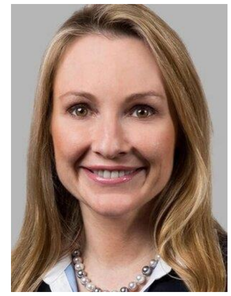
Unlocking Blockchain Opportunities Amid Legal Uncertainty

By **Teresa Goody Guillén, Robert Musiala and Steve McNew** (June 10, 2024)



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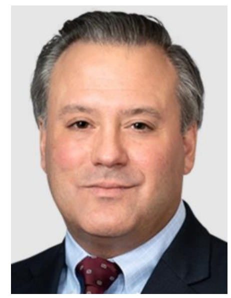

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Web3 and metaverse are catching on.

In the wake of a highly publicized, rapid rise and fall in expectations, many viable Web3 environments and projects have continued forward, providing real-world solutions and value across numerous industries and use cases.

According to a CasperLabs survey released in January 2023, "The State of Enterprise Blockchain Adoption in 2023,"[1] 87% of global businesses surveyed plan to invest in blockchain-based programs in the coming year, many of which will fall in the realm of Web3 and metaverse applications. Additionally, hundreds of the world's largest brands[2] are investing in projects that will help to shape the future of customer engagement and online experiences through these technological advances.

What these brands recognize is that blockchain technology, which largely powers Web3 and metaverse offerings, remains positioned — despite early overhyped and ongoing challenges in the cryptocurrency space — to become a transformative and even foundational technology for many enterprise and business-to-consumer applications.

Through these new channels, brands have the ability to create unique, immersive experiences, provide seamless user interfaces and connect virtual and real worlds in meaningful ways that engage customers and differentiate themselves from crowded and siloed marketplaces.

Importantly, the rules, requirements, standards, best practices and legal precedents are still forming in the Web3 and non-fungible token space. Thus, organizations looking to pursue these projects will need to ensure appropriate legal and compliance considerations and controls are addressed from the outset of their offerings.

NFT Loyalty Programs

NFT opportunities include enablement of customer engagement and loyalty programs. Traditionally, loyalty programs have followed roughly the same format: Registered customers are rewarded with points, discounts and other perks according to the amount of time and/or money they spend with a brand's products and services.

But that's starting to change.

Numerous global brands have recently implemented Web3-based engagement and loyalty programs to personalize their customer offerings, form deeper connections between their brand and consumers, and establish revenue-generating secondary markets for their products.

For example, last year, Lufthansa recently relaunched its frequent flyer program with an app that converts travel experiences into NFTs, which in turn hold value in the form of mileage bonuses, access to exclusive lounges and other benefits.

Fashion brands such as Gucci are creating exclusive NFT clothing, shoes and accessories, which can be used to outfit virtual avatars in the metaverse and in some cases provide exclusive access to real-world events or limited edition physical products.

As these and other use cases gain momentum in mainstream channels, industries including travel and transportation, gaming, entertainment and sports are likely to be the most active early adopters of customer loyalty and engagement offerings with digital assets elements.

Emerging NFT initiatives are providing customers with alternatives to ticketing programs, digital subscriptions and event participation.

In entertainment, musical artists can use minted NFTs and token-gated ticketing to allow fans to access and purchase seats at their shows. Similarly, musicians can provide NFTs to their premier fans as souvenirs or collectibles from live performances.

Success in implementing such novel solutions will hinge on many factors, from technical logistics, to creative design and appropriate legal positioning. Organizations will need to attend to the most pressing legal and regulatory considerations at the foundation to allow innovation to move quickly without undue risk. Top issues to consider include the following.

Regulatory Compliance

Regulatory uncertainty continues to hamper digital assets, Web3 and metaverse initiatives. While this makes it challenging for organizations to build compliance controls into their programs, there are a few regulations that can provide some guidance.

For example, data privacy laws, including industry-based, (e.g., Health Insurance Portability and Accountability Act, Gramm–Leach–Bliley Act), U.S. state-based (e.g., California Consumer Privacy Act) and international regulations (e.g., General Data Protection Regulation) are an important starting point, as most Web3 offerings will involve some level of collection, storage, use and/or sharing of customer information.

Any data privacy policies or controls in place for other uses of personal information should also be adapted to include new Web3 offerings. Likewise, in Europe, the Digital Services Act and the Digital Markets Act include requirements that will implicate certain Web3 interfaces and digital customer offerings, so programs should be assessed in the context of obligations and applicability under those laws.

In the U.S., there is still significant uncertainty as to whether the government will classify particular digital assets as securities, commodities or money, including inconsistency in their treatment among regulatory agencies such as the U.S. Securities and Exchange Commission and the Federal Trade Commission. These issues have been heavily debated in legislative proposals.

Organizations and persons intending to launch digital assets or facilitate their trading should work to comply with the evolving regulatory landscape, which includes how any NFT program or product is structured, offered and promoted.

Consumer Protection

In addition to consideration of consumer protections in new European regulations like the Digital Services Act and Digital Markets Act, in the U.S., the FTC regulates online marketing and digital advertising, and FTC requirements should be expected to apply to Web3 and other virtual environments.

There will be an array of controls organizations will need to build into their offerings to prevent consumer harms and related violations.

Customer and Vendor Terms of Use

Bespoke offerings leveraging Web3 and digital assets may require support from technology vendors and other third parties. Agreements and terms with node providers, payment processing platforms, other partners and customers will require unique contractual language that aligns to the nuances of Web3 environments, above and beyond typical contractual terms.

For example, terms to delineate ownership and rights for digital assets and user-generated content created as part of the Web3 experience may be necessary.

Money Transmission

Certain digital asset transactions may be vulnerable to financial crime and money laundering, which can lead to violations of the Bank Secrecy Act, Financial Crimes Enforcement Network and Office of Foreign Assets Control regulations.

To avoid potential issues, organizations minting, selling, trading or maintaining custody of NFTs should examine whether the Bank Secrecy Act provisions apply. Additionally, risks can be mitigated by ensuring policies, procedures and technical controls are in place to prevent transactions with Office of Foreign Assets Control-sanctioned countries and persons on the sanctions list.

Anti-Fraud and Anti-Corruption

Fraudulent activity can be an issue in NFT markets. Also, like any other valuable assets, NFTs may be used to facilitate bribes and other forms of corruption, posing a risk for organizations engaging in the NFT market to become caught up in Foreign Corrupt Practices Act violations.

NFT market participants can protect against fraud by conducting due diligence on NFT sellers and other third parties and by watching out for red flags, including typographical errors and obvious misspellings in emails, social media posts or other communications; promises of outsized investment returns; promises of free money; and secretive or complex strategies and fee structures.

In many ways, the "Law of Digital Assets" is analogous to the "Law of the Horse" concept. Just as there isn't a singular law that applies to horses (the laws applicable to a case involving a horse-related injury will differ from the applicable laws for a dispute surrounding ownership of a horse), there is no distinct law that governs the realm of digital assets.

Dozens of laws and legal precedents will come into the fore as Web3, metaverse, NFTs, etc., gain momentum and wide-reaching adoption. Instead of working to fit these into one category of law, organizations need to view and design their programs with a broader view of potential exposures — and opportunities.

Strong foundational best practices for governance, privacy and regulatory compliance can underpin new offerings so that they are built for risk resilience and adaptability as the space evolves.

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[1] https://cointelegraph.com/news/90-of-businesses-adopting-blockchain-technology-data.

[2] https://www.nfttech.com/newsroom/web3-report.