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Laws and Issues in the Metaverse (1)

Robotics/Artificial Intelligence Newsletter

July 27, 2022

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1. Introduction

In 2021, Facebook announced that it would invest a huge amount of money (more than 1 trillion yen) in something called the “metaverse” and change its name to Meta Platforms ("Meta"), a move that attracted attention around the world, including in Japan. Since the announcement, an increasing number of corporates are expanding into metaverse-related businesses. Yet, as would be expected for new and emerging technologies, the legal issues within and pertaining to the metaverse have not been sufficiently arranged and examined. In this Newsletter we outline the laws in question in the metaverse and discuss the points to be noted in doing business-related activities in a metaverse.

2. What is the Metaverse?

“Metaverse” has no clear definition and has not been established fully as a concept, so what one envisages when hearing the word differs by person and can be quite diverse. There are examples of using the term metaverse in both narrow and broad senses; an example of the prior being the name of a type of blockchain game. This Newsletter does not delve into the definition of metaverse, but for discussion purposes uses the phrase to loosely reference experiences that closely simulate the real world in virtual spaces, accessed through virtual reality (VR) systems or other such technologies, where users can engage in economic activities such as communication with other users, creation of content, and trading through identifiable avatars; for example, VRChat creates its own world and enables people to interact with it, Roblox is known as the gaming version of Youtube, and Decentraland provides NFT-enabled lands which can be traded. There are various types of metaverses, but for now they seem to fall under one of (or a combination of) the types identified in **Chart I**.

Chart I Classification of Metaverses

Type	Specific examples	Business Model	Main related laws
①Social	VRChat, NeosVR, cluster, Horizon Worlds	Advertising revenue, item sales	Intellectual Property Law, Personal Information Protection Law, and Civil Code (Moral Rights)
②Digital Asset Creation and Transaction	Decentraland, Roblox, The Sandbox	Goods and services sales, finance, and brokerage commissions	Financial Regulation Act, Intellectual Property law, Penal Act (Gaming Act), Consumer Protection Act, Tax Act
③Games	Fortnite, Roblox, The Sandbox	IP (Intellectual Property) Business	Intellectual property law
④E-commerce	Virtual market	Selling goods and services	Consumer protection laws
⑤Business	Horizon Workrooms	Subscriptions	Labor Law

The metaverse is not only compatible with Web3 (distributed networks) and blockchain, but relies on them to function at its full potential; indeed, blockchain is an essential element that allows users a high degree of freedom. In fact, NFT blockchain technology is often used in digital asset transactions in the metaverse, with some platforms employing decentralized autonomous organizations (DAO). However, metaverse, Web3, NFTs, and DAOs are not necessarily linked.

3. Intellectual property law

(1) General Overview

The metaverse allows for the provision of content in a virtual space. Consequently, arrangements between content providers and users regarding the IP rights of such content are likely to have issues. Some people may use or alter content without the permission of IP right holders, leading to the question of whether such actions can be restricted or prohibited as IP right infringements. In the United States, for example, when digital artist Mason Rothschild sold “MetaBirkin” (an image of a colorful fur on a Birkin, a celebrated Hermes handbag) online, Hermes filed a lawsuit against the digital artist claiming that he infringed their trademark.

Such incidents may also occur in Japan. In such cases, the related laws are primarily the Copyright Law, the Trademark Law, the Design Law, and the Unfair Competition Prevention Law. However, the problem peculiar to the metaverse is whether the IP rights of real goods can be exerted on infringement activities in a virtual space. (Since the service is conceptual, it seems the distinction between real and virtual in the service may not become an issue.)

(2) Contract law

As the metaverse allows for the provision of content in a virtual space, a license agreement will generally be entered into between content providers and users. The license agreement takes the form of “terms of service” made by platforms (service providers). In the metaverse, when selling items, it is necessary to conclude a license agreement rather than a purchase and sale agreement, as the data on offer is intangible; it is important to note that license agreements of this type have points that differ from sales agreements for real (tangible) goods.

(3) Copyright Act

(i) Copyrightability

First of all, when considering copyrights, for example, pictures of characters (or images thereof) are protected by copyright. So, in the metaverse, it is a copyright infringement to replicate or disclose something that is the same or similar to a particular copyrighted image. Nevertheless, precedents are divided as to whether copyrights will arise on items such as weapons, fashion (such as avatar clothes and shoes), and practical goods (such as furniture); the question being one of when an applied art copyright is established.

