NFTs, Cryptocurrency & the Metaverse

A new dimension for IP

Protect your brand on the blockchain

The new digital world and the IP risks involved

Could NFTs transform IP into liquid assets?

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IP Risks in the new Digital World

Ling Jin of Lusheng Law Firm and Holly White of Rouse outline the key considerations for IP owners to reduce risk when exploiting new digital technologies based on recent trends.

During the pandemic, investments in digital assets and experiences to build brands, expand customer bases, and facilitate new ways of working have skyrocketed, with digital assets such as non-fungible tokens (NFTs), virtual idols, avatars and virtual goods gaining significant popularity. The luxury, gaming, and sports sectors, in particular, have been making substantial developments in this space, and they are also starting to catch other sectors' attention. So far, we've seen pop-up stores being launched in the metaverse and unique NFTs being created for gaming experiences, such as The Sandbox, Roblox and CryptoKitties.

However, with brands racing to get involved with these technologies, it can be easy to forget the potential risks attached to these investments, especially around IP. To mitigate the risks, IP professionals and legal counsels play an important role in helping to protect brands' reputations whilst enabling the successful use of these brands and technologies. IP professionals should be engaged early in the process to effectively inform the strategy, and help brands adapt their products to work in different countries and regulatory environments - some of which require strict compliance.

How digital assets are influencing market trends

Over the past couple of decades, brands have been focused on boosting their social media presence and e-commerce options. Now, with blockchain technology providing new opportunities for businesses to engage with customers, there is huge new potential to reap new revenue. Brands need to focus on integrating digital and physical marketing to build their customer base.

For many brands, NFTs have become the answer. NFTs are digital representations of assets and

Ling Jin

Holly White

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Résumés

Ling Jin is Head of Digital and Commercial at Lusheng Law Firm, and **Holly White** is Head of Service Development at Rouse, navigating legal complexities in the digital world.

include online-only assets like digital artwork as well as digitized versions of physical assets such as real estate. They also extend to in-game features like avatars, digital and non-digital collectables, and domain names. The gaming sector has been the first to fully embrace NFT technology; a recent study by Stratis found that 72% of game developers are exploring NFTs and blockchain in new games.

The music industry is now also starting to invest more in NFTs, using them for large-scale events such as Coachella, one of the world's most popular and profitable music festivals. The organizers launched three NFT collections at the last festival in 2021, including a range of digital photos, soundscapes, and posters that could be redeemed for real-world experiences. The band Muse recently reached number one in the UK charts with an album that was sold as an NFT, in addition to traditional formats. The NFT album gave owners access to a downloadable version, alternative artwork and signatures of the band members.

Outside of this, many companies are now looking into how digital experiences can enhance other aspects of our lives. Microsoft recently launched Microsoft Mesh, which allows employees in different physical locations to collaborate and carry out projects with mixed-reality and holographic features. Alongside this, a recent McKinsey report found that individuals are also looking to transition some everyday activities like shopping to the metaverse.

Technologies such as NFTs and the metaverse are here to stay and likely to evolve, so it is critical for businesses to understand and address the IP risks at stake and put in place measures to test appropriate IP strategies, learn from them and adapt.

Key IP considerations to remember

Ownership and the extent of IP protection

The IP rights and protection available to brands are dictated by the digital assets in which they have invested. With a wide variety of digital assets to choose from in this current climate, this ultimately means that legal professionals must be ready to adapt their approach depending on each asset.

Let's consider NFTs – they can exist in many forms, as we discussed above, from digital artwork to cryptocurrency, and the underlying asset influences how they interact with IP.

NFTs in the music and entertainment industry can provide a good level of protection for artists and record labels because the music is stored and hosted on databases, making it easier for ownership to be established and verified. However, digital work does not offer the same protection because these types of creations can be easily replicated. Yet this is not factored into the terms and conditions of smart contracts or the platforms facilitating the sale of NFTs.

Similar protection limitations arise regarding digital avatars. Music artists naturally want to control the commercialization of their identity, a concept known as personality rights. But entertainment companies use digital characters to offer their consumers virtual versions of their favorite artists when delivering virtual concerts, meet and greets and other events – and this can pose a problem for the artists if they no longer have control. Typically, when an artist enters a contract with an entertainment company, and digital avatars are at play, personality rights and copyright are balanced to adequately benefit both parties. But when the contract is terminated or ended early, the question of ownership arises – to mitigate tensions between personality rights and copyright, this must be considered and accounted for when contracts are developed at the beginning of a project.

