NORTON ROSE FULBRIGHT

Navigating the metaverse: A global legal and regulatory guide

Part 2: Intellectual property and the metaverse

Introduction

In the space of a very short time, businesses are focusing on what the metaverse means for them. In addition to commercialising the opportunities available to them, such as new channels to market and enhanced customer engagement, businesses will need to understand and address the associated risks.

Such matters are extremely important for businesses, consumers, law-makers and lawyers alike. In this seven-part guide we consider the following key legal and regulatory issues in relation to the metaverse:

Part 1

What is the metaverse?

Who are the current big players building it?

What will the metaverse mean for business?

What are key technical, operational and governance considerations?

Part 2

Intellectual property and the metaverse

What are virtual reality worlds and virtual items?

Non-fungible tokens

How do traditional IP concepts sit with non-fungible tokens and other works in the metaverse?

Part 3

Anti-trust/competition law issues

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Will the EU Digital Markets Act apply to the metaverse?

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Part 4

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Data in the metaverse

Decentralised networks

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Data subject consents

Special categories of data

Children and the metaverse

Data sharing

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Responsibility for data breaches and cyber attacks

Part 5

Transacting in the metaverse

Buying "land" in the metaverse

What are the key issues when contracting in the metaverse ecosystem?

Non-fungible tokens, smart contracts and blockchain

Financial crime

Will metaverse risk and control considerations be similar to those relevant to the Internet?

Part 6

Digital marketing, adverting and social media in the metaverse

How will businesses be able to advertise in the metaverse?

Social media regulation

Regulating advertising content in the metaverse

Will AI have implications for marketing and the use of avatars in the metaverse?

Part 7

AI and the metaverse

Why is AI relevant to the metaverse?

How might AI regulation impact upon the metaverse?

How to operationalise AI risk mitigation in the metaverse

Data protection and AI

Overview of the legal and regulatory issues

The diagram shows the key legal issues and subject areas this guide covers. The breadth of issues means that mitigating risk associated with the metaverse is going to be a significant challenge for any business, but particularly so for a regulated business.

Intellectual property and the metaverse

Here we deal with IP rights in virtual reality worlds, and in particular, the increasing use of non-fungible tokens (NFTs), what they are (and what they are not), how virtual goods intersect with traditional IP concepts and some of the disputed issues surrounding them.

What are virtual reality worlds and virtual items?

With the proliferation of online "virtual worlds" or "metaverse", a new set of issues has arisen involving the use of third party IP rights. Some of the issues are arguably not that new though, since there have been platforms and games operating in virtual formats for some time now – for example, World of Warcraft and the Sims.

Second Life is one example of a large multi-player role-playing game that also operates as an online economy, allowing users to create their own virtual worlds, and even to sell their own branded creations (or those of others) for a profit.

Beauty and fashion brands have been quick to engage in these worlds by allowing avatars (virtual characters created by the users/players) to wear a virtual article of clothing that users may not be able to afford in real life. A common issue with the intersection of the virtual and real worlds has therefore been the use of real-world trade marks in or on virtual items.

Interoperability

There is presently no inter-operable standard software code for virtual items, so the products currently exist only in software code in their own compatible virtual worlds (for example, as downloadables in players' wallets in the particular game/world).

Non-fungible tokens

NFTs are not virtual items themselves, but are unique identification tokens that may reference an underlying asset that could be a virtual item (although they could equally, and sometimes do, link to a real world item).

NFTs are composed of software code in the form of a smart contract. NFTs are created – or "minted" – on a particular blockchain (that is, a distributed ledger technology) using cryptography, and they can be bought and sold or otherwise exchanged on any NFT marketplace based on the same blockchain (for example, OpenSea is a popular one).

The blockchain tracks the transaction history of the NFT from issuance to any number of subsequent transfers. It is the smart contract (code) constituting the NFT that contains details of the underlying digital or physical asset(s) (if any) to which the NFT relates, and also the rules and rights that attach to the NFT (for example, who owns it, if and how it can be transferred, what exactly the NFT represents (often just a personal use right), and perhaps even a rule that the original creator of the NFT gets paid a percentage of any subsequent resale value).

What do we mean by the underlying asset in this context? An NFT is linked to the underlying asset either by the digital work being encoded in the NFT (which is not very common) or by the NFT containing a cryptographic code (known as a "hash") that links to, or that can be used to identify, the digital file/copy of the image or artwork (which is the more common). Often the digital file is hosted online and the hash points to the webpage or virtual world where the digital file is hosted. A common problem arises in practice where that link is broken and/or the digital file is simply no longer there.

Understanding non-fungible tokens

A useful metaphor to help understand NFTs is to consider each NFT to be like a briefcase, in a chain of unique briefcases tied together. The process of chaining briefcases together represents the fact that NFTs sit as smart contracts on a blockchain, so that they may not be easily amended or deleted.

In this metaphor, each briefcase has a unique external luggage label, purporting to indicate what is inside.

