



LEGAL ISSUES IN THE METAVERSE

PART 2: COMMERCIAL OPPORTUNITIES

WEBBER WENTZEL

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THE METAVERSE:



OVERVIEW

In our [last edition](#) of this series, "*Legal issues in the Metaverse*", we outlined what the Metaverse is, some key terms and use cases, and some consumer-related and liability issues which are likely to be prevalent in the Metaverse.

In this edition, we will be focusing on the legal considerations for businesses that intend to commercialise opportunities in the Metaverse. Businesses in multiple sectors, both locally and offshore, have recently been exploring the opportunities available in the Metaverse. For instance, South African mobile network operator MTN

recently purchased its first virtual land in the Metaverse. Estée Lauder participated in Decentraland's Metaverse Fashion Week in March 2022, showcasing its Advanced Night Repair serum. Users had the opportunity to claim a free NFT wearable that gives their avatars a glowing aura from this serum.

There are numerous legal issues for businesses to consider when embarking on their Metaverse offering, including intellectual property protection and commercialisation, M&A transactions, competition considerations, the laws regarding decentralised finance and taxation.





INTELLECTUAL PROPERTY

PROTECTION

Well-known brands are increasingly becoming alive to the consequences of failing to protect their intellectual property in the virtual world. We anticipate a large number of trademark infringements and counterfeiting in the Metaverse. For example, two trademark applications were filed in the United States in 2022 by third parties to use the Gucci and Prada logos in relation to various Metaverse-related goods and services, including “downloadable virtual goods”, virtual worlds and virtual clothing used in virtual spaces. In 2021, luxury brand Hermès, the creator of the Birkin line of handbags, instituted proceedings against NFT artist Mason Rothschild. Rothschild created the MetaBirkin NFT artwork, and profited from the sale of these NFTs without permission from Hermès. None of the proceeds of the sale was transferred to Hermès.

The Metaverse is a very general term. As we discussed in our last edition of this series, we use it here to refer to a simulated digital environment or platform which mixes the “real” world with a “virtual” one, enabling a real time, virtual experience.

Brands should revisit their intellectual property protection strategies to ensure these are sufficiently broad to extend their brands' protection into the Metaverse. Unless they do so, businesses run the risk of their brands being diluted in the Metaverse, and become susceptible to counterfeiting. Many brands have taken a proactive stance by filing for trademark protection in Metaverse spaces, in the same way that brands filed for use on social media sites in their initial phases.

