

# Overview of Legal Issues with Virtual Currencies

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*All types of businesses are leveraging the many emerging business models associated with virtual goods and virtual currencies. While these trends present significant business opportunities, companies need to be aware of the various legal issues that must be considered to safely capitalize on these trends.*

*The following is an overview of some of the major categories of laws and legal issues that companies need to consider when dealing with virtual currencies and other micropayments. Failure to comply with such laws can give rise to lawsuits, fines, regulatory orders, civil and even criminal fines, in the U.S. (both federal and state) as well as internationally.*

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Pillsbury's Virtual Worlds & Video Games team has assisted many companies, from start-ups to Fortune 100 companies, in developing virtual goods and virtual currency business models and legal strategies. Our team of nearly 25 attorneys, including some of the leading attorneys in this field, can help you navigate the legal hurdles necessary to safely leverage these opportunities.

## **Virtual Currencies**

Many types of virtual currencies and virtual currency models exist. The associated legal issues vary depending on how the virtual currency is implemented. The following are a few examples of the relevant variables in some current business models.

### **Virtual Currency Model Components**

#### **How virtual currency can be acquired:**

- Purchased with real money
- Earned by in-world actions
- In sweepstakes and contests
- "Gambling"
- Release of user information
- Survey participation
- Acceptance of exposure to advertising
- Gift of currency from others

#### **What it can be used for:**

- Virtual goods and services in virtual worlds/games
- Cashed out for real money
- To buy real world goods
- Traded for other currency

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### When it can be acquired:

- At time of purchase of virtual goods
- Pre-purchased for later use

### Who it can be used with:

- Virtual world operators
- Third parties

Based on these and other components, a wide variety of virtual currency business models can be adopted. Some include “dual currency” models, which permit buying virtual currency for certain transactions, but only earning it for others. Many variations exist.

## Overview of Potential Legal Issues

Federal, state and international laws can apply to virtual currency. State laws can be triggered even where there is no physical presence or nexus to the state. Merely offering such a service to an individual resident in the state, even if only via the Internet (or otherwise), can be sufficient to trigger the application of state laws. Many countries have similar laws and obligations. Accordingly, it is very important that companies involved with virtual worlds and virtual goods understand these issues and take appropriate actions to comply.

Many companies are not aware that, depending on the combination of components within a given virtual currency model, many different categories of real world laws can apply:

### Stored Value/Unclaimed Property Laws:

- Many pre-purchased virtual currency models can trigger stored value/unclaimed property laws. Many of these laws can be triggered where virtual currency or other value has been earned or purchased, but not used by the owner.
- In the U.S., most states have laws providing that where “property” (which can include at least some virtual currencies) has been abandoned or unused by the owner for a specified period of time (e.g., 3 years in some states) the holder of such property must turn the value/funds over to the state of the owner of the property (in certain circumstances, it may be turned over to the state of the domicile of the holder).
- Companies typically have to comply with such laws annually, including filing required reports within very specific time frames, giving notice to the property owners and turning over the unclaimed funds/value to the appropriate states.

- Failure to comply results in interest and penalties, which, when compounded, can sometimes exceed the initial amount to be reported.
- Officers (often the CFO) must attest to the company’s full compliance with such laws and requirements.

### Gift Card Laws:

- Most states have laws that apply to gifts of value to another party. Many of these laws apply to electronic value—there is no need for a plastic gift card in order for such laws to be triggered.
- Many of these state laws prohibit expiration dates and service fees.
- A new federal law, coming into effect in August 2010, will provide that the minimum expiration date on most types of gift cards is five years, and will prohibit most types of fees until at least thirteen months after the “gift card” has been unused.
- Stricter state laws that are more protective of consumers are not preempted. Some of these laws even require cash redemption under certain circumstances.
- Many of these laws have specific penalties that can be applied and a number of class actions have been filed against issuers and sellers of such “gifts” that failed to comply.
- These laws are evolving and can change rapidly, with the trend being towards more consumer protection. This requires continuous monitoring to ensure compliance.

### Gambling/Sweepstakes:

- The U.S. has criminalized most types of “gambling” over the Internet.
- These laws have been enhanced during the past few years and are very broad in scope.
- Many states also regulate gambling, sweepstakes and contests.
- Some business models use a form of “gambling” or sweepstakes for users to acquire virtual currencies. These models can run afoul of the gambling and/or sweepstakes laws.

**Money Transmittal Licensure:**

- State and federal laws generally require licensure, and in certain circumstances, special registration, to engage in activity that involves the acceptance of funds and agreement to transmit, transfer or pay funds to another party (or in some instances, to even send such funds to yourself at another location), except where the funds are used by the purchaser to directly pay for merchandise or services offered by the virtual world itself.
- There is no requirement that real cash or currency be involved—most any type of monetary value can be covered, including but not limited to electronic value.
- Virtual currency models that allow for value to be transferred to third parties, including but not limited to redemption of virtual currency for real world money or goods, can trigger the need for such licenses.
- Such licenses can be very expensive and difficult to obtain. Where such licenses are required, but have not been obtained, civil and criminal penalties can apply.

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*Due to general lack of awareness of all of the potential issues surrounding virtual currency, many companies simply emulate other organizations without knowing that they too are not in compliance.*

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**Taxes:**

- In the U.S., a congressional study is under way and hearings have been held to determine how to deal with taxation of virtual goods and virtual currencies.
- Many states have passed legislation imposing taxes on “digital downloads.” Some of these and pending legislation arguably are broad enough to cover virtual goods and virtual currency transactions.
- Various countries have imposed or are considering imposition of a tax on gains from virtual goods and virtual currency transactions. For example, China has imposed a 20% tax on such transactions.
- Specific guidance on various tax issues, such as when a gain is realized/recognized and what, if any, reporting obligations exist and by which entities, remains to be provided.

