EVERSHEDS
SUTHERLAND

What is Web 3.0?

Understanding the basics, the practical uses and the legal issues at play

November 3, 2022
ACC SFBA

ACC Association of Corporate Counsel

SAN FRANCISCO BAY AREA

Today's Presenters

Sarah Paul
Partner and Co-Global Head of Corporate Crime and Investigations

Eversheds Sutherland US (LLP)

Brandi Taylor
Partner and West Coast Technology and Data Lead

Eversheds Sutherland US (LLP)

Jaya Kasibhatla
Associate General Counsel

Coinbase

Agenda

— What is Web 3.0?

— How are businesses using Web 3.0?

— What are some of the legal issues at play?

What is Web 3.0?

— Web 3.0 (or "Web3") is the next evolution of the internet

  - The definition is evolving, but the big idea behind Web 3.0 is using new technologies to make the internet more decentralized, meaning owned and governed by its users

— Evolution of the internet over time:

  - **Web 1.0** –
    - accessing content on the Web (i.e., reading web pages)
  - **Web 2.0** –
    - emergence of social media and other interactive websites
    - users could both consume and create content on the internet
  - **Web 3.0** –
    - users have ownership of content produced and shared on the internet
    - decentralized governance

Blockchain fundamentals

— The foundational building block of Web3 is blockchain technology (literally a digital chain of blocks)
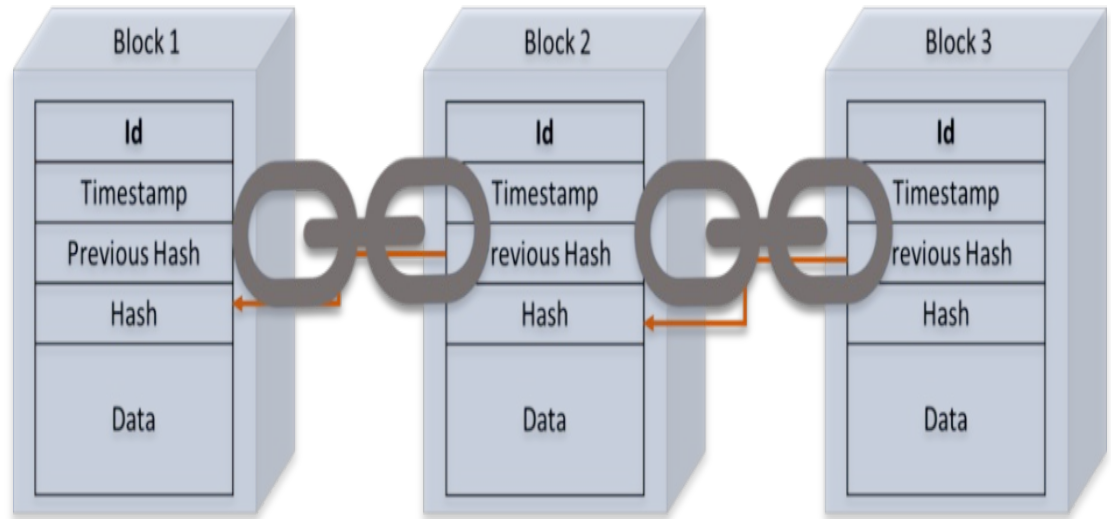
- As each transaction occurs, it is recorded as a "block" of data
- These blocks form a chain of data
- The blocks confirm the exact time and sequence of transactions
- The blocks link securely together to prevent any block from being altered or a block being inserted between two existing blocks
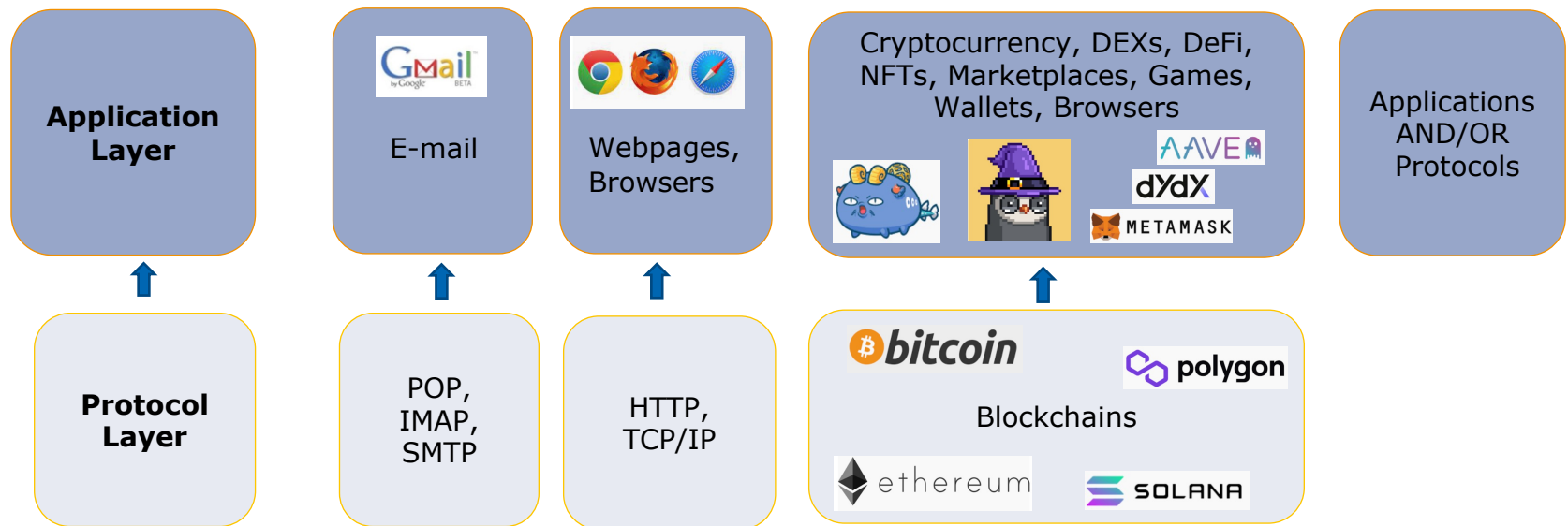
Blockchain fundamentals (con't.)

