

Virtual Goods—Developing and Protecting a Business Model

All types of businesses are leveraging new and emerging business models around virtual goods. Analysts estimate that virtual goods will generate \$1.6 billion in the U.S. this year and over \$7 billion worldwide. Some predict that the sales of digital goods will account for 20% of gaming revenue by 2011. Based on a recent report, 75% of survey respondents have used real-world money to pay for virtual goods, and roughly half expect to continue to spend about the same amount of real-world cash over the next 12 months. Whatever the actual numbers, the trend is clearly up. While these trends present significant business opportunities, companies need to address various legal issues to safely and profitably capitalize on these trends.

Pillsbury's Social Media, Entertainment & Technology team has assisted many companies, from start-ups to Fortune 100 companies, in developing virtual goods business models and legal strategies. Our team of over 30 attorneys, including the leading attorneys in this field, can help you navigate legal hurdles to safely leverage these opportunities.

Virtual Goods Overview

Virtual goods are digital representations of objects having at least some persistence, over which a user can exercise some dominion and control and for which there is an aspect of interconnectedness.

- **Digital representation of objects**—Many virtual goods are digital recreations of objects that exist in the real world or are at least inspired by real world objects. Other virtual goods often have no real world counterpart. Rather, they are objects created for use with virtual worlds, games or other social media applications.
- **Persistence**—Virtual goods typically have some level of persistence such that they exist even after a user turns off her computer. In many cases, the virtual good can persist for an indeterminate time. In other cases the virtual goods exist for some limited duration, based on time, use or other criteria.
- **Dominion and control**—For any copy of a virtual good, typically there is one user who can exercise dominion and control over that object at any one time. Virtual goods often can be traded, exchanged and sometimes stolen, just like real goods. Whether virtual goods are owned or merely licensed can be critical to various legal issues.

- **Interconnectedness**—Typically this means that a virtual good does not exist in isolation on one person's computer, but rather that the object is at least perceptible and affects and/or interacts with other users or systems. This distinguishes virtual goods from other media files (e.g., a song) that may reside on a single user's computer.

Many types of virtual goods exist. Some are functional, others are not. Virtual goods include rare/collectibles, social statements, fashion statements and branded items. People buy virtual goods for exactly the same reasons that they buy real world goods—for functionality (weapons in games), aesthetics (virtual clothing and accessories), scarcity (collectibles), brand association (branded virtual goods), social statements (political or philosophical) and other reasons.

How Users Acquire Virtual Goods

Virtual goods are acquired in many ways. They can be:

- bought with virtual currency
- bought with real currency
- earned through game play (winning battles) or other activity (viewing ads, responding to surveys, etc.)
- traded through player-to-player markets
- gifted by friends
- distributed as promotional items (e.g., branded virtual goods)
- won in contests

The use of virtual currency raises another whole set of legal issues. Our fact sheet on Legal Issues with Virtual Currency can be found on our blog, www.virtualworldlaw.com.

Overview of Potential Legal Issues With Virtual Goods

Business models vary for virtual goods, but any creator or distributor of virtual goods needs to develop a comprehensive legal strategy to protect their virtual goods and their customers. Depending on the business model, these strategies need to be customized and need to consider business, legal and technical components. The legal issues confronting companies leveraging virtual goods are manageable, but are best addressed early in the business planning stages. The following are some of the legal issues commonly encountered:

Terms of Service

Effective terms of service (TOS) customized to the platform, technology and business model are a must to protect your rights, manage users' expectations, minimize your liability and facilitate enforcement when necessary.

Among many other important things, effective terms of service should address:

- Whether users own or just have a license to use the virtual goods (and land, currency, etc.). This can be critical to whether you have any legal liabilities to users for the value of virtual goods in the event you: terminate a user's account (e.g., for breach of the TOS), shut down your service or a portion thereof, take action that impacts the value of virtual goods (e.g., create more copies of once scarce goods), or take other actions that impact access to or the value of a user's virtual goods. Litigations have occurred and are pending on these issues.
- Prohibitions on the right to transfer (e.g., by sale, gift or bequeath) virtual goods or entire accounts to others, including to help prevent unauthorized resale or trading of virtual goods on secondary markets. A 2010 case, *Vernor v. Autodesk*, confirms that developers of software based products (e.g., virtual goods) can own copies of what they license to users and can restrict distribution and/or resale if properly addressed in the TOS.