COMMERCIALISATION

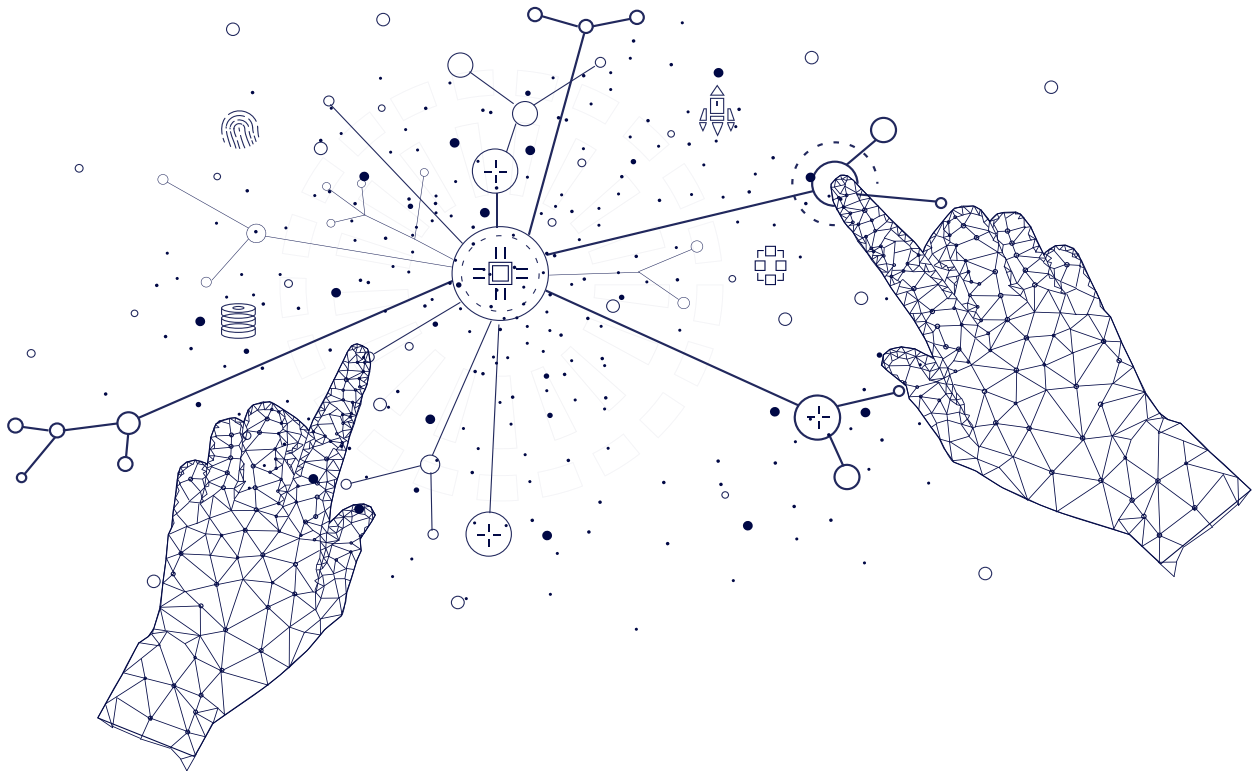
Commercial opportunities in the Metaverse raise questions around intellectual property ownership, transfer and licensing. It may be necessary to consider how assignment, licence and other intellectual property commercialisation agreements are drafted to ensure that they correctly reflect the intention of the parties. For example, if a franchisor grants a franchisee an exclusive licence to use the franchisor's intellectual property in a specific territory, there may be a potential breach of the franchise agreement if the franchisor expands its franchised offering into the Metaverse. In those instances, it may be that the franchise agreement should record that the franchisee actually has a sole licence (in terms of which the franchisor retains the right to use the licensed intellectual property) and not an exclusive licence (which precludes the franchisor from doing so). Territoriality will also be important in determining the jurisdiction in which intellectual property rights are created, and whether the transfer or licensing of these rights offshore requires regulatory approvals (such as exchange control approval).

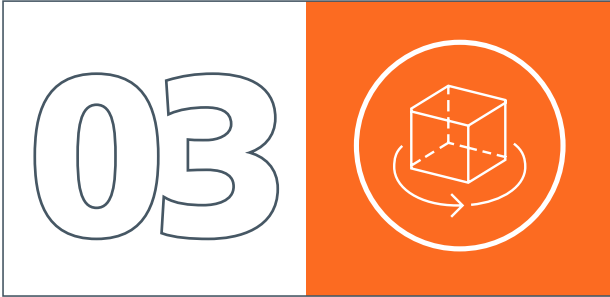
INTELLECTUAL PROPERTY CONTINUED

INTELLECTUAL PROPERTY OWNERSHIP

Intellectual property ownership is likely to be complex, given the large quantity of user-generated content in the Metaverse and the number of users, platform providers and businesses providing goods and services in the Metaverse. Ownership is further complicated by the fact that the nature and classification of NFTs is still in its infancy in many jurisdictions, and many of the laws regarding smart contracts (which will underpin much of the contracting in the Metaverse) are still being developed. In the absence of carefully considered terms of use and commercial agreements, it may be challenging to delineate where intellectual property rights vest.

In the race to capitalise on the opportunities in the Metaverse, businesses would be well advised to pause and revisit their existing agreements to ensure that these are still appropriate and accurate to support such a move. New agreements will need to be scrutinised to ensure that vesting and transfer or licensing of intellectual property rights are correctly recorded, and that regulatory requirements are satisfied.