Similar considerations and questions are needed when it comes to investing in the metaverse. Like blockchains, many virtual worlds are decentralized and owned by decentralized autonomous organisations (DAO). As a result, smart contracts are available for anyone to view, so there's less protection here for transaction-related trade secrets.

In light of this, when choosing to create a virtual world and determining the digital assets that will be included in it, it is important for legal professionals to support digital and marketing teams in prioritizing the digital assets that provide the most protection.

The rise in counterfeits

As investments in virtual advertising and experiences continue to increase, counterfeits of branded products are also expected to rise. In April 2022, a leading NFT marketplace, OpenSea, confirmed that at least 80% of NFTs it hosts were plagiarized, fake collections or spam. Since then, the company has adopted a 'blue tick' system (similar to that on Twitter) to verify legitimate NFTs.

We're already seeing notable brands such as Hermes and Nike take action to bring down counterfeiting efforts. And, in view of the potential scale of counterfeits, it is critical for brands to quickly and effectively locate the sources of fraudulent items.

However, despite the urgency around this matter, in certain regions, monitoring and regulation around counterfeits remain quite limited. In particular, in Southeast Asia, identity verification is not required on social e-commerce platforms, which enables counterfeiters to easily hide behind fake or anonymous accounts. Given this, brands looking to launch digital marketing campaigns in this region will be hoping for a higher level of obligations and consequences for NFT trading platforms to ensure the validity of digital assets on their platforms. There seem to be some positive developments happening in the region, with the first publicized NFT infringement case in China recently issued, in which the Hangzhou Internet Court held a Chinese NFT-trading platform responsible for copyright infringement. While the case is still in the second instance, we do not expect the decision to be overturned.

Navigating complex regulatory environments

In today's climate, more and more governments are taking strong action against non-compliance. Brands must be ready to understand the unique implementations required to launch digital campaigns and experiences across complex regulatory environments, such as China.

In 2021, the Chinese government enacted the Personal Information Protection Law (China's equivalent of GDPR) to enable greater scrutiny of consumer data collection and use. The consequences of data misuse under this law include high fines and loss of business licenses.

The companies most affected by this are those B2C businesses that rely on e-commerce and data analytics, as well as tech giants, who offer services to Chinese consumers through partners. However, other businesses investing in the metaverse will also have to consider their data habits in this region. Huge volumes of data are connected to various NFT forms, including digital fashion and art items, as well as the underlying smart contracts which enable trading. The blockchain technology behind NFTs is immutable, which means a significant challenge for brands is in managing, storing and hosting data. The servers that this data is hosted on falls under cross border data transfers which opens up further regulatory complexity.

Alongside this, any brand looking to operate in this region will need to be aware of the specific rules on NFTs. NFTs are currently allowed in China, but this only extends to digital collectables, digital artwork or virtual digital goods, not payment transactions. There are also policies on secondary trading and strict T&Cs with certain tech platforms, which considerably influence NFT activity and investment. NFTs can also only be bought in Renminbi, for instance, and cryptocurrency payment is not allowed in China.

To navigate such complex regulatory environments, brands must be prepared to understand what adjustments are needed to successfully launch digital campaigns.

Taking control

The use of digital assets and experiences will only continue to evolve, complicating IP protection and rights as we know them. Given the complexities at hand, the wish of some brands to wait to see how digital develops and whether IP enforcement in the digital world will replicate real-world enforcement is understandable. But businesses must remember that early movers can attract attention from consumers and build brand value using digital assets.

Testing out different strategies for key regions is critical to see what works and to build knowledge and learnings. Additionally, it is important for brands to strengthen their rights by filing additional IP registrations to add a layer of protection for virtual assets. Not doing so potentially exposes brands to other parties capitalising on their IP to create digital goods. However, above all else, legal professionals and those leading the innovation must work more closely together to understand and mitigate the risks at stake.

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Contact

Lusheng Law Firm
Room 2706, Park Place
1601 Nanjing Road (West)
Shanghai. China, 200040
Tel: +86 21 2356 4950
LSShanghai@lushenglawyers.com
www.lushenglawyers.com

Rouse
4th Floor City Tower
40 Basinghall Street
London, EC2V 5DE, UK
Tel: +44 20 7536 4100
london@rouse.com
www.rouse.com