For example, in the Intellectual Property High Court decision “TRIPP TRAPPII”, where the copyright of a distinctive child's chair was in dispute, the copyrightable nature of chairs was acknowledged where the creator's personality is demonstrated in the design. However, there are many judicial precedents that require aesthetic characteristics which depart from practical function be present in order to assess the copyrightable nature of a chair. Indeed, some of the rulings held after TRIP TRAPPII deny the copyrightable nature of particular practical and craft products. As such, practical goods may not be recognized as copyrightable in the first place.[1]

(ii) To replicate the real world

When replicating the real world in the metaverse, including buildings and artistic work that may be copyrighted, whether it is necessary to obtain licenses from the copyright holders remains unclear. In Japan, Section 46 of the Copyright Act stipulates that "it is permissible to exploit (i) an artistic work the original of which is permanently installed in an outdoor location or (ii) an architectural work, in any way whatsoever.” Although there are some exceptions,[2] essentially, the copyright can be used without the license of the copyright holder. However, there are cases that do no correspond to (i) or (ii) above, for example a copyrighted character appearing in an advertisement displayed on a building, where the image is not an original work of art or architecture, and therefore not subject to Article 46 of the Copyright Act. However, even in such a case, a "minor use" may be legally available (i.e. without the license of the copyright holder) under Article 30-2 of the Copyright Act.[3] This provides that if a copyrighted work’s presence is minor (in its entirety) and only incidental in the reproduction or transmission of a primary work, it can be used without the permission of the copyright holder, provided that the use of the copyright is not unreasonably prejudicial to the interests of the copyright holder.

The metaverse allows you to move freely around a virtual space, making it possible to focus on such works for as long as desired, which could lead to an argument about whether such works are actually “minor”; nonetheless, one interpretation would see such items being subject to Article 30-2 of the Copyright Act (and thus usable without license) because such works are only a small part of a larger metaverse. Further support for this way of thinking could come from any parallels that may be drawn between copyright and trademark laws, as inclusion of trademarks in the metaverse does not constitute trademark use (as described below), eliminating the potential that the presence of trademarks constitute trademark infringement.

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1 Intellectual Property Koban No. 2267, April 14, 2015, p. 91

2 Exceptions to Section 46 of the Copyright Act (i.e., forbidding exploitation) occur when:
(i) producing additional copies of a sculpture or making those additional copies available to the public by transferring them;
(ii) reproducing an architectural work by means of construction, or making copies of an architectural work so reproduced available to the public by transferring them;
(iii) reproducing a work in order to permanently install it in an outdoor location;
(iv) reproducing an artistic work for the purpose of selling copies of it, or selling those copies.

3 The provision of Article 30-2 of the Copyright Law on the filming of a film was expanded by a 2020 amendment.

(4) Trademark Law

When registering a trademark, an applicant must designate the goods or services category within which they are seeking protection. Once the trademark right is registered, the holder of the trademark only may prohibit the use of the trademark by others within such category's scope.

However, even if a registered trademark exists for a real product, will the designated products and services protection extend to the virtual version of the product? For example, with shoe trademark rights it is normal to register the designated product as "apparel" (category no. 25). Since virtual shoes are data and not apparel, the scope of the trademark right may not extend to such "software" (category no. 9) because the designated products (and associated categories) differ.

Moreover, the Trademark law's registered trademark protection extends to similar goods or services categories. "Similarity" is determined based on the likelihood of a potentially infringing product being mistaken for the protected goods or services (when such products are sold at the same location this is termed "source confusion"). This basis for determining trademark disputes may offer leeway for those wishing to recreate trademarked items in the metaverse as it seems unlikely that a court would decide that a virtual good could be mistaken for its real world counterpart.[4]

Furthermore, in order to establish trademark infringement, a potential infringer must be shown to be engaging in trademark use "as a business,"[5] which has been interpreted to mean in a repeated and continual fashion, but there may be cases where this requirement is not met. In addition, "trademark use" in-and-of itself may not constitute "trademark infringement," given that the latter involves accused infringers' potential for interfering with consumer identification capabilities or the goodwill and reputation associated with a trademark. An example of the prior being an attempt to confuse consumers as to the origin or source of a product and an example of the latter being trademark "free-riders" that attempt to alter and resell a trademarked product or associate their product with it in some way. Absent such potential harms, use may not translate to infringement in the real or virtual realms. For virtual use, courts may determine that the use does not involve an attempt to in some way manipulate consumer understanding of a products' sources and there is little room to claim that consumer ability to identify differences from the real version of a product has been impeded.