For example, the label may say, "This NFT is for Leonardo da Vinci's painting, the Mona Lisa." What is inside the briefcase may indeed be documents conferring ownership of the actual painting, or perhaps conferring ownership of a digital photograph of the painting or even the only digital photograph, or merely documents conferring rights to display or to reproduce the digital image under some circumstances.

The documents in the briefcase may confer value in some way, or no value at all (for example, purporting to confer rights that the creator of the NFT has no legal right to claim), or, indeed, the briefcase may be entirely empty (if the URL link is faulty or even no longer there).

How do traditional IP concepts sit with non-fungible tokens and other works in the metaverse?

Trade mark protection

Virtual goods (and NFTs) are still very much a developing area for trade mark protection and there is no firm consensus yet on the accepted method and practice of making trade mark applications specifically for such products.

For example, the EUIPO recently issued some guidance notes on its approach to classifying items relating to virtual goods. Their guidance is that virtual goods are proper to Class 9 (software) because they are treated as digital content or images. However since the term "virtual goods" on its own lacks clarity and precision, they point out it needs to be further specified by stating the content to which the virtual goods relate (for example, "downloadable virtual goods, namely, virtual clothing").

In relation to the rising tide of NFT-related applications, the latest edition (12th) of the NICE classification system (in force from 1 January 2023) – that is, the system used internationally for registering trade marks – incorporates a new accepted term of "downloadable digital files authenticated by non-fungible tokens" in Class 9. Again, these are likely to need further specification to the content to which they relate and perhaps also the added words "in online virtual worlds".

Many brand owners have already conducted an audit to ensure that their existing trade mark registrations provide sufficient protection for the metaverse (both from an offensive and defensive perspective).

Trade marks: filing strategies

Putting aside specific fresh applications, there is currently legal uncertainty over whether existing "real world" trade mark registrations for the physical product/service (for example, "clothing" in Class 25) covers its virtual equivalent. That uncertainty is just one of the unknowns that could lead to challenges in brand protection and enforcement.

Given that uncertainty, some brand owners are pursuing strategies of extending their existing brand registrations to cover the equivalent virtual equivalents. Filing activity for metaverse-related goods/services to date has been predominantly in the US and in first-to-file jurisdictions (for example, China). There has been a huge rise in such applications.

Monitoring for new conflicting trade mark registrations and brand infringement

A business with an existing trade mark watching service will wish to extend it to cover the additional "virtual world" specifications mentioned already, and perhaps consider using monitoring services which will identify infringements and potentially file take-downs of IP in the metaverse, particularly on NFT marketplaces.

The virtual environment will throw up challenging legal issues for brand owners when seeking to identify infringements and enforce their rights. For example, will use of a trade mark in the virtual world constitute "use in the course of trade"? To make a successful claim for trade mark infringement in the UK and EU, a brand owner must show their sign is being used without their permission in the "course of trade". It is not yet clear when, or even whether, dealing in virtual assets will amount to "use in the course of trade".

Take this example: suppose a user mints an NFT branded item of clothing for his or her avatar to wear in the metaverse. Is that "use in the course of trade"? What about if a private individual sells or transfers an NFT to another private individual? Is that "use in the course of trade"?

It may prove challenging for brand owners to take action against individuals replicating branded digital assets or creating virtual equivalents of real life products. On the other hand, there might be a better chance of success against a third party creating branded virtual clothing, and selling them to others for use in the metaverse.

Case study: Hermès v Rothschild

In November 2021, Mason Rothschild, formerly known as Sonny Estival, created and sold one hundred NFTs linking to a depiction of a digital Hermès Birkin bag covered in faux fur and patterns, polka dots, and artworks such as the Mona Lisa and Van Gogh's Starry Night.

Rothschild also registered and used the domain name www.metabirkin.com and social media handles such as @metabirkins to promote the sale of the "MetaBirkins" NFTs. By early January 2022, Rothschild had sold in excess of US$1m in "MetaBirkins" NFTs.

Hermès brought suit in the Southern District of New York against Rothschild, asserting claims of trade mark infringement, trade mark dilution, cybersquatting and unfair competition under the Lanham Act and New York law based on Rothschild's use of the Birkin mark to promote and sell the MetaBirkins NFTs.

Hermès alleged that Rothschild's use of the Birkin mark had caused actual confusion among consumers, sophisticated commentators, and even intellectual property attorneys who believed that the MetaBirkins NFTs were affiliated with, authorised by, or sponsored by Hermès.

Rothschild defended his actions on the grounds that his "MetaBirkins" works, and his efforts to promote and sell the same, were protected artistic expressions under the First Amendment of the U.S. Constitution. The district court judge twice refused to dismiss the Hermès claims prior to trial. Background to Hermès' original claim against Mason Rothschild is detailed in our article together with our commentary, here.

On February 8, 2023, a jury found Rothschild liable for trade mark infringement, trade mark dilution and cybersquatting. The jury specifically concluded the First Amendment did not bar liability for any of these claims.

