

Virtual goods, gaming and the trouble with secondary markets

Many creative business models enable users to acquire virtual goods or virtual currency and then use those virtual items to participate in an activity that may give them a chance to win something or acquire virtual items through some element of chance. James G. Gatto, a Partner at Pillsbury Law, discusses the legal issues presented by virtual goods and the secondary market, which by its very nature implies that virtual items are far from valueless.

Since the early days of online games, 'virtual goods' have been used to enhance game play and to provide revenue to game developers. These are earned by accomplishing tasks or bought from the developer, typically for use in the game in which acquired, but exceptions may exist. Secondary markets, online markets where players can sell virtual goods or currency to another player, have sprung up. In most cases, the secondary markets are not authorised by the game publisher and the sale of virtual goods or accounts is precluded by the games' terms of service. As with real goods, scarcity is one factor that drives the perceived 'value' of virtual goods.

The US market for virtual goods and currency is estimated to be over \$3.5 billion annually. While virtual goods-based business models are flourishing, a number of legal issues have arisen with their use, particularly with secondary markets. The law in this area is still evolving and some important issues have yet to be addressed. For some industries, the resolution of these issues could have a significant impact. One such industry may be social gaming.

Social gaming

Social gaming is a rapidly growing field featuring 'gambling-like' games, but not for real money. So most social gaming activities do not run afoul of the gambling laws and are not subject to gambling regulation. One example is Zynga poker: users pay real money to buy virtual chips which are wagered in online games. The chips can only be accumulated, not cashed in for anything of value. In contrast, some other social gaming activities involving virtual goods, if not done properly, may cross the line. In other popular business models, users acquire virtual goods and/or currency and use them to enter 'contests' or sweepstakes or have a chance to win virtual goods or currency.

Secondary markets can be a turn off for some gamers: when certain virtual items can only be acquired through skillful game play, it is a badge of honour to possess those virtual goods. However, if the same item can be bought, it devalues that honour. For players who are not skillful enough or lack time to earn certain virtual goods, secondary markets enable them to buy these items.

One legal issue is whether the user actually owns virtual goods. Most terms of service make clear that users only have a licence to the virtual goods and the licence is terminated if they breach those terms. Thus, if a user sells a virtual good on the secondary market, the licence terminates and the good becomes worthless. Additionally, if a user's violation of the terms of service is severe enough, their account may be terminated. By having a licence provision, the game operator need not reimburse the user for any virtual good in the terminated account.

A number of companies have taken action against secondary market operators. On 8 April 2010

Zynga sued Playerauctions.com for operating a website that provides an unauthorised secondary market for enabling Zynga game users to post and sell virtual currency and virtual goods allegedly in violation of Zynga's Terms of Service.

According to Zynga, its Terms of Service prohibits users from selling virtual currency or virtual goods for real-world money or anything of value outside of its games. No decision has yet been rendered.

In a somewhat analogous case, the United States Supreme Court has validated the ability of software developers to prevent customers from owning the copy of software they acquire. Because software developers can limit the customers' rights to a mere licence, they can impose restrictions that can prevent the customer from reselling the software. This was a huge win for software companies as it limits the resale or 'secondary' market for software. This ruling may also benefit the virtual goods industry in validating the approach of limiting a user's rights to a licence rather than ownership. To get the benefits of this decision, the software or virtual goods distributor must carefully craft its user agreement. If drafted properly, these agreements can help prevent unauthorised resale of virtual items via secondary markets or otherwise.

This may also eliminate one basis for alleging that virtual goods have value. If other users are willing to pay for a virtual good that might suggest that the goods have value. Why does this matter? One of the important legal factors in a gambling analysis is whether a user stakes or wins something of value. When virtual goods are used in connection with social gaming activities, this must be considered.

The role of secondary markets in gambling issues

Social gaming seeks to leverage the excitement and mechanics of gambling without running afoul of the gambling laws. In the US, gambling is predominantly governed by state law. The law varies by state, but there are some common elements. Many states also have anti-lottery laws. Often, but not always, an illegal lottery also constitutes illegal gambling. For simplicity, I will generalise the law of the 50 states. Under most states' law, an activity is illegal if it includes all three of the following components: consideration, chance and a prize. In a classic example, if a user pays money (consideration), for a random draw (chance) to win money (prize), that is illegal (unless done as part of a state run lottery). To avoid being an illegal activity, an activity typically must eliminate one of the three components.

Complicating this analysis, however, is that most states' laws do not limit consideration or prize to just money or tangible items. Rather, often the laws refer to anything of value. This is where the issue of virtual goods and secondary markets come into play. If an activity involves users staking virtual goods or currency, which has value, for the chance to win a prize, that might be deemed to be consideration. If a user has a chance to win virtual goods or currency that has value, arguably that is a prize. So when do virtual goods and currency have value?

Many states' statutes do not define what constitutes a 'prize' and little relevant case law exists. Traditionally, prizes have been considered to be things such as money and tangible items, which clearly have an established value. With the rise in popularity of virtual goods and currency more non-traditional prizes are being awarded. Therefore, an increasingly important question is whether the

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awarding of virtual items based upon the outcome of games, contests or sweepstakes constitutes a prize having value.

No US court has squarely addressed this precise issue. Some legal scholars have opined that the existence of secondary markets for virtual goods may be one factor to support an argument that virtual goods have value. They theorise that if people are willing to pay money for a virtual item, that is an indication of value.

However, the answer may not be so clear. In fact, a recent case addressed a somewhat similar issue relating to secondary markets for basketball tickets. This lawsuit alleged that the NCAA ran an illegal lottery for tickets to Division I championship games. The alleged lottery required customers to pay the full face value of the tickets, prior to knowing whether they would get the tickets, and a nonrefundable application fee. Winners received the tickets. Those who were not selected for tickets were refunded the full amount of the cost of the tickets, but not their application fee. So arguably, users paid consideration (the application fee) for a chance to win something of value (the tickets). One argument levied in that case was that because there was a secondary market for the tickets, winning the right to buy the tickets was a prize. It was argued that even though the user paid face value for the tickets, they could resell them for much more on the secondary market.

A federal judge in Indianapolis dismissed the suit on all counts in 2009. The court found that there was not an illegal lottery, despite there being a secondary market for the tickets. The plaintiffs' appealed and the appeals court reversed the earlier decision to dismiss the suit and returned the case back to the Indianapolis court for further consideration.

In its decision, the appeals court ruled that Plaintiffs sufficiently 'alleged' that the NCAA's ticket distribution process may meet the three elements necessary to establish a lottery: a prize, an element of chance and consideration for the chance to win a prize. However, a dissenting opinion in that decision disagreed with the notion that the secondary market mattered. It stated: 'Face value is in fact the value realised by the issuer. After allocation, they acquire, as a result of the very process of allocation, a resale value, not necessarily to be realised, and for that reason irrelevant.'

So at this point it is clear that not even the judges agree on the role, if any, of secondary markets in determining whether an activity involves an illegal lottery. But at least the judges authoring the dissenting opinion were not persuaded by the argument that the presence of a secondary market meant there was a prize of value.

Conclusion

Many creative business models involve virtual goods or currency used in an activity that may give players a chance to win something. Other virtual items are acquired via chance. Some of these models are structured in a way that is legal. Some push the envelope. The legal issues with virtual goods and secondary markets are far from clear. The role of these factors in gambling and illegal lottery analyses also presents uncertainty. However, with advice from knowledgeable legal counsel many things can be done to structure these activities in such a way that is clearly legal or at least present solid arguments, based on the law, that they are legal.

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