**PATRIOT Act and Bank Secrecy Act (and comparable state and international laws):**

- Where value is being transmitted, electronic wallets are held, stored value is issued, or sold or redeemed, currency is exchanged, bills are paid or other similar activities occur, then the PATRIOT Act and Bank Secrecy Act requirements can apply.
- These requirements can include, but are not limited to obligations to:
  - Obtain and retain specific information on such transfers
  - File reports with federal and state governmental agencies
  - Register as a money services business
  - Maintain an appropriate anti-money laundering program, including appointment of an experienced anti-money laundering (“AML”) compliance officer, appropriate written AML policies, procedures and internal controls, ongoing AML training for employees (and in some instances, agents), an annual independent audit of the AML program, and broad examination rights by the Internal Revenue Service, other federal regulators and state regulators.

**Data Privacy and Security:**

- 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 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 currencies) and mandate certain security procedures.

### Child Protection:

- Many of the most successful virtual goods and virtual currency implementations to date have involved kids, 'tweens and teens.
- Privacy laws impose strict obligations, especially where information is obtained about a minor. Some laws apply until the minor is 16. Failure to comply with certain of these laws can result in civil and criminal sanctions. For example, California law provides that it is a crime for a company to market to a child under the age of 16 using personally identifiable information obtained, where the parent has told the company it may not do so. Similarly, in some states it is a crime to tape record a telephone conversation without consent from all parties.
- Dealing with minors raises a whole host of issues, including the Children's Online Privacy Protection Act (COPPA) and issues with transacting with minors.

### Terms of Service:

- If you are a virtual world (or other platform) provider, effective terms of service provisions can enhance your ability to control use and misuse of your virtual currency. Carefully drafted terms of service agreements can help manage expectations of users and limit your liability to them, as well as provide you with contractual remedies (in addition to intellectual property remedies as discussed below).
- Among other things, an effective terms of service should address:
  - Whether users own or just have a license to use the virtual currency.
  - User rights in virtual currency (if any) in the event they cancel their account, if you terminate your service or if their account is terminated (e.g., for violations of terms of service) and your ability to terminate for violations.
  - Rights (if any) to transfer (e.g., by sale, gift or bequeath) virtual currency or entire accounts to others, including to help prevent unauthorized resale or trading of virtual currency on secondary markets.

One of the lawsuits that has been filed concerned a user who sued Linden Lab (operator of Second Life) when his account was terminated for allegedly violating the terms of service, which resulted in his being denied access to the value of thousands of dollars worth of virtual goods/currency.

### Secondary Markets

Secondary markets are mechanisms by which virtual goods/currencies are bought, sold or traded for real world money or other value or entire accounts. Some virtual currency providers allow, or even encourage, users to "cash out" by providing an official exchange through which the operator or other party swap real world money for users' virtual currency or vice versa. One virtual world operator even operates a bank that is regulated by the Swedish government, through which users can exchange virtual currency for real world money. However, not all platform operators want users buying and/or selling their virtual currency. Unauthorized exchanges can have an adverse impact on value or stability of virtual currencies.

### Intellectual Property Protection:

- Copyright—some representations of virtual currency are easily and inexpensively protectable by copyright.
- Trademarks—"branded" virtual currencies can be and are being protected by trademarks (typically in Class 36, which relates to virtual currencies).
- Patents—some of the technologies and emerging business methods relating to virtual currencies are patentable subject matter.

### Enforcement:

The success of virtual currencies has led to an increase in the frequency with which they are copied and/or sold. Policing and successfully abating infringement or unauthorized use of virtual currencies can be complex due to their digital nature, but a combination of tools and tactics are available to minimize infringements and misuse, including:

- 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 or virtual currency brand in connection with the sale of virtual currency.
- Patent infringement—you can prevent competitors from infringing on your virtual currency technology and/or business models if you have patented them.

- Terminate accounts of users who violate your terms of service by misusing virtual currency.
- Request termination of user accounts on other sites for infringement or misuse of your currency on those sites—many virtual worlds and other platform providers have a provision in their terms of service that prohibits infringing or other unlawful activity. For repeat offenders it is sometimes feasible to prevent further infringement or misuse by having the infringer's account terminated.
- Breach of contract—you can bring action based on violations of terms of service (e.g., if users only have a license to virtual currency, then misuse can be a breach of contract for exceeding the scope of the license).
- Other tools and tactics are available and need to be considered on a case-by-case basis.

### How Pillsbury's Virtual Worlds & Video Games Team Can Help

Our team can:

- Analyze your virtual goods/virtual currency 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/currencies
- Monitor and enforce unauthorized uses, including secondary markets
- Draft privacy, COPPA, DMCA and data protection/storage policies

#### Reference:

For additional information see our advisory on copyrights of virtual goods: [Copyright Registration for Virtual Goods: The Benefits of Timely Filing](#)

### About Pillsbury

Pillsbury Winthrop Shaw Pittman LLP is a full-service law firm with market-leading strengths in the energy, financial services, real estate and technology sectors. Based in the world's major financial and technology centers, Pillsbury counsels clients on global corporate, regulatory and litigation matters. We work in multidisciplinary teams that allow us to anticipate trends and bring a 360-degree perspective to complex business and legal issues—helping clients to take greater advantage of new opportunities and better mitigate risk. This collaborative work style helps produce the results our clients seek.

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