

Legal Uncertainty in Virtual Worlds and Digital Goods: Do the Same Laws Apply?

Alanna Sadler
University of Miami School of Law

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Legal Uncertainty in Virtual Worlds and Digital Goods: Do the Same Laws Apply?

Alanna Sadler*

The growth of virtual worlds and digital goods will force US courts to examine whether traditional laws are sufficient to protect consumers. To do so requires judges and legislative officials to possess a deep understanding of concepts that are everchanging. Many aspects of virtual worlds, such as the metaverse(s), are driven by web3 technology, the technology responsible for the NFT and cryptocurrency craze of recent years. It is impossible to ascertain the impact of virtual worlds on daily life, however, companies must nevertheless prepare for the shift toward virtual spaces and digital goods. There is greater skepticism regarding the utility of a metaverse compared to other recent technological advancements, such as artificial intelligence models, but the push for metaverses prevails even in 2023. Brands, creatives, and consumers will turn to courts for clarification on traditional laws within intellectual property, securities, privacy and data, and torts in the digital landscape. This note argues in favor of the application of the traditional intellectual property regime as it relates to digital goods, as it incentivizes creators to produce content in virtual spaces. Without adequate protection of digital works, even when such works exist in new “markets” like the metaverse(s), concerns over protection of intellectual property will arise.

*While we are still in the early stages of relevant cases, there are a handful of rulings that provide some clarity. In *Hermès International v. Rothschild*, the Southern District of New York*

* Juris Doctor Candidate and Master of Laws (LL.M.) Candidate in Entertainment, Arts, and Sports Law, University of Miami School of Law, Class of 2024; I would like to give a very special thank you to Professor Cheryl Zuckerman for her guidance and support in writing this Note.

ruled on whether a digital good, such as an NFT, could infringe on another's trademark using the same legal analysis as a traditional trademark infringement. The court in Hermès applied the Rogers v. Grimaldi test (the test that protects some artistic works under the First Amendment), holding that an NFT consisting of another's mark should be analyzed using the Rogers test so long the use of the mark does not function primarily as a source identifier that would mislead consumers. Additionally, the court in Yuga Labs Inc. v. Ripps. dealt with a well-known NFT collection and a lookalike collection. The California Central District Court in Yuga Labs Inc. held that trademark law and the Lanham Act applies to "intangible" goods (including) NFTs, but unlike Hermès, the court refused to apply the Rogers test, holding that the lookalike NFT collection failed to reach the artistic threshold required to engage in the First Amendment analysis.

Additionally, the Supreme Court's recent ruling in Andy Warhol Foundation for the Visual Arts, Inc. v. Goldsmith may have transformed the meaning of artistic works and fair use in copyright law. The Court's ruling should exist as a warning to creatives that the threshold for a transformative work is higher than anticipated. This is significant evidence that other intellectual property regimes, like trademark law, will be impacted, and it is possible the Rogers test may require satisfaction of a similar threshold to qualify as an artistic work. Nevertheless, it is likely that traditional intellectual property law will apply smoothly to virtual worlds and digital goods. Thus, to adequately protect one's brand, companies must expand trademark filings to apply to virtual spaces, and artists/creatives must be cautious when using another's mark— particularly if artists hope that the First Amendment will come to save them.

Additional questions arise surrounding digital goods and other fields of law, like securities law. The U.S. Securities Exchange Commission's recent actions toward influencers advertising cryptocurrency coins implies that it will soon categorize cryptocurrencies and certain NFTs as securities bound by federal regulations. The issue of privacy and data collection is one of web3's greatest threats, as it is difficult to identify who governs in a decentralized space. This note argues that companies selling NFTs and offering metaverse interactive experiences should

comply with the highest standard of privacy and data collection, such as the European General Data Protection Regulation, to ensure compliance in an inherently globalized industry. This note further argues that torts, such as sexual and physical assault and harassment, should be regulated and controlled by the entity that controls the virtual experience. For example, if Meta runs its version of the Metaverse, Meta must have systems in place to protect against illegal conduct. The enforceability is difficult based on the decentralization of these digital worlds. Therefore, without minimum government requirements, it is the social responsibility of companies to provide a safe environment for users to interact and engage.

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INTRODUCTION

As virtual worlds and digital goods become more engrained in society, courts face the difficult task of reexamining legal doctrines to ensure consistency in their application to virtual spheres. While intellectual property is at the forefront of these technological advancements—

particularly those related to new spaces and goods that are backed by web3 technology—there are additional issues, ranging from regulation and governance to federal securities laws and torts.¹ The impact of web3-powered technologies, the metaverse, and other digital assets remains unknown,² however, lawyers should prepare for the societal shift from web2 to web3.

For many, it is challenging to comprehend the complexity of a virtual world. It is critical to define the “buzzwords” that often plague this industry. Part I of this note will introduce and define general concepts, like web3 and its preceding “version” of the internet, the metaverse, and NFTs. Part II will describe the impact of virtual worlds on industries as of December 2023, including the entertainment, sporting, and gaming industries. Parts III and IV will introduce relevant caselaw that has the attention of metaverse and NFT-enthusiasts. More specifically, an analysis of *Hermès International v. Rothschild*³ and *Yuga Labs Inc. v. Ripps*⁴ proves that courts turn to traditional analyses of intellectual property law for digital goods. Additionally, the recent Supreme Court decision in *Andy Warhol Foundation for the Arts v. Goldsmith* should further caution creatives from including third-party intellectual property in new artwork but begs the question as to whether the “same commercial purpose” analysis should apply in digital art, such as NFTs. Lastly, Part V through Part VII cautions against varying legal issues in the web3 space, including securities laws, privacy and data protection, and issues of governance and regulation.

Virtual worlds, such as the metaverses, are likely to be powered by web3 technology.⁵ To understand the concept of web3, it is first helpful to examine previous “versions” of the web. Web1, for example, refers to the early internet, such as web pages and discussion boards.⁶ Web2 is the internet as we understand it today—the version that hosts more complex

¹ See James Gatto et al., *Are You Ready for Web3.0 and the Legal Issues it Will Bring?*, SHEPPARD MULLIN, (Feb. 2022), <https://www.sheppardmullin.com/assets/htmldocuments/Web3%20Legal%20Issues%20Article%200222.pdf>.

² See Alexandra Pitkevish, *The Web 3.0 Paradigm Shift: A More Homogenous, Decentralized And Democratized Internet*, THE FAST MODE (Sept. 19, 2022), <https://www.thefastmode.com/expert-opinion/27580-the-web-3-0-paradigm-shift-a-more-homogenous-decentralized-and-democratized-internet> (“The advent of social media, kicking off the age of user-generated content . . . Web 3.0 is built on decentralization [and] users will own their content and have complete control over using the internet.”).

³ *Hermès Int’l v. Rothschild*, 603 F. Supp. 3d 98, 102 (S.D.N.Y. 2022).

⁴ *Yuga Labs, Inc. v. Ripps*, No. CV22-4355, 2023 WL 3316748, at *12-13 (C.D. Cal. Apr. 21, 2023).

⁵ Kevin Roose, *What is web3?*, THE N.Y. TIMES, <https://www.nytimes.com/interactive/2022/03/18/technology/web3-definition-internet.html> (last visited Nov. 6, 2022).

⁶ *Id.*

web pages, often with advertisements monetized by large companies, and where users create content on social media platforms such as YouTube, Twitter, and Facebook.⁷ While there is not one “owner” of the web2 version of the internet, proponents of web3 argue that web3 will replace the “centralized, corporate platforms [of web2] with open protocols and decentralized, community-run networks, combining the open infrastructure of web1 with the public participation of web2.”⁸ The decentralization of web3 may offer smaller companies, or even individuals, with greater opportunities to control, personalize, and monetize the internet experience. However, legally, a completely decentralized industry poses difficulties around the enactment and enforcement of policies to keep users and user data safe.