Therefore, trademarks for real goods may not be able to stop unauthorized use of such goods in the metaverse. However, one solution for trademark holders is to register their trademark as "software" for use in virtual space when registering a trademark (in addition to the product's standard category).

(5) Design Act

If a design has been registered as a design, the holder of the design right may exclusively use the design and prohibit its use by others.

However, despite the possession of design rights for real goods, there are several hurdles to their use with virtual products.

First, in order to constitute an infringement of design rights, the potentially infringing design must be shown to be used by a business (Article 23 of the Design Law).

In addition, the effectiveness of the design right extends to the same and similarly designed goods, and this "identical and similar" metric is determined in consideration of the nature, purpose, and use of the design. A court may determine that the use of a protected design in a virtual space is not identical or similar to the

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4 People's Collection 51 Volumes No. 3, 1055 March 11, 1997 [Komito longevity incident]

5 See Articles 2.1 and 26.1 of Japan's Trademark Law.

nature, purpose, and use of the associated real goods. For example, real shoes are used to walk, but virtual shoes are not used to walk, and their nature, purpose, application, and usage pattern differ from real shoes as well.

Therefore, design rights for real goods may not be able to stop unauthorized use in the metaverse.

As with trademarks, it is possible to register designs of images. However, in the Design Act, image designs can only be registered for images used for operational purposes, such as icons and display images (i.e., those that are displayed as a result of a device's ability to perform its designated functions). As a result, design rights often cannot be registered for avatars and virtual items used in the metaverse.[6]

Thus, it would be difficult to protect the design of real goods with design rights in the metaverse.

(6) Unfair Competition Prevention Act

The Unfair Competition Prevention Law prohibits the act of free-riding on another's product label, etc., including identifying (i) the act of inducing confusion of well-known labels and appearances of products and business, (ii) the misappropriation of famous labels and appearances of products and business, and (iii) the act of imitating the form of goods, as acts of unfair competition.

(i) Act of inducing confusion

Under the Unfair Competition Prevention Act, “product labeling” refers to displays that identify the goods and services of one business entity and distinguishes them from the products and services of another business entity. When making such displays, "causing confusion" is prohibited, especially with concern to “well-known” product labels and the appearances of products and businesses (Article 2, para.1, item 1 of the Unfair Competition Prevention Law).

Although product designs typically do not display product sources, it is believed that designs have unique identifiable characteristics that can be used to set them apart from similar products, and if they are used exclusively for a long period of time or in intensive short-term advertising, they may have other product identification functions as well.[7]

"Provocation of confusion" refers to actions that cause confusion with product labeling at the point of sale. In determining the possibility of confusion, in addition to the level of “identifiability” of a good’s markings, the nature of the product, the scope of users, and the form of transactions are considered. In the metaverse, as noted earlier, it is arguable that as long as you do not sell your items, there may be no confusion of source. In addition, it is a considerable burden to verify in court that product labeling, etc., is "well known," which should disincentivize some seeking to protect what they believe to be their rights in cases involving confusion in a virtual world.

(ii) Misappropriation of famous labels and appearances

"Misappropriating famous labeling and appearances of products and businesses" is prohibited (Article 2, para. 1, item 2 of the Unfair Competition Prevention Act). "Famous" means being known at the national level. Therefore, we can say that the hurdle for the requirement of "famous" is high. Unlike the act of inducing confusion of well-known labeling, right-holders seeking protection in cases involving misappropriation of famous labeling are not required to show confusion.

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6 Prior to the revision in 2019, the Design Act only allowed tangible property design registration; however, a 2019 revision enabled design right registration of images for the first time.

