More and more businesses are making virtual currency part of their business model. While the use of virtual currency provides great opportunities, businesses need to be aware of the emerging legal issues before using it as a means to build customer loyalty.

What is virtual currency and why is it used?

Put simply, "virtual currency" is any medium of exchange, other than real currency, used to facilitate online or other electronic transactions. Numerous companies are currently using forms of virtual currency. For example, Apple provides iTunes users the option of buying prepaid iTunes gift cards, which contain credits that can be redeemed for music and movies. Many online games allow players to earn and purchase "points", "tokens", etc. that can be redeemed for virtual and real-world prizes. Facebook recently started a system of "credits" that has a wide variety of applications apart from gaming, such as making charitable donations using a particular charity's Facebook page. Looking into the future, Google has announced that it acquired the start-up company Jambool and its proprietary "Social Gold" virtual currency platform. There is industry speculation that Social Gold will be used to supplement Google's current online payment system, Google Checkout.

The bottom line is the use of virtual currency in e-commerce is on the rise. This trend is due in significant part to the advantages that virtual currency affords to a vendor. Virtual currency platforms allow issuing companies to lower costs by eliminating the need for a third-party company, such as a bank or PayPal, to process each payment transaction. Further, a vendor has significant control over the value of, and authorized uses for, virtual currency. This control enables companies to realize higher revenues, cut costs, and build more-attractive customer loyalty programs.

While virtual currency offers these potential benefits, there are a host of legal issues to consider.

What are the laws and legal issues affecting virtual currency?

Gift card laws:

Both federal and state gift card laws may apply to the electronic value of stored virtual currency. For instance, the federal Credit Card Accountability Responsibility and Disclosure Act of

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2009 (CCARDA) contains provisions which prohibit retailers from setting expiration dates less than 5 years after a gift card is purchased. The CCARDA also prohibits retailers from changing dormancy, inactivity, and service fees unless a gift card has not been used for at least 12 months. If fees are charged after this period, the details of such fees must be clearly described on the card, and retailers cannot assess more than one fee per month under any circumstances.

State gift card laws may provide for even stricter requirements and are not preempted by the CCARDA. Thus, state law may further-limit a retailer's ability to penalize a customer for not regularly using a virtual currency account. That said, some state gift card laws provide exemptions for gift certificates or loyalty points that were provided to a customer on a promotional basis without consideration, and these may also apply to virtual currency.

**Unclaimed property laws:**

Unclaimed property laws may be triggered when virtual currency is earned or purchased but not used by the owner, i.e. "breakage". A typical state law provides that where property has been abandoned or unused for a specified period of time (usually 3-5 years), the property holder must turn over the value of such property to the state of the owner or to the state of domicile of the holder. Failure to comply with this type of law can result in interest and penalties which may exceed the initial amount to be reported.

In the context of virtual currency, unclaimed property laws may force a company to turn over a customer's stored virtual currency if that customer's account has been left with an unused balance for an extended period of time. Such laws may even require the officers of the company that issues virtual currency to attest to the company's compliance with unclaimed property protocol.

**Gambling/Sweepstakes laws:**

In some cases, companies will offer virtual currency units as a prize in a sweepstakes-type contest or will allow customers to use virtual currency as a wagering device in online games. When considering these applications, it is important to remember that federal law criminalizes most forms of online "gambling", a term which is broadly defined. Many states also regulate gambling, sweepstakes, and contests.

**Currency transmittal licensure laws:**

Federal and state laws generally require licensure, and sometimes special registration, for an individual or entity to engage in an activity that involves the acceptance and/or transfer of funds to a third party. These laws usually do not have a requirement that actual currency is being transferred and, thus, transfers of virtual currency could be covered. In particular, virtual currency models which allow value to be transferred to third parties, such as redemption of Facebook credits for a participating business partner's products or services, could require currency transmittal licensure. Failure to obtain a required license could result in civil and/or criminal penalties.

**PATRIOT ACT:**

Although the PATRIOT ACT has not been directly applied in the context of virtual currency as of October 2010, there is some speculation that the ACT may become relevant as the virtual currency market continues to grow in the future. There is a concern that if it becomes commonplace to hold
high value virtual currency accounts, such accounts could be used for money laundering. Additionally, it is worth asking whether an issuer of virtual currency becomes a "financial institution" for the purposes of the PATRIOT ACT by virtue of creating and managing customer virtual currency accounts. If so, then the ACT would require an issuer to obtain and record specific information on all virtual currency transfers, file corresponding reports with state and federal agencies, register as a "money services" business, and/or maintain an anti-money laundering program, including appointment of a compliance officer, implementation of internal audit procedures, and compliance with broad IRS examination rights.