While web3 and the metaverse are inextricably linked, the metaverse refers to the digital space where consumers can interact with virtual events, commodities, and users in real-time.⁹ The metaverse, however, does not refer to just one particular digital world.¹⁰ “The metaverse” seemingly implies one virtual entity; however, the term describes a series of “disconnected metaverses,” that may eventually combine to become one.¹¹ At its core, many experts believe it is merely a place “parallel to the physical world, where you spend your digital life.”¹² Still, as it stands today, most interactions within the metaverse require hardware to be connected to the virtual world like a virtual reality headset.¹³ For example, a consumer may wear a virtual reality headset to tour a city or visit a store to browse virtual depictions of real-life products.¹⁴ Purchasing consumer goods is one of the metaverses’ potential utilities, and if executed, this opportunity will monumentally impact e-commerce, advertising, and branding.¹⁵ Legally, this utility alone, shopping virtually, raises issues

⁷ *See id.*

⁸ *Id.*

⁹ *See* GREGOR PRYOR ET AL., REEDSMITH, REED SMITH GUIDE TO THE METAVERSE 5 (2d ed. 2022), <https://www.reedsmith.com/-/media/files/metaverse/guidetothemetaverse2ndedition.pdf>.

¹⁰ *See* Deborah Lovich, *What is the Metaverse And Why You Should Care*, FORBES (May 11, 2022, 07:45 AM), <https://www.forbes.com/sites/deborahlovich/2022/05/11/what-is-the-metaverse-and-why-should-you-care/>.

¹¹ *See id.*

¹² Shumani Joshi, *What Is the Metaverse? An Explanation for People Who Don’t Get It*, VICE (Mar. 15, 2022, 5:52 AM), <https://www.vice.com/en/article/93bmyv/what-is-the-metaverse-internet-technology-vr>.

¹³ PRYOR. ET AL., *supra* note 9, at 5.

¹⁴ *Id.*

¹⁵ *See* Cappasity, *Metaverse in e-commerce market is rapidly growing*, MEDIUM (Sept. 26, 2022), <https://medium.com/cappasity-blog/metaverse-in-e-commerce-market-is-rapidly-growing-11ae60e65e7>.

surrounding intellectual property, consumer privacy, data collection, and securities law.

Next, it is critical to distinguish non-fungible tokens, which are commonly referred to as “NFTs.” NFTs are included in the discussion of web3 and metaverses due to NFTs’ connection to decentralized security.¹⁶ NFTs can be described as a type of cryptocurrency powered by the various blockchains.¹⁷ For example, NFTs have been sold on both the Ethereum blockchain and the Solana blockchain. One would need to use Ethereum cryptocurrency to purchase an NFT on the Ethereum blockchain.¹⁸ Here, “Ethereum” refers to the cryptocurrency used to buy and sell NFTs, while “blockchain” refers to the decentralized public ledger that records and tracks all transactions.¹⁹ In other words, NFTs are a “unit of information recorded on a blockchain about a good or service that is not interchangeable.”²⁰

NFTs have gained a significant amount of international attention within recent years. Brands and celebrities continue to create and sell NFTs, often integrating them into collaborations and promotions.²¹ For example, Snoop Dogg released “A Journey with the Dogg,” an NFT collection that sold for thousands of dollars.²² Famous projects like the Bored Ape Yacht Club sell individual tokens for over \$1 million dollars each.²³ There are a few explanations as to why consumers wish to own and/or collect NFTs. Some have compared owning a Bored Ape NFT, for example, to owning a Banksy piece.²⁴ Consumers buy art, or in this case, NFTs, for a multitude of reasons.²⁵ It is possible that one simply

¹⁶ Aubrey Moore, *The relationship between NFTs and the Metaverse*, FINTECH NEWS (Nov. 2, 2022), <https://www.fintechnews.org/the-relationship-between-nfts-and-the-metaverse/>.

¹⁷ Mitchell Clark, *NFTs, explained*, THE VERGE (June 6, 2022, 8:30 AM), <https://www.theverge.com/22310188/nft-explainer-what-is-blockchain-crypto-art-faq>.

¹⁸ See Onkar Singh, *Why is Ethereum used for NFTs?*, COINTELEGRAPH (May 21, 2022), <https://cointelegraph.com/explained/why-is-ethereum-used-for-nfts>.

¹⁹ See *id.*

²⁰ PRYOR ET AL., *supra* note 9, at 15.

²¹ *Id.* at 20.

²² *Id.*

²³ Jeffrey Craig, *Why Do People Buy NFTs?*, PHEMEX (Apr. 26, 2022), <https://phemex.com/blogs/why-do-people-buy-nfts>.

²⁴ See Bobby Allyn, *What’s an NFT? And Why Are People Paying Millions to Buy Them?*, NPR (Mar. 5, 2021 7:00PM ET), <https://www.npr.org/2021/03/05/974089381/whats-an-nft-and-why-are-people-paying-millions-to-buy-them> (“But like with other collectables, whether it’s baseball cards, rare books or fine art, having an original is special”).

²⁵ See Robert Klonoski, *How and Why Do People Choose & Buy Art?*, ARTBUSINESS.COM, <https://www.artbusiness.com/osoconsume.html> (last visited Jan. 17, 2023).

appreciates the artwork, while another may purchase an NFT as a token of wealth. NFTs, however, tend to include an investment component that traditional, physical art may lack. As mentioned above, the Board Ape Yacht Club initially cost around 1 ETH, which, at its peak, was worth more than \$4,000.²⁶ As of late 2023, Bored Apes sell for an average cost of \$41,800, a profit of over 1000%, which is lower than previous years' costs.²⁷ The idea of investment and earning profit brings securities laws to the forefront of the conversation, and more specifically, whether the SEC or courts will opt to label NFTs as a security thus regulated by federal securities laws.²⁸

The value of web3, the metaverse, and NFTs relies on the notion of decentralization, but each represent slightly different ideas within the decentralized space. As implied above, there are varying opportunities for creators, artists, brands, and companies.²⁹ An artist may choose to create an NFT line, while a brand may prefer to build out business opportunities in the metaverse. So, while the concepts are undeniably connected, it is important, nevertheless, to distinguish the potential uses from one another.

I. THE IMPACT OF THE METAVERSE ON INDUSTRIES

A. *Corporate Interest and Investment*

Metaverses and other tools backed by web3 have network effects. The value of the metaverse increases as the number of users increase.³⁰ For example, a company's million-dollar investment toward a digital shop has no value without users. Similarly, if a music festival decided to invest in a virtual music festival with "live" artists performing as avatars, it would be worthless without the attendance of virtual fans and vendors.

Nevertheless, companies have invested and continue to invest heavily in the metaverse, in preparation for the shift to web3. Facebook's rebranding to Meta is perhaps one of the biggest indicators of corporate

²⁶ *Ethereum (ETH) price per day from Aug 2015 – Oct 09, 2023*, STATISTA, <https://www.statista.com/statistics/806453/price-of-ethereum/> (last visited Oct. 23, 2023).

²⁷ *NFT Stats, Bored Ape Yacht Club NFT*, NFT STATS, <https://www.nft-stats.com/collection/boredapeyachtclub> (last visited Oct. 23, 2023).

²⁸ See Gatto et al., *supra* note 1.

²⁹ See Bernadette Giacomazzo, *Here Are Just a Few of the Many Celebrities You Can Find in the Metaverse*, AFROTECH (Apr. 13, 2022), <https://afrotech.com/metaverse-celebrities-rappers> (citing Jay Z, LeBron James, Rick Ross, and Floyd Mayweather as examples).

³⁰ Vivekanand Jayakumar, *Big Tech and the antitrust debate: Do network effects outweigh competition concerns?* THE HILL (July 31, 2020, 9:30 AM), <https://thehill.com/opinion/technology/509933-big-tech-and-the-antitrust-debate-do-network-effects-outweigh-competition/>.

interest in the decentralized virtual space.³¹ It is reported that Meta has spent nearly \$15 billion on its Reality Labs venture since the beginning of 2021.³² Most recently, Meta announced a thousand-dollar virtual reality headset.³³ Meta has stated that it does not expect to see immediate returns, putting it lightly, considering its Metaverse division has since lost \$3 billion.³⁴ Google invested \$39 million into a Metaverse fund, Epic Games invested \$1 billion, and Nike acquired a digital sneaker design studio which has attracted over 7 million people worldwide.³⁵ Notably, there is clear diversity among these companies—Google, a provider of search and advertising services, Epic Games, a video game company, and Nike, a powerhouse brand.