M&A TRANSACTIONS

BUILDING IN THE METAVERSE

Building the Metaverse is a long-term project that will involve a focus on the physical infrastructure (such as virtual and augmented reality headsets/glasses and data servers) as well as the virtual experience. It will also present a number of different commercial and investment opportunities. While some technology companies have actively begun ventures in the Metaverse (such as the proposed acquisition of video game giant Activision Blizzard by Microsoft, as mentioned in our [last edition](#) of this series, and Sony's proposed acquisition of Bungie), companies in other sectors are exploring this space too (e.g. Nike's acquisition of RTFKT, a company that creates virtual sneakers and other collectibles in the form of NFTs). This is likely to increase as the Metaverse piques the interest of more businesses across different sectors. At the core of these tech transactions, also known as tech M&A, is intellectual property rights. Increased global tech M&A is anticipated in the next three quarters of 2022.

Intellectual property is key to tech M&A, and buyers must, in addition to conducting careful due diligence of the target's intellectual property rights, pay close attention when they negotiate representations and warranties relating to a target's intellectual property. Buyers typically prefer to specify longer periods to bring claims for breaches of warranties relating to intellectual property and higher caps on liabilities arising from breaches of such warranties.

EVOLVING COMPLEX REGULATORY ENVIRONMENTS

With the increase in tech M&A, including an increase in cross-border deal-making activity to access tech talent, has come an increased regulatory focus. National regulators have sought to assess and regulate the impact of tech M&As on national security, competition and privacy.

In this time of increasing, and increasingly competitive, deal activity (with venture capital pouring into the tech sector) and attendant heightened regulatory interest, it is more important than ever to conduct nimble and thorough due diligence investigations of a target's relevant documents and the regulatory environment or environments in which it operates. What approvals are required to be obtained, and what notifications are required to be given to regulators in the relevant jurisdictions and whether they need to be structured as conditions precedent to closing the deal or not, are important considerations for dealmakers.

M&A TRANSACTIONS CONTINUED

LEGAL DUE DILIGENCE RELATING TO INTELLECTUAL PROPERTY RIGHTS

As noted above, any new agreements need to ensure that vesting, transfer and licensing of intellectual property rights are correctly recorded, and that regulatory requirements in respect of ownership, transfer and licensing are satisfied. It is important to get this right at the outset since, given the significance of intellectual property rights in any subsequent tech M&A transaction, a key focus of the legal due diligence will be on scrutinising these intellectual property rights.

Legal due diligence in the context of an M&A transaction will need to be approached with caution. There should be a specific focus on: (i) examining the terms of the platforms and smart contracts to determine the rules governing ownership, use, licensing and disposal; (ii) verifying the rules governing ownership, use, licensing and disposal of assets in the Metaverse (including intellectual property and NFTs); and (iii) verifying the underlying assets that may be represented in the Metaverse via tokenisation.

SPACs

Earlier this year, the London Stock Exchange welcomed Hiro Metaverse Acquisitions to its main market. Hiro Metaverse Acquisitions is a special purpose acquisition company (SPAC) that intends to focus on targets in the following sectors: video gaming, e-sports, interactive streaming, GenZ social networks, connected fitness and wellness and Metaverse technologies, with principal business operations in the United Kingdom, Europe and Israel. SPACs, which are companies that have no existing business or operating revenue, raise capital and list their shares in an initial public offering and then seek a target to acquire. Although they are less popular than they once were in the United States following increased regulatory scrutiny, the number of SPAC listings globally has risen at a rapid rate. SPACs are expected to continue to feature in tech M&A activity globally in the coming months.

PE DEALS

Another feature of current tech M&A is the increase, year on year, in private equity (PE) deals. The technology sector has, in short, become global PEs key focus. Dealogic reported that at mid-December 2021, PE firms had announced backing for United States technology deals totalling USD401.71 billion, including new purchases, asset sales and add-on deals. It also appears that competition authorities' interest in tech M&A will present greater opportunities for PE investment as part of a potential antitrust/competition solution.