— Key Features:

- Enhanced security
- Transparency
- Traceability
- Increased efficiency and speed

Big Picture:
# You already know how to conceptualize Web3

Application Layer	E-mail	Webpages, Browsers	Cryptocurrency, DEXs, DeFi, NFTs, Marketplaces, Games, Wallets, Browsers	Applications AND/OR Protocols

Protocol Layer	POP, IMAP, SMTP	HTTP, TCP/IP	Blockchains	

The difference is decentralization

Protocols are usually open, whereas apps/platforms

are not

<u>Walled Garden</u>:

— User data

— Activity

— Content

— Followers
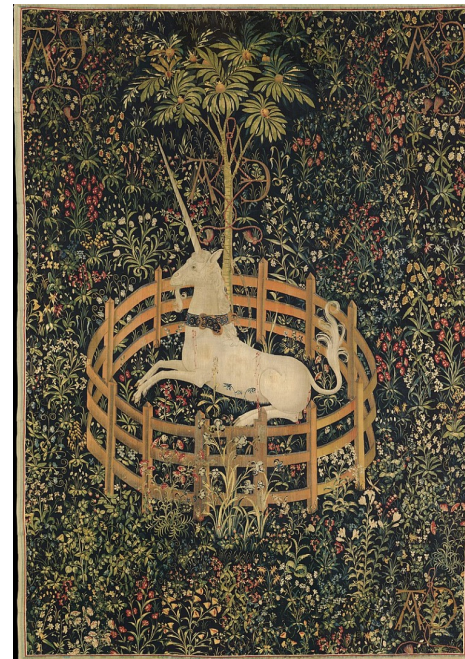
Source: Unicorn Tapestry, Cloisters

Web3: Apps v. dApps

Who controls what?

Web2 App/Platform	Decentralized App (dApp)
User Account	Wallet Address*; user accounts often optional
Username or Handle	Decentralized Identity (DiD) – portable on-chain username/handle
Activity	On-chain display of activity or transactions
Followers	Could be Part of DiD – portable
Content	On-chain/decentralized storage

Big takeaways

By increasing interoperability or portability across protocols, you "decenter" any single app or platform

— Preserves choice, competition, moves away from model of 1-3 platforms dominating the space

Decentralization allows for more value to be captured by Users/Creators, not just platforms

— "Creator Economy"

Cryptocurrency defined

— **<u>Cryptocurrencies</u>** are virtual currencies secured by a blockchain, whose values are intrinsically linked to users' trust in the blockchain

- Unlike government-backed currencies, cryptocurrencies allow transactions to occur without the use of third-parties
- Two of the biggest cryptocurrencies in the market are Bitcoin and Ether

Web3 in Action – Cryptocurrency

— **Make purchases possible via cryptocurrency**

- Individuals can engage in certain transactions using cryptocurrency

- For example:

  - Starbucks now allows customers to reload their Starbucks cards using cryptocurrencies

  - AT&T now accepts online bill payments from customers through BitPay, a cryptocurrency payment processor

  - Colorado now accepts cryptocurrency in payment for state taxes

What are digital tokens?