B. *The Gaming Industry*

The gaming industry has a natural connection to metaverses and digital goods. From a recent study conducted by Ernst & Young, ninety-seven percent (97%) of gaming executives believe the gaming industry is central to the development of the metaverse.³⁶ The development of gaming in the metaverse is not slowing, and executives agree that companies will work to offer various types of games to attract consumers of varying demographics.³⁷ For example, the gaming company Axie Infinity offers web3 “play-to-earn” games that provide players with NFTs as they beat levels and advance in the game.³⁸ However, players who “play-to-earn” have the opportunity to take real ownership of their in-game assets, or

³¹ See Andrew Ross Sorkin et al., *Could a New Name Help Facebook After All?*, THE N.Y. TIMES, <https://www.nytimes.com/2021/10/29/business/dealbook/facebook-meta-rebranding.html> (Nov. 10, 2021) (“It’s a clear move by the founder Mark Zuckerberg to de-emphasize the company’s most successful product and reorient itself around a vision of a virtual-reality enabled future that Meta’s own executives admit, based on today’s technology, can’t yet exist.”).

³² Samantha Delouya, *Meta has burned \$15 billion trying to build the metaverse – and nobody’s saying exactly where the money went*, INSIDER (Oct. 13, 2022, 7:29 PM), <https://www.businessinsider.in/tech/news/meta-has-burned-15-billion-trying-to-build-the-metaverse-and-nobodys-saying-exactly-where-the-money-went/articleshow/94847061.cms>.

³³ *Id.*

³⁴ Conor Pritchard, *Top 10 Companies Investing in the Metaverse*, PARCL (July 31, 2022), <https://www.parcl.co/blog/top-10-companies-investing-in-the-metaverse>.

³⁵ See *id.* Large companies, such as Google, Nike, and Epic Games are investing sums of money to prepare for a populated Metaverse to implement real-world services digitally.

³⁶ SCOTT PORTER ET AL., ERNST & YOUNG, GAMING INDUSTRY SURVEY 2022 5 (2022).

³⁷ See Esther Shein, *Game on: The gaming industry is core to development of the metaverse*, TECHREPUBLIC (May 18, 2022, 8:50 AM), <https://www.techrepublic.com/article/gaming-industry-core-development-metaverse/>.

³⁸ PRYOR ET AL., *supra* note 9, at 22.

even exchange tokens on the blockchain for cash.³⁹ “Skins, weapons, characters, in-game currency . . . can all be traded or sold for profit, just like any other NFT. And just like with any other NFT, some of these in-game assets can sometimes fetch an eye-watering amount on the secondary market.”⁴⁰ This leads to a variety of questions, including whether earned in-game assets should be taxed or whether play-to-earn users should be considered employees subject to employment regulations.⁴¹

Another issue seen in metaverses rest in players’ ability to connect and socialize with other players.⁴² Players choose avatars that represent their real-life persona and often interact freely with other avatars. In Meta’s metaverse, users create avatars by first taking a photograph of themselves.⁴³ This may pose issues surrounding data protection and privacy. Additionally, the social element of gaming brings alternative legal consequences to the forefront. There have been increased reports of sexual assault and harassment in gaming in the metaverse.⁴⁴ Some have called Meta’s metaverse “another cesspool of toxic content.”⁴⁵

Due to its decentralized nature, it is difficult to determine which set of laws apply. Europe has recently adapted the Digital Services Act to protect users from harassing, bullying, and harmful content.⁴⁶ In Germany, the Federal Protection of Young Persons Act aims to protect children against harm resulting from media use including immoral and violent content.⁴⁷ In a decentralized world, which jurisdiction wins? Governments may struggle to hold users accountable. Instead, governments should place greater liability on the companies that run a particular game or virtual world. If there are instances of violence and sexual assault in Meta’s

³⁹ See Jex Exmundo, *What Are Play-to-Earn Games? A Guide to Your Future Side-Hustle*, NFTNOW (Aug. 15, 2022), <https://nftnow.com/guides/the-best-play-to-earn-games-for-nft-and-crypto-lovers/>.

⁴⁰ *Id.*

⁴¹ See David Kemmerer, *How Are Cryptocurrency Games Taxed?*, COINLEDGER, <https://coinledger.io/blog/cryptocurrency-games-taxes> (last visited Feb. 15, 2023).

⁴² See Sudeep Srivastava, *How Could Metaverse be a Game Changer for the Virtual Gaming Industry?*, APPINVENTIV (Oct. 28, 2022), <https://appinventiv.com/blog/metaverse-gaming/>.

⁴³ See Kris Holt, *Meta’s avatars are getting legs*, ENGADGET (Oct. 11, 2022, 3:09 PM), <https://www.engadget.com/meta-avatars-metaverse-legs-vr-virtual-reality-facebook-instagram-whatsapp-190937062.html>.

⁴⁴ See Trang Le, *Sexual assault in the metaverse is part of a bigger problem that technology alone won’t solve*, MONASH UNIVERSITY: LENS (July 22, 2022), <https://lens.monash.edu/@politics-society/2022/07/22/1384871/sexual-assault-in-the-metaverse-theres-nothing-virtual-about-it>.

⁴⁵ *Id.*

⁴⁶ PRYOR ET AL., *supra* note 9, at 26.

⁴⁷ *Id.*

metaverse, for example, Meta should have safeguards in place to either remove players indefinitely because of harassment or provide safeguards for those being harassed to exit the virtual space.

C. *The Entertainment and Sports Industry*

The metaverse has great potential in influencing the music industry and how fans interact with artists. Additionally, the movement toward virtual worlds increased as a result of the pandemic.⁴⁸ “[The] current global crisis has accelerated some of the cultural trends and behaviors that need to be in place for a metaverse to be created.”⁴⁹ Virtual worlds offer opportunities for artists to perform in virtual venues, increase digital visual production, interact with audiences in real time, collaborate with other artists digitally, and more.⁵⁰ Artists have already begun to take advantage of opportunities in the metaverse. The MTV Video Music Awards introduced a new category, called “Best Metaverse Performance,” and even announced a metaverse experience on the gaming platform Roblox.⁵¹ In a survey conducted among a representative sample of 4,420 U.S. adults, sixty-one percent (61%) of millennials’ responses said they would be “interested in attending a live concert in the metaverse, while an equal share said the same for having a digital avatar represent them.”⁵² The statistics were even higher for “Gen-Z” respondents.⁵³

In addition to virtual concerts, companies have expressed interest in events related to the sports industry. Sony recently partnered with Manchester City Football Club to develop new digital fan experiences, with the intention to create a global online fan community where fans can gather and interact with other fans.⁵⁴ Live virtual music events in the metaverse offer a host of legal issues, most of which relate to rights clearances.⁵⁵ In Reed Smith’s “Guide to the Metaverse,” the complexity of rights clearances in the metaverse can be shown through the following hypothetical:

⁴⁸ See Adam Simon, *How Covid-19 Is Leading Us to the Metaverse, Part One*, MEDIUM (May 14, 2020), <https://medium.com/ipg-media-lab/part-1-how-covid-19-is-pushing-us-closer-to-the-metaverse-c76a46e21cd2>.

⁴⁹ *Id.*

⁵⁰ PRYOR ET AL., *supra* note 9, at 28.

⁵¹ See Janelle Borg, *Is the metaverse disrupting the music industry?*, HYPEBOT, <https://www.hypebot.com/hypebot/2022/08/is-the-metaverse-disrupting-the-music-industry.html> (last visited Nov. 6, 2022).

⁵² Chris Teale, *In the Metaverse, Live Concerts Hold More Appeal Than Live Sports and Shopping*, MORNING CONSULT (Apr. 11, 2022, 12:01 AM), <https://morningconsult.com/2022/04/11/metaverse-activities-generations-survey/>.

⁵³ *Id.*

⁵⁴ *See id.*

⁵⁵ PRYOR ET AL., *supra* note 9, at 29.

