

Virtual Currencies: *Real Legal Issues for Interactive Entertainment Companies*

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Agenda

- Virtual goods and virtual currency market
- What is virtual currency and why do companies issue it?
- Real legal issues
- Recent developments and hot topics

U.S./Asia Virtual Property Markets

- U.S. virtual goods spending to exceed \$1B in 2009 and \$1.6B in 2010

Inside Virtual Goods: Tracking the US Virtual Goods Market 2009-2010

- Americans gave ~\$30M in virtual gifts this past holiday

PlaySpan study

- U.S. virtual goods spending to rise from ~\$600M in 2009 to \$2.5B in 2013

Piper Jaffray

- Asia virtual goods market is ~\$7B

Lazard

Examples of Virtual Currency

- Facebook Credits
- Farmville Cash and Coins
- Café Cash and Coins
- Mafia Wars Cash
- Puzzle Pirates Doubloons
- FooPets FooDollars
- WeeWorld Points
- Playfish Cash
- Playdom Game Cards
- Linden Dollars
- Puzzle Pirates Pieces of Eight
- Kwedit
- Pogo Tokens
- Candystand Tickets



Virtual Property and Social Gaming

- Social gaming in context
 - Facebook passed 400M monthly active users
 - Adding ~500 users per day
 - 100M unique game players every month
- Facebook Credit Terms – adopted on February 25, 2010
 - http://developers.facebook.com/terms_credits.php

Facebook Credit Terms

- FB will redeem Credits at \$0.10 per credit, less a service fee of \$0.03 per Credit; redemption rate and fee can change on 30 days notice
- FB may issue "a small amount" of promotional Credits for which the developer will not receive payment
- Developer is responsible for chargebacks up to 45 days after each transaction, except in case breach of FB's policies or high chargebacks
- Credits cannot be sold or traded, and generally cannot be used for tangible goods
- FB may revoke ability to accept Credits at any time

What is Virtual Currency?

"The Service may include a virtual, in-game currency ("Virtual Currency") including, but not limited to coins, cash, or points, that may be purchased from Zynga for "real world" money if you are a legal adult in your country or residence. The Service may also include virtual, in-game digital items ("Virtual Goods") that may be purchased from Zynga for "real world" money or for Virtual Currency. Regardless of the terminology used, Virtual Currency and Virtual Goods may never be redeemed for "real world" money, goods or other items of monetary value from Zynga or any other party."

(Zynga Terms, emphasis added)

What is Virtual Currency?

It is all over the map, but ...

Virtual Currency is:

- A proprietary medium of exchange (contract based)
- An electronic promise to provide goods or services
- Often characterized as a limited license to use a digital good

Virtual Currency is not:

- Legal tender (*i.e.*, "valid and legal offer of payment" — no further contract required)
- Primarily a virtual good

Virtual Currency can be:

- Stored value in an online wallet
- Completely virtual or evidenced by a physical record
- Paid or promotional or in between
- Closed loop or open loop
- Positioned as a gift certificate, coupon, ticket, jackpot or promotions prize

Why Virtual Currency?

- Revenue
- Low cost alternative to credit cards for micropayments
- Flexibility and in-game payment solution
- Prepaid solutions appealing to youth and other users without credit cards
- Loyalty
- Other

Virtual Currencies: Real Legal Issues

- Gift certificate laws
- Unclaimed property laws
- Sales/use tax laws
- Lottery and gambling laws
- Privacy and data security laws
- Financial services laws
- International laws
- Payment processing laws and association rules
- Consumer protection laws
- Commercial co-venture laws
- Etc., etc., etc.

Gift Certificate Laws

"You agree that all sales of Virtual Goods and Currencies are final. No refunds will be given, except in our sole and absolute discretion. All Virtual Goods and Currencies are forfeited if your account is terminated or suspended for any reason, in Zynga's sole and absolute discretion, or if Zynga discontinues providing the Service."