COMPETITION LAW



ABUSE OF DOMINANCE

Producers of augmented reality headsets will not hide anti-competitive practices from competition/ antitrust regulators. Globally, antitrust enforcers have signalled their interest in ensuring that fair competition exists even in digital and virtual platforms such as the Metaverse. For now, most of this scrutiny is likely to fall on large technology players, such as Meta Platforms Inc. New entrants and users of the platform who find themselves excluded from entering or expanding their commercial presence in the Metaverse should consider whether they are being subject to an abuse of dominance by one of the large players.



REGULATORY REGIME

Knowing which regulatory regime applies to you in the Metaverse will be a heated topic in coming years. Conduct which takes place in the Metaverse may be regulated by one or more local antitrust regimes. For example, the South African Competition Act will apply to all economic activity within, or having an effect within, South Africa. While the interpretation of this section of the Competition Act is currently subject to litigation, it is likely that the South African regulators will seek to intervene in any instance where South African consumers or competitors are being impacted. This means that foreign market participants may be subject to South African laws in certain instances. Similarly, South African market participants will have to consider whether their conduct is subject to foreign regulation.



COLLUSION AND BARRIERS TO ENTRY

With the Metaverse creating a blank page for new products and innovation, we can expect an increased need for standard setting, even between competitors, in order to establish new markets. This necessarily requires a sharing of information and collaboration between competitors. competition authorities will scrutinise any standard setting to ensure that it is not a cover for collusive activity and that the standards do not create artificial barriers to entry.



KILLER ACQUISITIONS

Start-ups expecting a healthy return on investment when they are purchased by a larger player with deep pockets may find their plans thwarted by competition authorities who have expressed a disdain for these "killer acquisitions" of innovative newcomers by incumbent players in the technology sector.



TAX

TRADING WITH DIGITAL ASSETS

Commercial transactions and dealings in the Metaverse, even though conducted on a virtual platform, may still result in taxable events. Trading with digital assets, such as NFTs or tokens, are just that – for tax purposes this is trading with assets which have a monetary value, regardless of the platform on which that trading takes place and irrespective of where the transaction takes place. The definition of an 'asset' is widely defined for tax purposes to include property of whatever nature, movable or immovable, corporeal or incorporeal and a right or interest of whatever nature to or in such property, excluding any currency. It should be noted that, for South African tax purposes, cryptocurrency is not regarded as a currency and therefore remains an 'asset', as defined. The normal income tax rules will apply to digital assets and taxpayers need to declare any gains or losses as part of their taxable income. Depending on the nature of the transaction, the income can either be taxed as revenue, if the digital assets were held as trading stock or traded on a regular basis for speculative purposes, or give rise to capital gains tax, if the assets were held as capital assets. This is a question of fact and will have to be determined on a case by case basis.

SOURCE OF INCOME TRANSACTIONS IN THE METAVERSE

Although there may still be some uncertainty regarding the source of income in relation to transactions taking place in the Metaverse, as a rule and, subject to certain exclusions, South African residents are taxed on worldwide income. Just because a transaction took place in the Metaverse does not make it exempt from compliance with any tax rules, whether from a South African perspective or otherwise. Non-South African residents are typically only subject to South African tax on South African source income, and it remains to be seen how the law is going to develop to cater for the source of virtual and digital assets.

SOUTH AFRICAN REVENUE AUTHORITY

The duty to declare all digital assets-related taxable income in the tax year in which it is received or accrued rests upon the taxpayer. Failure to do so could result in interest and penalties. In law, SARS is granted a wide range of collection powers, including a requirement for third-party service providers to submit financial data in respect of any person (natural or otherwise). With SARS having such a 360° view, taxpayers should be aware that their dealings in digital assets will not go unnoticed.

It is recommended that taxpayers seek the necessary advice to ensure that they understand the tax implications of their dealings with digital assets in the Metaverse and that they report on these dealings in compliance with the requirements of the revenue authorities.

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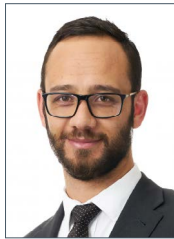
M&A TRANSACTIONS



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