To take an example, a digital music service provider (for instance, Spotify) could promote and host a live-streamed concert on a global games console platform (let's say, Sony PlayStation) during the interval of an eSports tournament being held and promoted by a leading games publisher (perhaps, Electronic Arts) working alongside a famous brand (maybe, Nike). To attend the concert, a consumer would need to be a user of the gaming platform and have purchased ticketed access to the eSports tournament. However, the live-streamed concert would only be available to a limited number of superfans who had entered a prize draw by buying an original NFT token issued by the headline performing artist (for example, Drake). Prizes might include, at the top level, attendance at the live virtual event and an authentic piece of digital merchandise, while runners-up might still get to see the concert on an on-demand basis at a later date, missing the live show.⁵⁶

The television and film industry has also seen changes due to web3 technology and the growth of digital worlds. Instead of an NFT that merely represents art, a production company may find value in selling tokens to fans to access additional content, like behind-the-scenes material or exclusive interviews.⁵⁷ As a result, law firms have seen “spike[s] in the number of negotiations centered on the grant of NFT rights . . . between the rights holder . . . and the acquirer of those rights looking to develop and/or exploit the property through an audiovisual production.”⁵⁸

D. *Growth in Advertising*

Perhaps most notably, brands and companies have the opportunity to advertise to consumers in new and meaningful ways. Web2 already offers “online-to-offline” commerce, but web3 can advance that concept to the next level. Online-to-offline commerce refers to the business strategy that entices customers online to make purchases in physical stores, whether through advertising, promotions, or other similar tools.⁵⁹ Companies will likely shift focus to “metaverse-to-offline” commerce, and some have already begun to do so. For example, in April 2022, Chipotle offered

⁵⁶ *Id.*

⁵⁷ *Id.* at 36.

⁵⁸ *Id.*

⁵⁹ Adam Hayes, *Online-to-Offline (O2O) Commerce Definition and Trends*, INVESTOPEDIA (Oct. 08, 2021), <https://www.investopedia.com/terms/o/onlinetooffline-commerce.asp>.

burrito vouchers to the first 30,000 visitors to its restaurant in the Roblox metaverse.⁶⁰ Those vouchers, of course, were only redeemable in physical, real-world Chipotle restaurants. Nike has also become a staple in the Roblox metaverse, offering purchases of virtual sneakers, clothes, and wearable accessories for avatars in the metaverse.⁶¹ At first glance, it may seem hard to believe that users are willing to spend money on items that are only wearable in digital worlds, but it has already proven to be a lucrative venture. For example, Gucci offered Roblox users a free walk-through to shop its digital fashion collection.⁶² Gucci managed to sell a virtual bag for more than its physical counterpart.⁶³

Other, more traditional forms of advertising will exist in the metaverse, as well, such as virtual billboards and banner advertisements. In these cases, legal issues related to data collection and data privacy laws may arise. Again, it may be difficult to determine which data privacy laws will apply in a decentralized space. The General Data Protection Regulation (“GDPR”) in the European Union (“E.U.”) should apply because it has an agency to carry it out, whereas the United States does not.⁶⁴ Additionally, the GDPR applies to U.S. based companies that serve E.U. citizens.⁶⁵ If in the future, one decentralized metaverse becomes the norm, governments will need to consider whether it is worth creating a separate set of laws for that virtual world.

II. COURT CASES IN THE UNITED STATES THAT ANALYZE WEB3, METAVERSE, AND NFTS

There are several court cases in the U.S. docket that relate to web3, the metaverse, and NFTs. While many of these cases are still in the early stages of litigation, courts have provided some insight into how judges plan to analyze virtual worlds from a legal perspective. The following section of this note will analyze two popular cases involving NFTs,

⁶⁰ Eric Hazan, et al., *Marketing in the metaverse: An opportunity for innovation and experimentation*, MCKINSEY (May 24, 2022), <https://www.mckinsey.com/capabilities/growth-marketing-and-sales/our-insights/marketing-in-the-metaverse-an-opportunity-for-innovation-and-experimentation>.

⁶¹ See Rachel Breia, *Advertising In the Metaverse*, SENSORIUM (Apr. 13, 2022), <https://sensoriumxr.com/articles/advertising-in-the-metaverse>.

⁶² *Id.*

⁶³ *Id.*

⁶⁴ See Derek Hawkins, *The Cybersecurity 202: Why a privacy law like GDPR would be a tough sell in the U.S.*, THE WASH. POST (May 25, 2018), <https://www.washingtonpost.com/news/powerpost/paloma/the-cybersecurity-202/2018/05/25/the-cybersecurity-202-why-a-privacy-law-like-gdpr-would-be-a-tough-sell-in-the-u-s/5b07038b1b326b492dd07e83/>.

⁶⁵ See *id.*

Hermès International v. Rothschild and *Yuga Labs Inc., v. Ripps*. Specifically, Southern District of New York Judge Rakoff’s analysis in *Hermès* hints that trademark law will treat virtual commodities, such as NFTs, similarly to traditional, physical goods.⁶⁶

A. *Hermès International v. Rothschild*

Hermès caught the attention of lawyers, brands, and consumers alike, and many have tracked the case closely. In 2021, Mason Rothschild created digital images depicting a fur Birkin bag under the name of “MetaBirkin.”⁶⁷ Rothschild sold the MetaBirkins as NFTs, and the image closely resembled the famous luxury handbags of Hermès International and Hermès of Paris, Inc. (collectively, “Hermès”).⁶⁸ Hermès filed a lawsuit on January 15, 2022, arguing that (1) the MetaBirkin NFT infringed and diluted Birkin’s trademark and business reputation, and (2) the MetaBirkin falsely designated the origin of the NFTs.⁶⁹ Defendant Rothschild, on the other hand, defended his position on First Amendment grounds, arguing that the MetaBirkin is artistic expression.⁷⁰ Further, Rothschild argued that Hermès failed to establish any significant likelihood of consumer confusion, as shown by the lack of evidence of misled consumers.⁷¹ In response, Hermès filed an amended complaint that sufficiently alleged Rothschild’s use of the trademark as not “artistically relevant and that the use is explicitly misleading.”⁷²

In May 2022, Judge Rakoff denied Rothschild’s motion to dismiss, rejecting Rothschild’s argument that *Rogers v. Grimaldi*⁷³ protected the MetaBirkin NFT from Hermès’s infringement claim.⁷⁴ The *Rogers* test seeks to balance trademark law with First Amendment interests.⁷⁵ In *Rogers*, the Second Circuit held that the use of a famous trademark in connection with a work of art “does not infringe trademark rights so long as (1) the name is ‘minimally artistically relevant’ to the product, and (2)

⁶⁶ See *Hermès Int’l v. Rothschild*, 603 F. Supp. 3d 98, 104-07 (S.D.N.Y. 2022).

⁶⁷ *Id.* at 100.

⁶⁸ *Id.*

⁶⁹ *New District Court Decision Provides Useful Guidance on Application of Trademark Law to Virtual Goods*, GIBSON DUNN (May 20, 2022), <https://www.gibsondunn.com/new-district-court-decision-provides-useful-guidance-on-application-of-trademark-law-to-virtual-goods/>.

⁷⁰ See *Hermès v. Rothschild: A Timeline of a Case Over Trademarks, NFTs*, THE FASHION LAW, <https://www.thefashionlaw.com/hermes-v-rothschild-a-timeline-of-developments-in-a-case-over-trademarks-nfts/> (Apr. 23, 2024).

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Rogers v. Grimaldi*, 875 F.2d 994 (2d Cir. 1989).

⁷⁴ *Hermès Int’l v. Rothschild*, 603 F. Supp. 3d 98, 102 (S.D.N.Y. 2022).

⁷⁵ See *id.* at 103-04.

the use does not “explicitly mislead” as to content, authorship, sponsorship, or endorsement.”⁷⁶ In *Hermès*, Judge Rakoff noted that “Rothschild’s use of NFTs to authenticate the images does not change the application of *Rogers* . . . [and] using NFTs to authenticate an image and allow for traceable subsequent resale and transfer does not make the image a commodity without First Amendment protection.”⁷⁷ This court was persuaded that traditional intellectual property analyses, such as *Rogers*, are sufficient even in the context of digital goods and virtual spaces.⁷⁸ And while the threshold for artistic relevance under *Rogers* is low, Rothschild admitted to initially selling the MetaBirkin as a tribute to Hermès famous Birkin handbag.⁷⁹ This was a sufficient allegation that Rothschild intended to associate the MetaBirkin with the popularity of Hermès.⁸⁰

Later, in June 2023, Judge Rakoff issued another opinion after a nine-day trial returned a unanimous verdict against defendant Rothschild.⁸¹ The district court in the Southern District of New York opined that:

[E]ven the modest elements of artistic expression contained in Rothschild’s works entitled him to a total First Amendment protection against Hermès’s claims unless Hermès proved that Rothschild intentionally misled consumers into believing that Hermès was backing its products, the jury had no difficulty in concluding that Hermès had so proved.⁸²

This opinion reiterates the low threshold required for an artistic work to be protected under the First Amendment but excludes such protection in cases where the unauthorized user intentionally misleads consumers.