In rendering a verdict across the board for Hermès, the jury necessarily reached the conclusion that Rothschild's promotion and sale of the "MetaBirkins" NFTs was likely to confuse consumers as to the source or sponsorship of the same.

The jury awarded US$133,000 in damages to Hermès, an award consisting of a disgorgement of Rothschild's net profits, US$110,000, and an award of statutory damages totalling US$23,000 for Rothschild's cybersquatting. Post-verdict motions and appeals of the final judgment are highly likely.

As one of the first cases to consider the intersection of trade mark and First Amendment law in the digital age, brand owners and creators should watch how any appeals proceed. The First Amendment defence does not give artists the unfettered licence to infringe another's trade marks, but does permit creators to create artistic works which comment upon the products or services offered by brand owners. At some point, however, the public's interest in avoiding consumer confusion or competitive exploitation will override the interests sought to be protected by the First Amendment.

Trade marks: how will location of use and jurisdiction be established?

Trade marks are territorial rights, so infringement of a US trade mark requires use in the US, and infringement of a Chinese trade mark requires use in China. How will this work in the virtual world? We have guidance from the courts on how online use is connected to a particular jurisdiction – for example:

- Use of top-level country domains (for example: .co.uk).
- Language and currency of the website.

However, in the virtual world, where platforms use .org or .game gTLDs, and permit users to trade using cryptocurrency, it is hard to make those connections to a specific jurisdiction. Until the courts are required to consider these issues, it could be difficult for brand owners to establish location of use and/or jurisdiction.

Trade marks: how will brand owners detect infringement and identify infringers?

There may be challenges in linking anonymous avatars, living in the digital world, with their real world users, meaning it is difficult or near impossible to identify infringers.

Similarly, blockchain technology that underpins the use and trade of NFTs could make it tricky for brands to monitor infringing trades in NFTs, and consequently to enforce their rights. Metadata and blockchain ledgers, which verify the owner of an NFT, still may not point to a real world individual or organisation against whom a claim can be made.

NFT marketplace strategy

In the event that infringing activity is being carried out by the user of a third party platform (Opensea, DecentraLand, etc), brand owners can report the infringement to the platform, using the platform's "notice and take down" policy, if there is one. Many do already have in place these policies, perhaps reflecting a view that platforms and marketplaces are unlikely to want to be held liable for contributory infringement by failing to remove infringing content which is notified to them in this way.

Copyright

To assert copyright protection in a work, you need to establish authorship and ownership of copyright in the work in question. These issues are likely to be complex issues to determine in relation to the metaverse.

For example, if there are multiple metaverses, what would be the position if a copyright protectable work is created by many metaverse participants in different parts of the world, and the work is continually being developed? Here determining authorship and ownership of copyright at a particular moment could be challenging.

Having said that, registering copyright in metaverse assets and software (where available, for example in the US) could be beneficial, particularly where take down policies in NFT marketplaces are based on Digital Millennium Copyright Act (DMCA) principles.

Just as with trade marks, detecting copyright infringements and identifying the persons responsible for them could also be challenging. Finding infringing material could require virtual detection. New technologies might need to be developed to help here.

IP and AI

We discuss later how Artificial Intelligence (AI) will drive much of the metaverse. There are many IP issues that AI could give rise to in the metaverse (and IP issues relating to AI apply just as much outside the metaverse too). For example:

- The courts in many jurisdictions are currently grappling with whether AI can be an inventor for purposes of a patent.
- The courts and probably legislatures in many jurisdictions will need to decide whether copyright can subsist in a work (say, one generated in a metaverse ecosystem) created by AI.
- As AI both depends on vast amounts of data as well as generates data, there are going to be issues for the courts and legislatures to consider globally about the extent to which IP can be used to assert rights in such data, and so entrench its value.

Finally, turning from AI to IP rights and the metaverse more generally, what is clear is that a combination of judicial, regulatory and legislative action will shape the IP and NFT landscape in the virtual world in the years to come. It will be important to understand how NFTs fit into the world of intellectual property – both as IP rights stand today, and as they may evolve as we move into the future. Without such clarity, it will become increasingly difficult for businesses to innovate and protect their rights in the online virtual world.

What effect may virtual worlds have on existing and future IP licences and agreements?

The arrival of the metaverse may have an impact on various terms in IP licences entered into by a business (both licences in and licences out).

For example, while many licences (particularly for copyrights and trade marks) currently permit use on the Internet, it is untested whether that would include use in the metaverse.

Use on the metaverse also raises questions of territory, due to its decentralised nature. Businesses may therefore wish to start thinking about whether use in the metaverse should be in or out of scope of an IP licence, and to consider expressly permitting or prohibiting it where appropriate.

Where such use is permitted, thought should also be given as to whether that use should be limited to certain specific parts of, or platforms within, the metaverse, and how other provisions might apply in that context (for example, royalties, exclusivity etc.).

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