7 Tokyo Jishin No. 1607, March 21, 1997, p. 94 [Fujimura Art and Textile II Case]

(iii) Imitating the form of a good

Imitating the “form of goods” refers to the act of making a so-called “dead copy” (including unnecessary features in a product from a functionality perspective that mimic a more well-known product, creating potential consumer confusion), and the acts of assigning, leasing, or displaying such imitation for the purpose of assignment or lease, as well as the exporting or importing of counterfeit goods (Article 2, para. 1, item 3 of the Unfair Competition Prevention Act).[8]

The term "imitation" as used herein means the creation of goods in substantially identical form to that of another’s goods (Article 2, para. 5 of the said law). In relation to the metaverse, given that the prohibited acts are transactional in nature, use of an imitation for the user’s own purposes likely would not qualify as prohibited acts. In addition, there is a question as to whether transactions within the metaverse will be considered as "domestic," the answer to which will impact the application of the Unfair Competition Prevention Act in that realm. Moreover, when comparing real goods and their virtual counterparts there is controversy as to whether we really can say they are of "substantially identical form."

(7) User Generated Content

"User Generated Content," typically abbreviated “UGC,” is one of the attractions of the metaverse, given that it allows users to create items, avatars, games, buildings and so on. When UGC is created in a metaverse, however, it raises questions about how to handle the related intellectual property concerns.[9] For example:

- Should the UGC's intellectual property be attributed to the user?
- How far can the user allow the original content to be modified?
- Where can users go to have their rights approved or enforced (copyrights, etc.)?
- Can the user allow the item to be transferred to a third party? If so, what is the scope of third party rights and how should such licensing agreements be structured?
- Can users create content for commercial purposes (monetization)?

The attribution of UGC intellectual property rights is an important issue for both metaverse platformers and users. If platformers don't want users to hold the intellectual property rights to UGC created within their platforms, platformers might reduce incentives to create or prevent users from using their platform. In addition, the answers to the above questions are also important factors in enhancing user creativity and willingness to participate (and improve) platform marketing effectiveness (such as through word of mouth). For example, the ability to modify content has traditionally been problematic (and pricey), but on many platforms it has contributed to the formation of certain cultures and the expansion of fan-bases. However, without the establishment of clear rules, ambiguity may cause a chilling effect for users (as penalizations may appear to occur at random or based on an indecipherable matrix of requirements).

UGC's handling of intellectual property is a problem not only between platforms and users, but also between users. However, as UGC transaction patterns are diverse, it can be said to be an issue to be examined in the future.

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[8] Imitating the form of goods is prohibited for a period of three years from the launch of the original goods in Japan (Article 19, para.1, item 5 (a)).

[9] UGC in the metaverse is created on the platform or created by a user outside the platform and brought to the platform. Regarding the former, a particular issue is whether the UGC IP rights are to be attributed to the platform or the user.

(8) NFT

The data that make up digital assets are intangible and have characteristics different from those of tangible things such as land and automobiles. Because the data is intangible and cannot be controlled exclusively, the concept of ownership with exclusive control is not applicable (making the phrase "data ownership" somewhat of a misnomer).

With regard to digital property, NFTs (Non-Fungible Tokens: non-substitutable tokens) using blockchain have recently appeared and become a topic of interest. NFTs attracted much attention, for example, because Beeple's NFT art titled “Evertdays = The First 5000 Days” was auctioned for about 7.5 billion yen at Christies. Currently, many artists are selling NFT works, and NFT is booming.

NFTs have a variety of types and characteristics, including NFTs for trading cards like baseball cards, NFTs for digital art, NFTs for games, and land in a metaverse made into an NFT. It is sometimes said that NFTs are (i) one-of-a-kind digital property, (ii) impossible to falsify, and (iii) capable of returning profits to the author at the time of secondary distribution. However, as mentioned above, there is no “ownership” of data. Whether profits can be returned to the author at the time of secondary distribution depends on the specifications of the platform where such distribution is to take place. Therefore, only item (ii) above is correct.[10]

Nevertheless, NFTs have allowed handling of digital assets in a manner quite different from that of the past, such as (a) linkage between data and its holders, (b) verification of the uniqueness of data, and (c) the impossibility of tampering. This will open up new possibilities for the handling of digital assets, and is certainly worthy of close attention. Below is an explanation of NFT intellectual property law issues focused on NFT art.