Judge Rakoff partially doubted the applicability of the *Rogers* test after the Supreme Court’s recent decision in *Jack Daniel’s Properties, Inc. v. VIP products LLC*.⁸³ In *Jack Daniel’s Properties*, the Court stated, “[w]ithout deciding whether *Rogers* has merits in other contexts, we hold that it does not when an alleged infringer uses a trademark in the way the Lanham Act most cares about: as a designation of source for the infringer’s own goods.”⁸⁴ In *Hermès*, Rothschild used an existing trademark to designate the source of his own goods (i.e., using another’s trademark as

⁷⁶ GIBSON DUNN, *supra* note 69.

⁷⁷ *Hermès*, 603 F. Supp. 3d at 103-04.

⁷⁸ *Id.* at 102-03.

⁷⁹ *See id.*

⁸⁰ *Id.*

⁸¹ *See Hermès Int’l v. Rothschild*, 678 F. Supp. 3d 475, 481 (S.D.N.Y. 2023).

⁸² *Id.* (emphasis omitted).

⁸³ *Jack Daniel’s Props., Inc. v. VIP Prods. LLC*, 599 U.S. 140 (2023).

⁸⁴ *Id.*

your own trademark), so the applicability of *Rogers* stood. However, had Rothschild used the Birkin trademark in a non-source-identifying way, it is possible that Judge Rakoff would have applied the *Rogers* test in favor of Rothschild. For example, if Rothschild had used the Birkin design (e.g., shape, colors, or other recognizable features of the Birkin brand) in designing his digital bag, and labeled it something other than “MetaBirkin,” the *Rogers* test may not have applied. Nevertheless, that raises questions of traditional intellectual property law—the inclusion of digital goods such as NFTs would not alter the analysis. It is essential for brands and creatives to employ traditional intellectual property analyses, even when dealing with scenarios involving the metaverse and digital assets.

B. *Yuga Labs Inc. v. Ripps*

Those interested in the NFT space have also closely watched the case, *Yuga Labs v. Ripps*, which recently survived a motion to dismiss.⁸⁵ In this case, two artists allegedly sold replicas of the famous NFT collection, Bored Ape. The Bored Ape NFT collection, released in 2021, depicts cartoon profile pictures of apes and achieved enormous popularity after being endorsed by celebrities like Justin Bieber and Paris Hilton.⁸⁶ The NFTs generated more than \$2 billion in total sales.⁸⁷ The defendant in the case, Ripps, argued that his lookalike NFT collection, named RR/BAYC, “critiques neo-Nazi and alt-right imagery found in the real Bored Ape collection.”⁸⁸ The defendants sought summary judgment based on the *Rogers* test, however, U.S. District Judge John F. Walter concluded that *Rogers* does not apply and did not find any idea or expression other than the association with the original Bored Ape collection.⁸⁹ Judge Walter stated, “[a]lthough there is a low bar for artistic relevance, . . . it is not infinitely low.”⁹⁰ In December 2022, the defendants filed an answer and counterclaim, alleging that Yuga’s lawsuit was an attempt to “silence

⁸⁵ See Isaiah Poritz, *Bored Ape Yacht Club NFT Creator Advances Trademark Lawsuit*, BLOOMBERG LAW (Dec. 19, 2022, 1:11 PM), <https://news.bloomberglaw.com/ip-law/bored-ape-yacht-club-nft-creator-advances-trademark-lawsuit>.

⁸⁶ See Connor Sephton, *Jimmy Fallon, Paris Hilton and Justin Bieber Among Stars Facing Lawsuit for Promoting Bored Ape NFTs*, COINMARKETCAP (Dec. 15, 2022), <https://coinmarketcap.com/alexandria/article/jimmy-fallon-paris-hilton-and-justin-bieber-among-stars-facing-lawsuit-for-promoting-bored-ape-nfts>.

⁸⁷ Poritz, *supra* note 85.

⁸⁸ *Id.*

⁸⁹ See *Yuga Labs, Inc. v. Ripps*, No. CV22-4355, 2023 WL 3316748, at *12-13 (C.D. Cal. Apr. 21, 2023).

⁹⁰ *Id.* at *13.

creators who used their craft to call out a multi-billion-dollar company built on racism and neo-Nazi dog whistles.”⁹¹

In April 2023, Yuga moved for summary judgment as to its cause of action for false designation of origin.⁹² The defendants argued that Yuga was not entitled to summary judgment because NFTs are intangible and therefore ineligible for trademark protection.⁹³ The district court in the Central District of California responded, “this Court agrees with the court in *Hermès*,” and tangibility is *not* a requirement for Lanham Act liability.⁹⁴ Therefore, although virtual, NFTs are goods for purposes of the Lanham Act.⁹⁵

The defendants also argued that *Rogers* should apply in this case because their look-alike collection is an expressive work protected under the First Amendment. The court held that (unlike *Hermès*), *Rogers* does not apply here.⁹⁶ The look-alike collection did not express an idea or point of view, but merely pointed to the same online digital images associated with the original collection.⁹⁷ “[C]ommercial activities designed to sell infringing products . . . is no more artistic than the sale of a counterfeit handbag, making the *Rogers* test inapplicable.”⁹⁸

In *Yuga Labs*, an important take-away is the categorization of NFTs as virtual goods. Prior to this case, it was not clear whether NFTs were something else entirely, such as a digital certification. In *Hermès* and *Yuga Labs*, the courts maintain use of traditional trademark analyses in cases involving digital and virtual goods. For companies, this is a positive sign, particularly if the company expands its trademark registration to apply to digital commodities. Though, for artists, *Yuga Labs* and *Hermès* represent two losses pertaining to artwork in the digital space. Artists looking to draw inspiration from a third-party’s intellectual property for a digital creation must be mindful of their marketing approach and the presence of an expressive element that may warrant First Amendment protection. The previously mentioned cases do not offer artists flexibility, even when their work is classified as a digital product.

⁹¹ *Id.* at *2.

⁹² *Id.* at *4.

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.* at *5.

⁹⁶ *Id.* at *12.

⁹⁷ *Id.*

⁹⁸ *Id.*

III. FAIR USE: REAL-WORLD AND DIGITAL APPLICATION

As the utility in metaverses increases, brands and artists will similarly increase their virtual presence. It is certain that issues surrounding fair use analyses will arise for creatives and brands in virtual spaces. Fair use is an affirmative defense that permits unlicensed use of copyright-protected works.⁹⁹ The Supreme Court's recent decision in *Andy Warhol Foundation for the Visual Arts v. Goldsmith*, while positive for photographers, will stifle creativity and disincentivize artists' from creating works based on underlying copyrighted works. Before detailing the *Warhol* opinion, it is helpful to understand the traditional, real-world application of the fair use defense.

To evaluate a question of fair use, courts analyze the following four factors:

- (1) the purpose and character of the use, including whether the use is of a commercial nature or is for nonprofit educational purposes;
- (2) the nature of the copyrighted work;
- (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and
- (4) the effect of the use upon the potential market for or value of the copyrighted work.¹⁰⁰

Regarding the first factor, courts are more likely to categorize noncommercial use as fair use.¹⁰¹ Second, the more creative the copyrighted work, the less likely courts are to deem it fair use.¹⁰² For example, unlicensed use of copyrighted song may be subject to stronger protections than unlicensed use of factual information, such as a news article. Third, courts look to the quality and quantity of the copyrighted material used.¹⁰³ Lastly, regarding the fourth factor, courts aim to assess whether the unlicensed use may harm the market.¹⁰⁴ For example, if an unlicensed use may result in a decrease in sales of the original copyrighted work, a court may be less likely to find fair use. Just as fair use is relevant for real-world goods, it also likely will be relevant in digital spaces.

In March 2022, the Supreme Court granted certiorari on behalf of the Andy Warhol Foundation after a Second Circuit decision ruled in favor of

⁹⁹ See *U.S. Copyright Office Fair Use Index*, U.S. COPYRIGHT OFFICE, <https://www.copyright.gov/fair-use/> (Aug. 2023).

