Virtual Currencies (2):
Additional Legal Issues in the Real World

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This first in this pair of articles by Attorney J. Dax Hansen<http://www.perkinscoie.com/dhansen/> with contributions from colleagues Andrew H. Grant<http://www.perkinscoie.com/agrant/> and Kirk Soderquist<http://www.perkinscoie.com/ksoderquist/> began an interesting legal perspective on the growing use of synthetic or virtual currencies in massively multiplayer online role-playing games (MMPORGS) and virtual worlds such as Second Life<http://secondlife.com/whatis/>. The remainder of this column is entirely their work with minor edits.

Key topics are labeled in boldface and practical tips are headed in italic. “Issuer” refers to the organizations which run the virtual environment and issue the virtual currency.

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Financial Services Laws: As the popularity of the Issuer’s virtual currency increases, the Issuer considers allowing users to redeem the virtual currency with third party vendors, building peer-to-peer transfer capability, and offering full cash redemption. As virtual currency shifts from being a prepayment for goods or services redeemable with one company to a widely-accepted proxy for real currency or a means of transmitting money between various participants, Issuers need to consider state and federal services laws such as money transmitter laws and money service business laws. Financial services laws involve significant compliance obligations, costly and time-consuming licensing requirements, and civil and criminal penalties for non-compliance.

Practical Tip: Limit the scope of your virtual currency system to resemble a “closed loop” gift card redeemable for goods or services of one company, unless you fully understand the implications of broadening the system and you are prepared to comply with complex financial services laws.

Illegal Lottery: Instead of allowing users to purchase virtual currency, the Issuer allows users to earn virtual currency through game play. Allowing users to earn virtual currency through game play that can then be redeemed for valuable virtual or real-world property presents a risk that the Issuer is engaging in an illegal lottery or gambling under applicable state and federal laws. In general, it is illegal to require a person to pay money or expend significant effort (in legal terms, “consideration”) in order to enter a promotion or participate in a game in which the participant may win a prize if there is a significant degree of chance involved (e.g., a random drawing to determine winners). Any game play that involves these three elements (consideration, valuable prize and chance), is generally an illegal lottery or constitutes gambling, and therefore must be re-structured to eliminate one or more of these elements. There are two main ways that game play can be structured to avoid being an illegal lottery or constitute gambling: (1) by eliminating the element of consideration (this kind of game play is called a sweepstakes), and (2) by eliminating the element of chance (this kind of game play is called a contest).

Practical Tip: If you allow users to earn virtual currency through game play that can be exchanged for a valuable prize, you can reduce the risk participation in the game constitutes an
illegal lottery by eliminating the element of chance by awarding virtual currency based on some objective measure of the user’s skill and ensuring that game play does not involve randomized elements or decisions (e.g., basing it on the number of levels passed, the completion of certain in-game tasks that require skill or awarding virtual currency based on frequency of play).

**Privacy and Security Issues:** The Issuer partners with an increasing number of payment service providers to monetize the virtual currency, and finds that its partners’ agreements inconsistently address privacy and security issues. Simple virtual currency programs raise the same privacy and security issues that arise in any e-commerce context, such as compliance with the Payment Card Industry Data Security Standard<https://www.pcisecuritystandards.org/index.shtml>, because consumers must provide their payment information when purchasing virtual currency. In addition, complex virtual currency and virtual wallet programs involve more complex privacy and security issues, such as joint ownership or sharing of customer information and assumed merchant of record responsibilities. Each program warrants thoughtful allocation of responsibility for privacy and data security issues, as well as related fraud management.

Practical Tips: Determine which privacy policy or policies apply to the virtual currency program or platform. With the understanding that each virtual currency program is unique, take the time to understand the flow of money and personal information through the program and then thoughtfully allocate privacy and security and fraud responsibility between the parties involved.

So if you are getting heavily involved in virtual currency, or if you are part of a virtual world organization, pay attention to these guidelines. It may be a game to the players, but regulators and lawyers take the real-world consequences of virtual currency seriously – and so should you.

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