Intellectual Property Protection

- **Copyright**—Creative expressive aspects of virtual goods can be easily and inexpensively protectable by copyright registrations. Yet many companies overlook this and forgo some of the significant benefits of timely filing for this protection, including statutory damages, attorney fees and certain legal presumptions. For more details, see our advisory on Copyright Registration for Virtual Goods: The Benefits of Timely Filing, found here.
- **Trademarks**—"Branded" virtual goods can and are being protected by trademark registrations. The U.S. Patent and Trademark Office has created a new class description to facilitate this.
- **Patents**—Functional aspects of technologies and certain business methods that relate to displaying, interacting with, monetizing, and distributing virtual goods can be patentable.

Intellectual Property Enforcement

The more popular and valuable your virtual goods, the more likely an unauthorized secondary markets will be created and used to illegally sell the goods. Assuming you have obtained the available IP protection and contractual protections (TOS), many tools may be available to terminate unlawful secondary markets or other infringement of your rights.

- **Digital Millennium Copyright Act (DMCA)**—You can issue a DMCA takedown notice to cause the infringing copies to be removed from third-party sites; but you need to be aware that misusing the DMCA can subject you to liability.
- **Copyright infringement**—You can sue for copyright infringement (but often this is only economically feasible if you have timely filed for a copyright registration).
- **Trademark infringement/unfair competition**—You may be able to sue for unauthorized use of your company brand in connection with the sale of virtual goods.
- **Patent infringement**—You can prevent competitors from infringing on your virtual goods technology and business models if you have patented them.

Data Privacy and Security, and Child Protection

- The sharing of information between third parties, even affiliates, can trigger opt-out and opt-in requirements under certain federal, state and international laws.
- A company's own usage of such data must itself be compliant with the laws as well as the company's own published privacy policies.
- Some states (e.g., California) even require that specific types of privacy policies be maintained, and it is a violation of state law to fail to comply.
- Some states and countries dictate how and where you store data (e.g., data associated with virtual goods) and mandate certain security procedures.
- Many of the most successful virtual goods implementations to date have involved children and teenagers. Dealing with minors raises a whole host of issues, including the Children's Online Privacy Protection Act (COPPA) and issues with transacting with minors.

Other Regulatory Aspects of Virtual Goods

- **Taxes**—Some countries and states have passed laws that impose taxation on gains from and/or the sale of virtual goods.
- **Gambling/sweepstakes**—Some companies have used contests, sweepstakes and other creative ideas to sell virtual goods. Some are legal, but some violate gambling and/or sweepstakes laws.

What Pillsbury's Social Media, Entertainment & Technology Team Can Do to Help

- Analyze your virtual goods business model to help you avoid legal pitfalls.
- Draft a solid terms of service agreement—with a focus on your virtual goods and virtual currency models to minimize user issues and liability.
- Develop and implement IP strategies to protect your virtual goods.
- Monitor and enforce unauthorized uses, including secondary markets.
- Draft privacy, COPPA, DMCA and data protection/storage policies.
- For up-to-date information on cases and legal issues involving virtual goods, please visit our blog at www.virtualworldlaw.com.

About Pillsbury's Social Media, Entertainment & Technology Team

Pillsbury's multidisciplinary Social Media, Entertainment & Technology team, the first of its kind, includes nearly 30 attorneys around the world working at the forefront of emerging business and legal issues relating to virtual worlds, mirror worlds, augmented reality, virtual goods, virtual currency and other social media. The team, which can assist clients with venture capital and private equity funding, mergers and acquisitions, legal and business strategies for virtual goods and currency, intellectual property strategies, implementation and enforcement, preparation of key agreements and policies, including: terms of service agreements; development agreements; DMCA policies, compliance and enforcement; data protection and privacy policies; COPPA policies; and much more, has represented both the largest players in the industry and some of the most promising emerging companies. Additional information about the Social Media, Entertainment & Technology Team can be found at www.pillsburylaw.com/socialmedia.

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