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² *See id.*

¹⁰³ *Id.*

¹⁰⁴ *Id.*

Goldsmith, the listed defendant in the Supreme Court case.¹⁰⁵ In this case, Goldsmith, a professional photographer, photographed Prince and later licensed the photograph to Vanity Fair.¹⁰⁶ Vanity Fair then commissioned Andy Warhol to create artworks based on Goldsmith's photograph, however, Warhol created artistic works without attributing Goldsmith's photograph.¹⁰⁷ After Warhol's passing, the Andy Warhol Foundation owned his life works, including the Vanity Fair piece, known as the "Prince Series."¹⁰⁸ When Goldsmith learned of this, she registered the original photographs with the U.S. Copyright Office, announcing that the Andy Warhol Foundation had infringed her copyrighted photographs.¹⁰⁹ The district court granted summary judgment in favor of the Foundation based on a fair use defense.¹¹⁰ Specifically, the lower court held that Warhol's artistic work portrayed Prince as an icon, whereas the original Goldsmith photograph portrayed Prince as vulnerable.¹¹¹ In part, this was sufficient evidence to prove the "transformative" nature of Warhol's artistic work as compared to Goldsmith's original photograph.¹¹²

On appeal, the Second Circuit overruled the lower court's decision, holding that there "must be something more than the imposition of another artistic style" to categorize a work as "transformative."¹¹³ Ultimately, the Second Circuit was not convinced that Warhol's artwork was transformative enough, and found that the artwork retained the elements of Goldsmith's original photograph.¹¹⁴ Notably, the Second Circuit "dismissed as a valid consideration the 'intent of the artist or the meaning or impression that a critic—or for that matter, a judge—draws from the work.'"¹¹⁵

¹⁰⁵ See Andrew Costa and Nicole D. Galli, *Transforming the Fair Use Doctrine? Highlights From 'Warhol Foundation v. Goldsmith'*, LAW.COM (Dec. 29, 2022 01:47 PM), <https://www-law-com.daytona.law.miami.edu/thelegalintelligencer/2022/12/19/transforming-the-fair-use-doctrine-highlights-from-warhol-foundation-v-goldsmith/>.

¹⁰⁶ See Murphy Yanbing Chen, *Andy Warhol Found. For Visual Arts, Inc. v. Goldsmith*, 11 F.4th 26 (2d Cir. 2021), Cert. Granted, 212 L. Ed. 2d 402, 142 S. Ct. 1412 (2022), AM. UNIV. INTEL. PROP. (Nov. 30, 2022), <http://www.ipbrief.net/2022/11/30/andy-warhol-found-for-visual-arts-inc-v-goldsmith-11-f-4th-26-2d-cir-2021-cert-granted-212-l-ed-2d-402-142-s-ct-1412-2022/>.

¹⁰⁷ See *id.*

¹⁰⁸ See *id.*

¹⁰⁹ See *id.*

¹¹⁰ See *id.*

¹¹¹ See *id.*

¹¹² See Chen, *supra* note 106.

¹¹³ See *id.*

¹¹⁴ Costa & Galli, *supra* note 105.

¹¹⁵ Chen, *supra* note 106.

In May 2023, the Supreme Court issued its decision in favor of photographer Goldsmith, holding that the first fair use factor, the “purpose and character” of the work, did not favor Warhol because it shared the same commercial purpose as the original photograph.¹¹⁶ The Supreme Court stated, “if an original work and secondary use share the same or highly similar purposes, and the secondary use is commercial, the first fair use factor is likely to weigh against fair use[.]”¹¹⁷ Additionally, works have the same purpose if a new work is likely to substitute or supplant the underlying work.¹¹⁸ Here, the Court was not convinced that Warhol’s version of the Prince photograph had an alternative purpose to the original photograph.¹¹⁹ “Moreover, because [Warhol]’s copying of Goldsmith’s photograph was for a commercial use so similar to the photograph’s typical use, a particularly *compelling justification* is needed. Copying the photograph because doing so was merely helpful to convey a new meaning or message is not justification enough.”¹²⁰

This should serve as a warning for creatives intending to use third-party intellectual property in new works, including digital works in virtual spaces. Here, it can certainly be argued that Warhol’s version of Prince portrayed an alternative meaning and message from the original work. Though, this was not sufficient to protect Warhol from liability. The substitution analysis of the first fair use factor (i.e., if one work is likely to substitute the underlying work, then it serves the same commercial purpose) will be difficult to apply in relation to digital goods in virtual spaces. For example, what if Warhol’s version of the photograph sold as an NFT? Had it been sold as an NFT, the substitution analysis would have cut against Goldsmith. The probability of an NFT replacing a physical item, like a photograph in a magazine, is low. The Court’s focus on the substitution analysis becomes inconsequential when dealing with NFT-related cases. As a result, courts will likely need to focus on the remaining fair use factors—the nature of the copyrighted work; the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and the effect of the use upon the potential market for or value of the copyrighted work. At present, it remains crucial for creatives to secure appropriate licenses when incorporating third-party intellectual property into their new artistic endeavors. This requirement holds true, irrespective of whether the artwork exists within an unconventional medium like the metaverse.

¹¹⁶ Andy Warhol Found. for the Visual Arts, Inc. v. Goldsmith, 598 U.S. 508 (2023).

¹¹⁷ *Id.* at 532.

¹¹⁸ *Id.* at 528.

¹¹⁹ *Id.* at 550.

¹²⁰ *Id.* at 512 (emphasis added).

IV. NFTS AS SECURITIES REGULATED BY THE U.S. SECURITIES EXCHANGE COMMISSION

Another cryptocurrency and NFT-related question that remains partially unanswered involves federal securities laws. The Securities Act of 1933 provides a range of potential securities, such as stocks, notes, investment contracts, and any instrument “commonly known as a security.”¹²¹ The Supreme Court case *S.E.C. v. W.J. Howey Co.* is most commonly used to define an investment contract.¹²² In *Howey*, an investment contract means “a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the effects of the promoter or a third party.”¹²³ Additionally, the SEC issued guidance on how to apply the *Howey* test to digital assets, explaining that “digital assets may be investment contracts where users (1) exchange some form of currency or consideration for the digital asset; (2) engage in a ‘common enterprise’ through the digital asset; and (3) have reasonable expectations of profit derived from others’ efforts.”¹²⁴

Under this analysis, cryptocurrency coins are likely considered “investment contracts,” however, NFTs are more complicated. For example, it can be argued that a purchaser of an NFT may not expect reasonable profits derived from others’ efforts.¹²⁵ The value of the NFT may increase in value over time, but it is unlikely to be a result of others’ efforts.¹²⁶ It is helpful to compare this to a more traditional understanding of a security, such as a stock. A stock, in its simplest terms, represents the value of a company. When one buys a stock, the purchaser hopes that others (e.g., the corporation’s Board of Directors, Officers, and employees) work to increase the value of the company, thus increasing the stock’s worth. As stated above, some argue that NFTs do not require the same type of “effort” to achieve profits as seen in traditional securities.¹²⁷

However, under the *Howey* analysis, most NFTs are likely to be categorized as securities. Owners of NFTs constantly work to increase the value, whether through community engagement, celebrity endorsements,

¹²¹ See Securities Act of 1933, 15 U.S.C. § 77(b)(1).

¹²² *S.E.C. v. W.J. Howey Co.*, 328 U.S. 296, 298-99 (1946).

¹²³ See *id.* at 298-99.

¹²⁴ See *Are NFTs Securities? Analysis of the NBA Top Shot Litigation and Other NFT-Related Actions*, PATTERSONBELKNAP (Mar. 29, 2022), <https://www.pbwt.com/securities-enforcement-litigation-insider/are-nfts-securities-analysis-of-the-nba-top-shot-litigation-and-other-nft-related-actions> (citing SEC, FRAMEWORK FOR “INVESTMENT CONTRACT” ANALYSIS OF DIGITAL ASSETS 2-3 (2019), <https://www.sec.gov/files/dlt-framework.pdf>).

¹²⁵ See SEC, *supra* note 124, 2-3.

¹²⁶ *Id.* at 5.

¹²⁷ *Id.*

or advertising.¹²⁸ For example, it was reported that YouTube “celebrity” Jake Paul earned \$2 million promoting NFTs.¹²⁹ Although this differs from a corporation working tirelessly to improve its product or service to increase the value for shareholders, purchasers of NFTs nevertheless may expect profit derived from efforts of others. However, it is important to note that this argument fails to consider NFT purchasers who acquire NFTs without a desire to sell for profit. After all, many consider NFTs a form of art, and it is plausible that purchasers will keep a particular NFT forever, regardless of increase in value or price.¹³⁰ Still, a study found that sixty-four percent (64%) of NFT purchasers buy the digital tokens to make a profit.¹³¹ For those selling NFTs, it is safer to assume that digital assets are deemed “securities” bound by federal regulations. Navigating securities regulations can be a complex undertaking, posing challenges for many individuals. In order to promote the development of new NFTs and to ensure that artists remain motivated to create fresh artwork, there should be more explicit guidance regarding the compliance requirements. Moreover, if the primary intent behind acquiring an NFT is not profit-seeking, there should be a relaxation of securities regulations.