(i) Relationship between NFT and content

NFTs exist on a blockchain. To be clear, taking NFT Art as an example, content such as an NFT Art's image data and music data are generally not listed in the blockchain, but rather only metadata such as the URLs where the image data and music data are stored. This is because recording a large amount of data in a blockchain increases the fees (energy costs) required to approve the transaction. As the actual NFT content thus exists outside the blockchain, certain risks exist, such as tampering and disappearance (however, there is a way to reduce such risks by using a distributed file system such as IPFS.).

(ii) Relationship between NFT and copyright

If an artist makes an NFT and sells it, the copyright of that artwork will not be transferred automatically to the purchaser, but will remain with the artist. For this reason, artists are free to dispose separately of the copyrights associated with their art. In other words, the attribution of NFTs and the attribution of copyrights are not linked. However, even if a purchaser of NFT Art does not have a licensing agreement with the artist, a reasonable interpretation of the transaction is that the artist is granting the NFT purchaser a license to publish an image of the art on the net (public transmission) or store it on a server (duplication).

(iii) Notes on NFT

While many NFTs have economic value that is traded in exchange for a certain amount of money or cryptocurrency, the characteristics of NFTs described above suggest that the following problems may arise:

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[10] Accurately, falsification is extremely difficult, and it is possible to falsify it through a 51% attack, etc.

(a) An unauthorized person who has not created a piece of art may attempt to create an NFT from it.

It is technically possible for someone to make an art-based NFT without the permission of the copyright holder of the artwork. For example, as URLs are not copyrightable, it would not be piracy for someone to mint an NFT that just included the URL of where the image of a piece of art is stored. However, in many cases, when selling art as an NFT, it is thought that, in a sense, the “image” of the art is being “used,” so it may be possible for an adjudicator to focus on this point and decide that this tactic indeed constitutes piracy. Again, as a burgeoning area of law, such matters have yet to play out in full. Moreover, this situation is further complicated by the fact that unauthorized conversion to NFT in-and-of itself cannot be prevented quickly or easily. This means that for purchasers there is a risk of purchasing unauthorized NFTs. As with internet based sales generally, it can be said that purchasers of NFTs should seek out reputable sources with reliable transaction mechanisms.

(b) Artists who have sold NFTs turn many identical and similar works into NFTs.

If an artist sells an NFT, the copyright of that art will not be transferred automatically to the buyer, but will belong to the artist. Thus, artists can use any of their copyrighted works unless prohibited by the NFT sale contract. It is also possible for artists to sell numerous NFTs of the same and similar works as those already sold by converting them into NFTs, unless the agreement prohibits such actions.

(c) Artists who sell NFTs can transfer the copyright to a third party.

Artists can transfer the copyright of their art (or the right of exploitation) to third parties even after they have sold a related NFT. In that case, the party that acquired the copyright may require the holder of the NFT to prohibit the use of the art based on the copyright. In this respect, in accordance with Article 63-2 of the Copyright Law of Japan, the holder of the right of exploitation of a copyrighted work may claim the right of exploitation against the holder of the copyright or a third party. Therefore, the holder of the right of exploitation of the copyrighted work may use the copyrighted work in accordance with this provision.

Given this, the rights of NFT buyers are fairly weak. In order for purchasers to protect their rights, it is important to take measures such as having proper contracts with NFT sellers. It is also desirable that rules be put in place to ensure that the rights of purchasers of NFTs are properly protected.

From the standpoint of artists, NFTs can play a role in securing profits by, for example, establishing a mechanism for returning profits on secondary distributions. On the other hand, the issuance of NFTs by unauthorized persons and fraud can damage artists. As such, further development of this technology, and legal certainty surrounding its treatment, would be beneficial to all (legitimate) parties.

(9) SUMMARY

It is important to note that the metaverse uses products and services in virtual spaces, where intellectual property rights based on real products do not naturally extend. Moreover, there are currently distinct differences, and even barriers, between the way the real and virtual realms are treated in the Japanese legal system. Taken together, the metaverse is shrouded in greyness and in need of the illumination of rule formation.

As for NFTs, it is necessary to note that the holders of NFTs do not have automatic copyrights.

This article continues in the next edition.

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