— **<u>Tokens</u>** are digital assets representing ownership of digital property

- In contrast to cryptocurrencies, which are the native asset of a specific blockchain network, tokens build on top of existing blockchains
- Tokens can be used to show membership in a particular group, to reward participation in a community or to trade for benefits on a platform
- Tokens are fungible and transferable

Web3 in Action – Digital tokens

— **Utility tokens**: can be released by a company to provide users with a means to pay for new products or services

— **Security tokens**: can act like a stock or a share in a company, and their value may rise and fall in relation to the company's performance

— **Social tokens**: backed by the reputation of an individual, brand or community

Creator Economy: NFTs

What are NFTs? (non-fungible tokens): *Non-Fungible Tokens (NFTs) are blockchain-based tokens that represent a unique digital asset.*

What you own – Deed of Ownership for a digital asset

What you don't necessarily own – copyright in underlying work

— Where is the underlying work? → decentralized storage, less likely on-chain

Advantages and Legal Issues

Advantages of NFTs

1. Minting on the blockchain: immutable record of transaction/auth
2. Transparency in transaction: provenance can be traced
3. Content associated with NFT: no single point of failure for storage
4. Programmable: features of an NFT can evolve over time
5. Revenue streams: royalties, experiences, merchandise, content
6. Community: borderless belonging

Legal Issues:

— How do I tell what license I have?

— How do I collect royalties?

— What happens if my NFT is stolen?

— What if my NFT contains unlawful content or infringes on IP?

— Is my NFT a security?

Legal issues and Web3

— **<u>Data Privacy Considerations</u>**:

- *Transparency* – Because of the complexity and relative unfamiliarity of the average consumer with Web3 technologies, transparency around the processing of user data can be challenging

- *Controllership* – Due to its decentralized nature, a public permissionless blockchain is not anticipated by most privacy laws

- *Deletion* – With a public blockchain, the data that is tied to a persistent public key is publicly accessible and cannot be deleted

- *Data Transfers* – Careful analysis is needed to determine when a data transfer is occurring, given the increased regulatory scrutiny on international transfers

Legal issues and Web3 (con't.)

— **<u>Securities Law</u>**:

- Certain digital currencies could be considered a "security" by the US Securities and Exchange Commission (SEC) and subject to federal (and potentially state) securities laws.

- **NFTs** – NFTs are "non-fungible" and not interchangeable, so they are generally less likely to be deemed securities, except in certain situations

— **<u>Commodities Regulations</u>**:

- The Commodity Futures Trading Commission (CFTC) has stated that cryptocurrencies fall within the Commodity Exchange Act's broad definition of "commodity"

- Recent legislative proposals have suggested that the CFTC, rather than the SEC, should have the power to regulate most of the crypto industry

Legal issues and Web3 (con't.)

— **<u>Sanctions Obligations</u>**:

- The Office of Foreign Assets Control (OFAC) has issued guidance emphasizing that sanctions compliance requirements apply to the virtual currency industry in the same way as they do to traditional financial institutions

- OFAC has issued advisories stressing potential sanctions risks that could arise from ransomware payments

- OFAC has recently been sanctioning virtual currency exchanges and mixers

Legal issues and Web3 (con't.)

— **<u>Anti-Money Laundering (AML)</u>**:

- **Digital Currencies**:
  - FinCEN has made it clear that administrators and exchangers of virtual currency are money services businesses under the Bank Secrecy Act (BSA) and subject to the BSA's regulations
  - Companies using digital currencies may need money transmitter licenses or the global equivalent

- **NFTs**:
  - Treasury has expressed concern about the money laundering risks of NFTs
  - FinCEN may decide that NFTs qualify as "antiquities" under the AML Act of 2020

Legal issues and Web3 (con't.)

— **<u>Tax Compliance</u>**:

- Virtual currency transactions carry tax implications

- Taxpayers must track their basis in their virtual currency in order to determine gain or loss on the subsequent transfer of the coins

- There are also tax reporting requirements for certain businesses that deal in virtual currency

Legal issues and Web3 (con't.)

— **<u>Intellectual Property (IP)</u>**:

- Existing IP laws and licensing regimes were not initially designed to address the concept of 'ownership' of digital objects

Copyright Disputes:

- Digital artist Mason Rothschild created NFTs tied to digital images of luxury accessory designer Hermes' famous Birkin bag
  - While the project began as a one-off, Rothschild eventually sold more than one hundred NFTs for more than $1.1 million over various NFT trading platforms such as Opensea, titling the project "MetaBirkins"
  - In January, Hermes filed a claim against Rothschild, alleging his use of the likeness of the Birkin bag constitutes copyright infringement
- Miramax sued Quentin Tarantino over Pulp Fiction NFTs
- HitPiece (NFT site) accused of selling NFTs of songs by musicians like Britney Spears and Taylor Swift without permission

License Uncertainty:

- Crypto Punks -- user concerns due to uncertainty over the license terms

The future of digital assets regulation

— The White House's Comprehensive Framework for Responsible Development of Digital Assets

— Released on September 16, 2022

— Follows an executive order issued by the Biden administration in March 2022, which outlined a "whole-of-government" strategy

— What's next?

EVERSHEDS
SUTHERLAND

Sarah Paul
Partner and Co-Global Head of Corporate Crime and Investigations
Eversheds Sutherland US (LLP)

Brandi Taylor
Partner and West Coast Technology and Data Lead
Eversheds Sutherland US (LLP)

Jaya Kasibhatla
Associate General Counsel
Coinbase

eversheds-sutherland.com