In August 2023, the SEC fined an entertainment company over \$6 million, alleging the company-sold NFTs were unregistered crypto asset securities.¹³² “The SEC alleges [the company] told investors who purchased [the NFTs] that they would ‘profit from their purchases’ if the company was successful down the road.”¹³³ The promise of value categorizes the NFTs as investment contracts. The question now turns to whether NFT marketplaces should also be subject to SEC regulations. Currently, artists and NFT-promoting businesses need to exercise caution in their product promotions. They should be cautious about using language that implies potential future value. Thoughtfully choosing their words can help position NFTs outside the realm of investment contracts.

¹²⁸ See *How Do NFTs Gain Value?*, SUPRA ORACLES (Aug. 16, 2022), <https://supraoracles.com/academy/how-do-nfts-gain-value/>.

¹²⁹ *Id.*

¹³⁰ See Juliet Bennett Rylah, *Why do people buy NFTs?*, THE HUSTLE (July 7, 2022), <https://thehustle.co/07072022-nfts/>.

¹³¹ *Id.*

¹³² Cheyenna DeVon, *SEC orders LA-based company to pay \$6.1 million for alleged sale of NFTs as unregistered securities-what investors should know*, CNBC (Sept. 1, 2023, 9:00 AM), <https://www.cnbc.com/2023/09/01/sec-issues-first-nft-related-enforcement-action.html>.

¹³³ *Id.*

V. PRIVACY, DATA PROTECTION, AND OTHER ISSUES

Digital worlds offer unique data protection and regulatory issues. As technology advances, data privacy is increasingly important. The United States, for example, has a patchwork of data protection laws that is mostly enforced by the Federal Trade Commission (“FTC”).¹³⁴ When referring to digital worlds, or the metaverse, typical data privacy issues will ensue. However, in addition to the usual data collection, such as users’ names, locations, email addresses, etc., digital worlds that use hardware will obtain a greater wealth of data.¹³⁵ A hardware device, such as a virtual reality headset may have hand and head tracking capabilities.¹³⁶ A director at the University Michigan argued that “people have almost like a fingerprint about how you move your head and your hands when you talk.”¹³⁷ Therefore, tracking devices are capable of identifying individuals.¹³⁸ Although consumers are accustomed to privacy policies and collection of personal data, such as name and email address, consumers are unlikely to expect this level of data collection through the use of virtual reality headsets. Equally concerning, the tracking of a user’s eye movements can allow companies to decipher when a user lingers on a particular advertisement, and thus “construct a personality profile of you based on things that interest you.”¹³⁹ This is a level of data collection that we have yet to see, and it is critical for companies to obtain the proper consent from users to collect such information.¹⁴⁰

In addition to the wealth of information collected in digital spaces, there is further confusion as to which jurisdiction applies.¹⁴¹ Data privacy laws in the United States vary from data privacy laws in the European Union.¹⁴² Digital worlds are inherently global, so it may prove challenging to decide which laws apply and to what extent. Further, proponents of the metaverse argue that it should be decentralized.¹⁴³ However, it must be

¹³⁴ See David Harrington, *U.S. Privacy Laws: The Complete Guide*, VARONIS (Sept. 2, 2022), <https://www.varonis.com/blog/us-privacy-laws>.

¹³⁵ PRYOR ET AL. *supra* note 9, at 63.

¹³⁶ Andrea Vittorio, *Metaverse Technology Opens Up a Wider World of Privacy Concerns*, BLOOMBERG LAW (Aug. 30, 2022, 5:05 AM), <https://news.bloomberglaw.com/privacy-and-data-security/metaverse-technology-opens-up-a-wider-world-of-privacy-concerns>.

¹³⁷ *Id.*

¹³⁸ *Id.*

¹³⁹ *Id.*

¹⁴⁰ PRYOR ET AL. *supra* note 9, at 63.

¹⁴¹ See James Cooper, *Why we need ‘meta jurisdiction’ for the metaverse*, THE HILL (Dec. 2, 2021 3:30PM), <https://thehill.com/opinion/technology/583529-why-we-need-meta-jurisdiction-for-the-metaverse/>.

¹⁴² PRYOR ET AL. *supra* note 9, at 64.

¹⁴³ See *id.*

widely understood that an entity, whether that be a government, corporation, or third party, must enforce and monitor data collection to an extent. Without enforcement, consumers are at risk for giving up a great deal of information without consenting to do so. Moreover, children's privacy will likely be an issue of contention and different countries and jurisdictions treat children differently.¹⁴⁴ Even insofar as what defines a "child" varies from country to country.¹⁴⁵

There is also potential for violence and harassment in digital worlds. In May 2022, a 21-year-old woman alleged that her avatar was raped in a metaverse platform released by Meta, Horizon Worlds.¹⁴⁶ In this particular metaverse, users feel another's touch through the vibrations of the controller.¹⁴⁷ This can create a "disorienting and disturbing physical experience during a virtual assault" and the alleged victim claimed she disassociated during the incident.¹⁴⁸ This was not an isolated event, and there have been a myriad of claims ranging from sexual harassment, to verbal abuse, racial slurs, and invasion of personal space.¹⁴⁹

As part of a report on the dangers of the metaverse, SumOfUs researchers entered Horizon Worlds to experience it firsthand.¹⁵⁰ Within minutes of entering the metaverse, researchers experienced "homophobic slurs, gun violence, drugs," and users stalking a woman's avatar.¹⁵¹ The issue is lack of oversight. Even Meta's Chief Technology Officer, Andrew Bosworth, admitted that moderation in the metaverse "at any meaningful scale is practically impossible."¹⁵² The SumOfUs report found two issues in Meta's failure to enforce its guidelines. First, it is argued that Meta has a lack of content moderators, and second, there is an abundance of underage children engaging in the metaverse.¹⁵³ Users have claimed that reporting incidents can be "unclear" and lack "transparent follow-up."¹⁵⁴ Without an entity enforcing guidelines and moderating users' actions, it is

¹⁴⁴ See Emma Day, *Data governance for children: An emerging priority area for privacy professionals*, UNICEF (May 19, 2022), <https://www.unicef.org/globalinsight/stories/data-governance-children-emerging-priority-area-privacy-professionals>.

¹⁴⁵ See PRYOR ET AL., *supra* note 9, at 68.

¹⁴⁶ Adriana Diaz, *Disturbing reports of sexual assaults in the metaverse: 'It's a free show'*, N.Y. POST (May 27, 2022, 2:23 PM), <https://nypost.com/2022/05/27/women-are-being-sexually-assaulted-in-the-metaverse/>.

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*

¹⁴⁹ See generally SUMOFUS, *METAVVERSE: ANOTHER CESSPOOL OF TOXIC CONTENT* (2022), https://www.sumofus.org/images/Metaverse_report_May_2022.pdf.

¹⁵⁰ See *id.* at 7.

¹⁵¹ See *id.*

¹⁵² *Id.* at 8.

¹⁵³ See *id.*

¹⁵⁴ See *id.* at 9.

impossible to create a safe space for users to interact. As seen in the Meta case above, corporations cannot be trusted to enforce and moderate content without further regulation.

VI. ANALYSIS: HOW TO NAVIGATE ISSUES IN THE METAVERSE

Regardless of whether one believes in the success of the metaverse, there is no question as to the increasing popularity of NFTs and virtual commodities in our society. Issues surrounding this new phenomenon include intellectual property, securities law, privacy and data collection, and tort.

A. Intellectual Property

As noted in Section III, there are several court cases related to web3, the metaverse, and NFTs—many of which relate to intellectual property.¹⁵⁵ At its core, *Hermès* is a traditional issue of trademark law.¹⁵⁶ In *Hermès*, a well-known brand, Hermès, seeks to protect its mark from unauthorized use.¹⁵⁷ Similarly, at the core of *Yuga Labs Inc. v. Ripps* lay traditional issues of trademark law. In both cases, the courts apply traditional trademark analyses, and the subject of NFTs does not change the analyses. Moving forward, we should be confident that existing trademark law is sufficient to analyze digital goods in virtual spaces.

