicated to determine in the metaverse ecosystem unless one always localizes the activity where the employee resides or is located, which in turn gives rise to other challenges. Finally, the last criteria refers to the establishment of the employer which again gives the employer a lot of opportunity to pick the most accommodating jurisdiction. Consequently, legislators and judges probably have to think about how the law needs to evolve to adapt to this new situation.

Tax

Just because transactions in metaverses are taking place virtually, it (unsurprisingly) does not mean that tax authorities will not want to tax these transactions.

Whether it is fashion brands that sell digital accessories or clothes to dress up your avatar, artists who perform online, or conferences that take place in a virtual world, there is always a tax angle that should be taken into account. Indirect taxes such as VAT and sales tax will be at the forefront of these developments.

Where retail brands generally sell physical goods to their customers, digital "goods" are for VAT purposes regarded as a provision of electronic services, which brings a different set of VAT rules to the table. In addition, companies should take into account that wholesale operations may change to retail operations in the metaverse ecosystem. These changes trigger unique VAT considerations. For example, whereas a sale in a physical shop requires local VAT rates of the location in which the shop is to be charged, in a metaverse ecosystem it is more important to identify the physical location of the virtual customer. Businesses selling goods in metaverses must be able to identify the physical location of all their customers as every sale potentially triggers the requirement to remit VAT to the respective jurisdiction in which that customer is located. Perhaps there will be the opening of virtual tax offices to help facilitate payments and collections!

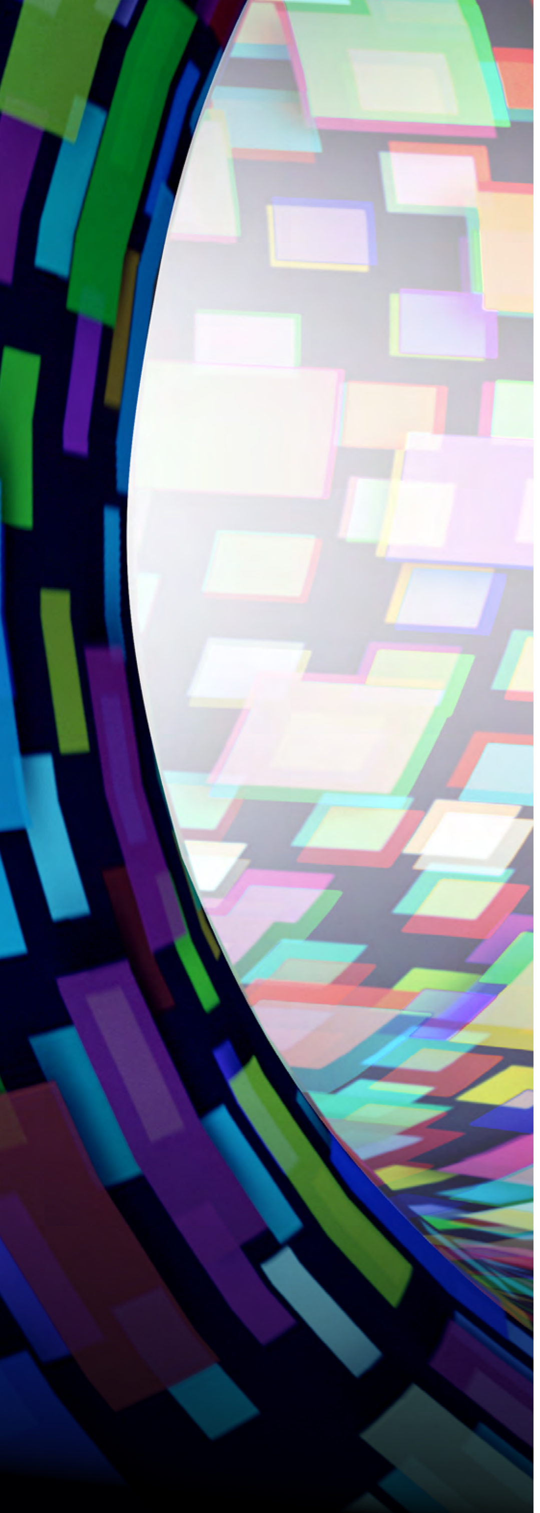
Additionally, new business concepts such as virtual marketplaces in metaverses will run into tax legislation that is not yet updated to accommodate these developments. As a result, undesirable consequences such as the risk of accumulation of VAT may occur if transactions between private users take place on these platforms. A good setup is therefore crucial.

Risk and compliance

The main compliance risk faced by brands in metaverses, other than the question of sustainability, is that of money laundering and the financing of terrorism.

Another compliance risk that can also be added is the compliance with international sanctions or certain bans. Indeed, let's not forget that China banned Initial Coin Offerings, the mining of cryptocurrencies in China and transactions with cryptocurrencies. Hence, if NFTs as such are forbidden, it is practically impossible to trade them in China.