(Zynga Terms, emphasis added)

Gift Certificate Laws

- Generally, apply to promises to provide goods or services of a certain value to the bearer of a record
- Restrictions and requirements:
 - Expiration dates
 - Inactivity or service fees
 - Conspicuous disclosure of key terms
 - Cash back
 - Exemptions for "promotional" gift certificates

Gift Certificate Laws

- Recent developments:
 - Skype Credit consumer class actions
 - Credit Card Act of 2009 (cards, codes, account #s, barcodes, chips)
 - Increase in "offers"-based virtual currency (OfferPal, gWallet, etc.)

Unclaimed Property Laws

"We may contribute to a charitable organization selected by us (and charge additional standard redemption fees for that transaction) all redemption amounts we are unable to pay to you within 2 years of receipt of the associated Credits because we have been unable to reach you, have not received adequate payment instructions from you, or have not received a request to redeem such Credits."

(Facebook Terms, emphasis added)

Unclaimed Property Laws

- Generally, apply to intangible property (including money, consumer credits, stored value, etc.) held by a company that is abandoned or unclaimed by the owner after a statutory dormancy period
- Requirements:
 - Pay the value of "unclaimed" property to states in accordance with established jurisdictional rules
 - Track it (administrative effort)

Unclaimed Property Laws

- Unique issues related to virtual currency in online games:
 - Identifiable vs. anonymous
 - Platform owner or third party distributor vs. virtual currency "issuer"
 - Social networks

Virtual Currency – Sales Tax Issues

"It is your responsibility to remit all duties, taxes (including, without limitation, sales tax and VAT) and other fees that apply to your transactions, including the redemption of Credits. To the extent that our issuance of a Credit is considered a taxable event and you subsequently receive that Credit as payment for a transaction, or we otherwise remit taxes related to a Credit you receive, you agree to reimburse us for any remittance we make related to that Credit. If duties, taxes or fees apply to the redemption of a Credit, the service fee may be adjusted by Facebook so that the net amount received by Facebook remains \$0.03 per credit redeemed. You agree to indemnify and hold us harmless from and against any claim arising out of or related to your failure to comply with this paragraph."

(Facebook Terms, emphasis added)

Virtual Currency – Sales Tax Issues

- Generally apply to retail sales of TPP and specified services with retail seller collecting the tax from buyer and remitting to taxing authority
- Conflicting risks
 - Potential liability for failing to collect tax if applicable
 - Potential liability for collecting tax if not applicable

Virtual Currency – Sales Tax Issues

- Key issues:
 - Taxability – sale at retail? (who is the consumer?) of taxable good/services? "digital goods" "amusement services"
 - Sourcing – where is the transaction deemed to occur?
 - Nexus –Physical presence, affiliate or attributional nexus, economic presence
- Recent Developments:
 - Streamlined Sales Tax Project, Model ABA Tax Overpayments Act, Amazon laws

Financial Services Laws

"Kwedit is not a bank, money services business or money transmitter. The Network may not be used by persons under the age of thirteen or to send or receive payments for: any form of gambling activities; where the total payment amount exceeds two hundred dollars per day or one thousand dollars per month (or US dollar equivalents);
..."

(Kwedit Terms, emphasis added)

Financial Services Laws

- Depending on structure, virtual currency programs may involve banking laws, MSB laws, money transmitter laws, GLBA, etc.
- Requirements and impacts:
 - Significant compliance obligations
 - Costly and time-consuming licensing requirements
 - Civil and criminal penalties for non-compliance

Financial Services Laws

- Potential triggers:
 - Open loop
 - P2P transfers
 - Cash out
 - Over \$1000/day/person
- Recent developments:
 - FinCEN's Proposed Rule 74 Fed. Reg. 22129, at 22141

International

"Zynga operates and controls the Service from its offices in the United States. Zynga makes no representation that the Service is appropriate or available in other locations. The information provided on the Service is not intended for distribution to or use by any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Zynga to any registration requirement within such jurisdiction or country."

(Zynga Terms, emphasis added)

International

- Interactive entertainment companies need international solutions
- Many international legal considerations for virtual currency, including:
 - New comprehensive Japan Payment Services Law, which covers "points"
 - EU eMoney Directive and Payment Services Directive
 - OFAC
 - Chargebacks and contractual allocations of risk/liability with international payment gateways

Questions?

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