The Supreme Court's decision in *Warhol* and its focus on substitution when analyzing two similar artworks and their commercial purposes should serve as a warning to brands and creatives looking to use third-party intellectual property in digital goods. In copyright cases, artists should exercise caution and obtain adequate licensing instead of relying on a fair use defense. In trademark cases, companies should file registrations that expand their trademark protection to virtual worlds. Brands have already begun to do so—by October 2022, there were 6,855 trademark applications filed for NFTs and related goods and services.¹⁵⁸ This number rose from just 2,142 filings in 2021.¹⁵⁹ Filed registration

¹⁵⁵ See *supra* Part III.

¹⁵⁶ See generally *Hermès Int'l v. Rothschild*, 603 F. Supp. 3d 98, 102 (S.D.N.Y. 2022).

¹⁵⁷ *Id.*

¹⁵⁸ Judith Bannermanquist, *Trademarks filed for NFTs, metaverse and cryptocurrencies soar to new levels in 2022*, COIN TELEGRAPH (Nov. 07, 2022), <https://cointelegraph.com/news/trademarks-filed-for-nfts-metaverse-and-cryptocurrencies-soar-to-new-levels-in-2022>.

¹⁵⁹ *Id.*

expansions came from brand giants, such as Nike, Adidas, and Versace.¹⁶⁰ Thus, it is crucial for artists and companies to be aware of the potential intellectual property issues that will arise in digital spaces. It is advisable to treat NFTs, digital art, and digital commodities with the same principles as those applied in the physical world. Courts are expected to extend conventional trademark law to encompass this industry.

B. *Securities Law*

As noted in Section V, the SEC recently made its first enforcement action against a company selling NFTs as unregistered securities. At its core, the definition of a security is incredibly broad, as it concludes “any instrument commonly known as a security.”¹⁶¹ Thus, the SEC can likely regulate NFTs if it wishes to do so. Notably, the steep requirements of federal securities laws could potentially dissuade NFT creators from offering NFTs for purchase entirely:

These [requirements] may include, for example, a requirement for the issuer and distributors of the NFT to be licensed or approved by the relevant regulator(s) and to comply with ongoing conduct-of-business requirements (e.g., in relation to disclosure of information to purchasers of the NFT, fitness and properness of personnel involved in running the NFT offering, etc.).¹⁶²

Moreover, the type of NFT may lead to different conclusions. For example, an NFT that is a “play-to-earn” requires purchasers to play a game on a particular platform to earn tokens in the form of NFTs may not pass the *Howey* test.¹⁶³ Pay-to-earn NFTs require active involvement from the investor and would therefore fail the *Howey* test requirement of expected profits solely from the efforts of a promoter or a third party.¹⁶⁴ The SEC’s first enforcement action serves as a precedent for companies to follow when selling NFTs primarily as an investment. Those selling NFTs should be cautious as to how they are advertised to avoid its categorization

¹⁶⁰ Trishla Ostwal, *Brands Filing for Trademark Applications for the Metaverse Have Waned*, ADWEEK (Nov. 23, 2022), <https://www.adweek.com/programmatic/brands-filing-for-trademark-applications-for-metaverse/>.

¹⁶¹ See Securities Act of 1933, 15 U.S.C. § 77(b)(1).

¹⁶² Hagen Rooke & Nina Carlina Sugianto, *Is My NFT a Security?* REEDSMITH (Aug. 1, 2022), <https://www.reedsmith.com/en/perspectives/metaverse/2022/08/is-my-nft-a-security>.

¹⁶³ See *id.*

¹⁶⁴ See *S.E.C. v. W.J. Howey Co.*, 328 U.S. 296, 298-99 (1946).

as an “investment contract.” It is recommended to avoid a future promise or guarantee value, whether monetary or otherwise.

C. *Privacy and Data Collection*

Privacy and data collection is a large issue even in the physical world as it stands. For example, Facebook (as Meta), a classic form of web2, had to pay over \$700 million dollars to settle a lawsuit resulting from its privacy practices.¹⁶⁵ Thus, even today, some of the largest platforms with experienced legal teams fail to comply with the standards. As noted in Section VI, the metaverse and virtual headsets can collect vast amounts of data—enough to accurately identify an individual.¹⁶⁶ This is certainly not something users expect. As the metaverse becomes more mainstream, controlling entities may require heightened responsibility on the part of companies that create these devices, such as Meta. Though, decentralization is at the core of web3, so it will be difficult to decide whether an entity can govern, and if so, the type of entity to govern.

Moreover, countries differ in approaches to privacy and data collection.¹⁶⁷ For example, the European Union uses the GDPR, while the United States offers a patchwork of privacy laws.¹⁶⁸ At least for now, it is recommended that companies comply with the GDPR because it requires a higher standard than other privacy laws. The metaverse is inherently global, so complying with a particular state’s privacy laws may fail to meet the global requirements. Moreover, because of its global reach, it is likely that European consumers will use the devices and metaverse. Therefore, compliance with the GDPR would be required nonetheless.¹⁶⁹ To adequately prepare for the global reach of the metaverse, brands that own hardware devices and/or metaverse spaces, such as Meta, should opt to comply with GDPR requirements. From a user’s perspective, companies should communicate transparent data policies and security measures to its users and allow for easy user opt-outs. Companies should always obtain explicit consent from users, and such consent should be separate from consent to general terms of service. Finally, a company should conduct

¹⁶⁵ See Clare Duffy, *Meta agrees to pay \$725 million to settle lawsuit over Cambridge Analytica data leak*, CNN (Dec. 23, 2022, 11:45 AM), <https://www.cnn.com/2022/12/23/tech/meta-cambridge-analytica-settlement/index.html>.

¹⁶⁶ See Vittorio, *supra* note 136.

¹⁶⁷ See Elle Todd et al., *Data protection and privacy*, REEDSMITH (Aug. 1, 2022), <https://www.reedsmith.com/en/perspectives/metaverse/2022/08/data-protection-and-privacy>.

¹⁶⁸ See *id.*

¹⁶⁹ See Marie Kulbeth, *Does the GDPR apply in the USA?*, SIXFIFTY (Mar. 9, 2020), <https://www.sixfifty.com/blog/does-the-gdpr-apply-in-the-usa/>.

regular assessments and privacy audits to ensure compliance with its standards.

D. Torts

Similarly, torts that occur in the metaverse are complicated, as it is difficult to assess which jurisdiction applies. Virtual assault and harassment, as discussed in Section VI, should be monitored, regulated, and controlled by the controlling entities. For example, Meta should have the means for users to report other users internally, and a clear protocol for dealing with users who violate the terms of service. If the metaverse continues to grow in popularity, governing entities may implement minimum requirements that controlling companies must adhere to, however, that has yet to happen. Until an appropriate jurisdiction is deemed a “regulator” of digital spaces, it is incumbent upon the companies themselves to protect the consumers. For example, a company like Meta should clearly communicate its terms of service for participation in its Metaverse. Additionally, upon illegal or inappropriate conduct, users should have the ability to promptly exit the virtual space to speak with a designated Meta representative. Other security measures, such as user identity verification and user education should be implemented to create a safer experience for everyone on the platform. If a company falls short in this regard, it is the responsibility of governments to hold companies accountable for negligent failure to establish sufficient safety measures for digital interactions.

CONCLUSION

The evolving landscape of digital assets and metaverses will force courts to grapple with some portions of traditional intellectual property analyses, such as factors within the fair use analysis. However, most intellectual property laws will seamlessly transition into issues involving NFTs and other digital assets. Additionally, most NFTs will continue to fall under the umbrella of the SEC, unless the NFT is sold primarily for other reasons, such as digital certifications or art. This will provide a level of financial accountability in this sector but poses some threats to the likelihood of NFT production due to compliance complexity. Privacy and data collection, on the other hand, will likely need to be altered to adequately protect consumers. The volume of data collection itself is unprecedented, and the inconsistency among various countries’ approaches to privacy laws will pose an issue of control. Lastly, torts in virtual spaces will need to be regulated and controlled by companies until governing entities implement guidelines. It is impossible to predict the

impact of web3 on our society. However, it is important to adequately prepare for the legal implications that arise with a decentralized virtual space.