Data privacy & security laws and standards:

Virtual currency platforms raise many of the same privacy issues that arise in any e-commerce context. For instance, it is common for virtual currency to be purchased by credit/debit card. In those instances, the Payment Card Industry Data Security Standard (PCI DSS) would apply for a company that may not otherwise accept credit cards as part of its business.

State laws may also dictate how and where a company is permitted to store data associated with virtual currency accounts, depending on the nature of the information stored in the accounts. Some states (e.g. California) even require specific types of privacy policies to be maintained by companies that store electronic customer data. In the event of a breach of sensitive virtual currency user information, state data breach notification laws may also be triggered.

Child protection laws:

Many virtual currency applications are found in online games and social media sites where a significant portion of the user community is comprised of minors. State and federal laws generally impose stricter privacy obligations where minors are involved. The Federal Children's Online Privacy Act, for example, details what a website operator must include in a privacy policy, when and how to seek verifiable consent from a parent/guardian, and what responsibilities an operator has to protect children's privacy and safety, including restrictions on marketing to individuals under the age of 13. Similarly, California law provides that it is a crime for a business to market to a child under the age of 16 using personally identifiable information where a parent has indicated to the company that it may not do so.

Intellectual property laws:

Virtual currency and virtual currency platforms can be protected by trademark, copyright, and patent. In fact, the only substantial virtual currency-related litigation has been based on intellectual property claims. Zynga, maker of the popular "FarmVille" and "Mafia Wars" gaming apps for Facebook and wireless devices, has filed suits against several websites for copyright and trademark infringement, as well unfair competition, false designation of origin, and other claims. Zynga alleges that the defendant sites offered an unauthorized secondary market for the virtual currency used in Zynga's apps and used/reproduced various Zynga trademarks without authorization. In other litigation, Actus LLC, filed a claim against various major financial firms and retailers, alleging infringement of 4 patents that relate to virtual currency or "electric tokens". 
How can a company using virtual currency protect itself?

Before any virtual currency platform is implemented, a business must first identify the specific federal and state laws applicable to its situation, keeping in mind that laws will vary from state to state. When reviewing the laws, look for expiration service fee restrictions applicable to gift cards and determine whether those restrictions would likely apply equally to virtual currency. Determine whether the applicable laws require unused virtual currency to be transferred as unclaimed property, so that there are no surprises after implementation and once any dormancy period runs. Consult a financial and/or accounting expert regarding the tax implications of the proposed virtual currency platform. Obtain any required financial and/or transmittal licenses. Research similar registered copyrights, trademarks, and patents to avoid implementation of a virtual currency platform that could be subject to intellectual property litigation. Implement a comprehensive data security and breach notification plan in compliance with applicable privacy and data security laws. Finally, consider the use of a compliance officer to monitor the implementation and continued operation of the virtual currency platform.

After identifying the applicable laws and tailoring the virtual currency platform to those laws, draft and implement an effective Terms of Service (TOS), privacy policy, and related disclaimers. An effective Terms of Service will be detailed and will clearly define the duties of, and the relationship between, all parties involved. Draft provisions that clearly define who is the issuer of the virtual currency, especially in situations involving third parties. Include whether consumers own the virtual currency or merely have a license to use the virtual currency. If a company sells virtual currency and gives it away for loyalty purposes, make sure that the TOS differentiates between the two types and states whether either form can be expired, is subject to service/inactivity fees, etc. State whether consumers have a right to transfer their virtual currency and provide the process with which either the vendor/issuer or consumer can terminate a virtual currency account. An effective Terms of Service will also address privacy concerns. Incorporate a privacy policy that promotes compliance with applicable data privacy & security laws and child protection laws. Importantly, make any TOS and/or privacy policy highly visible and make acceptance of the TOS/privacy policy a requirement before a consumer can use the virtual currency platform.

The importance of a well-crafted TOS is demonstrated by the recent case of Bragg v. Linden Research, Inc. In that case, plaintiff user sued defendant after plaintiff's virtual currency account was terminated for an alleged violation of the TOS. Account termination resulted in plaintiff losing thousands of dollars worth of stored virtual currency. This type of claim can be defended against, or in some cases, avoided altogether with a well-drafted TOS and related disclaimers.

Conclusion:

Before using any system of virtual currency, a company must consider the numerous laws and legal issues that are implicated. Each virtual currency platform has its own unique issues. Once these issues are resolved, a business can let the games begin!