We have seen that cryptocurrencies are unavoidable in the metaverse and we know they have suffered the reputation of being the preferred money of crime. Although this bad publicity is slowly decreasing as most cryptocurrencies are perfectly traceable and law enforcement agencies now understand that tracing the money allows them to fight crime. Moreover, cryptocurrencies and service providers are increasingly becoming more regulated.



Money laundering and fraud, more generally, is still an issue in the metaverse ecosystem. The risk will likely decrease over time as mandatory legislation kicks in. Indeed, one of the main aims of regulation is to fight against money laundering and the financing of terrorism. This was, and still is in a lot of countries, the entry point towards regulation of this environment. A good reflex in terms of compliance is for brands to ensure that they only deal with regulated service providers in metaverses to procure the cryptocurrencies needed to trade them for NFTs.

But anti-money laundering (AML) compliance in the metaverse ecosystem goes beyond cryptocurrencies. Indeed, the question is rather whether the existing rules also apply to NFTs. Even though the Financial Action Task Force (FATF) took a position in October 2021 stating that AML legislation probably does not apply to NFTs as they are unique collectibles, FATF also recognized that this might depend on the case at hand. Indeed, by extension current legislation requiring art merchants and jewellers (merchants in precious metals and stones) to comply with AML law under certain circumstances, can perfectly apply to an NFT representing ownership of a diamond, for example. Further, merchants in art may be subject to the same AML compliance rules whether the art is material or virtual. Finally, cash transactions over a certain amount are also subject to AML compliance. In this context, it is important to note that in Europe e-money is assimilated to cash. With the emergence of stable coins and their imminent regulation the application of these rules to the metaverse environment are not just theoretical.

On a more general note, there is no reason why anyone who would launder money using avenues like buying a Picasso or a luxury watch, cannot also do so on metaverses by buying digital art or collectibles.

Existing contracts

Metaverses and NFTs open up a number of new opportunities for brands that may not have been envisaged when the company entered into its existing contractual arrangements. Accordingly. it is likely that a brand's existing contracts with a range of third parties, for example, with distributors, retailers, agencies and influencers will not adequately capture the party's rights in connection with metaverse or NFT activity.

Accordingly, it is worth revisiting these existing contractual arrangements to assess if any amendments are required to clarify what each party is entitled to do (and not do) when it comes to any metaverse or NFT related initiatives.

For example, is it clear whether a distributor is permitted to distribute on a metaverse type platform (is there a broad description of platform which could cover gaming and metaverse type platforms or are specific sites listed)? Is an influencer permitted to promote the brand via an avatar, rather than their physical likeness / identity? Can an authorized retailer sell via a virtual store? Is an influencer allowed to create NFTs out of photographs that were taken in connection with a brand campaign?

In addition to looking at existing contractual partnerships, we recommend that brands review their standard terms and contract templates. Brands may need to make updates to ensure that these reflect the brand's preferred position with respect to the ownership and licensing of intellectual property and any other key issues which could arise on a NFT or metaverse project.

Glossary of terms

AI – Artificial intelligence. A wide-ranging branch of computer science concerned with building smart machines capable of performing tasks that typically require human intelligence. AI is being used in retail to create personalized customer experiences as well being utilized in supply chain management to improve efficiencies, amongst other uses.

AR – Augmented reality. Supplementing the user's physical world with virtual things, so they appear to be in the same environment. In a retail context, for example, AR can be used in virtual fitting rooms.

Blockchain – A distributed database for recording digital information in a secure, transparent, and immutable way. Transactions are recorded in "blocks" linked together to form a "chain" of previous transactions. The immutability, encryption, transparency, and decentralization creates trust in the blockchain system without a trusted third party. Blockchain technology is increasingly being used by CG&R businesses in supply chain management as a means of building and retaining consumer trust by substantiated provenance. Cryptocurrencies and NFTs also rely on blockchain technology to provide a verifiable proof of ownership. In addition, in the decentralized architecture of the metaverse ecosystem, blockchain will be key to keep a record of activity.

Cryptocurrencies – Digital currencies in which transactions are verified and records maintained using blockchain technology, rather than by a centralized authority, avoiding the need for intermediaries, bank accounts or transfer fees. There are many cryptocurrencies including: Bitcoin, Ethereum, Tether and Dogecoin.

Metaverse – a simulated digital environment that uses augmented reality, virtual reality, and blockchain, along with concepts from social media, to create spaces for rich user interaction mimicking the real world. Several metaverses exist and several more will emerge over time.

NFTs – Non-fungible tokens. A digitally unique record of ownership of a digital work. NFTs represent items like digital art, virtual real estate, or music, but are distinct from the digital items they represent. In the metaverse ecosystem, NFTs are likely to be leveraged to control/govern digital ownership. NFTs are increasingly being used by designers and retailers in the online environment.

VR – Virtual reality. A computer-generated environment with scenes and objects that appear to be real, making the user feel they are immersed in their surroundings. This environment is perceived through a device known as a VR headset or helmet.

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