Virtual Property – Business Models And Pitfalls

Richard Eisert and S. Gregory Boyd

DAVIS & GILBERT LLP

Richard Eisert

S. Gregory Boyd

I. Big Picture

In the last several years, online games and communities have experienced exponential growth. A number of these worlds such as EverQuest, Second Life and World of Warcraft are self-contained persistent worlds where consumers spend many hours a week. Traditionally, the main revenue stream for these businesses in the United States has been from subscription sales. However, a new method for achieving additional revenue is growing in popularity. This new method is virtual property sales, and it is growing in popularity because it allows game businesses to fine tune prices to match a broad spectrum of consumer demand. But this new revenue stream is not without potential problems. The purpose of this article is to outline the main virtual property models used by online businesses and highlight potential issues as these business models develop.

II. Introduction To RMT

For the purposes of this article, virtual property is anything of value created in a game, virtual world or similar online community that can be traded. Most commonly, virtual property consists of objects, characters, land and currency. For illustration, consider currency exchange. There are online exchange rates for various international currencies against various online world currencies. A person may trade dollars for Second Life dollars (Linden dollars) as easily as he could trade dollars for yen. Exchanging virtual property for real money outside the game is referred to as a Real Money Trade or RMT.

Despite its growing use as a means to generate revenue, in the early days of online worlds, RMT was not considered a business model so much as it was considered cheating. However, two forces have recently begun to work against the notion that RMT is merely cheating. First, some games in Europe and Asia are supported entirely on game company managed RMT. Second, forbidding RMT in the U.S. has led to a strong underground black market in virtual property. The market in virtual property is estimated at 1.8 billion dollars in world-wide value and much of that is unlicensed.[1] Independent third-party companies have spent years capitalizing on this underground market for virtual property in games and made millions of dollars in the process. Between these two forces, U.S. game companies are beginning to come around to the idea that RMT should be taken out of "pirate" hands and be run by the game companies themselves.

As a result of the above, games and other online communities are now implementing and planning the development of games that incorporate RMT internally as an alternative revenue source. Consider from a business perspective how traditional subscription models and even advertising are relatively blunt instruments for monetizing online worlds. Both of these methods tend to assign the same value to every customer. A subscription charges a customer a monthly or annual cost and advertising pays per user or per view at a set cost. But, people do not value goods this way. Each person places a different value or "willingness to pay" to be a part of an online community. RMT helps companies extract that value. For instance, a person may want special privileges, objects in the world, or some other perk to excel in or become more a part of the online world. RMT allows game companies to satisfy that need and extract appropriate value as well by "fine tuning" the price point so that each user pays the price the service is worth to him individually.

III. Implementation

How are online companies implementing RMT and what are the potential pitfalls? There are a number of ways RMT can be implemented (and they need not be mutually exclusive), but three of the most popular mechanisms are currency systems, microtransactions, and land sales. Each mechanism has advantages and disadvantages.

Currency Systems

Online worlds, like the real world, have currencies that are used as a mechanism of exchange. There are two major ways to monetize these currencies. First, a company can sell the currencies directly from the company to a player. Second, the company can facilitate the exchange of currencies between players. Selling the currency directly to the user allows the company to literally print money. Facilitating a currency exchange allows the company to take a transaction fee while allowing users to "cash out" of in-game currency for government-backed money. In both of these scenarios, there exist sophisticated markets for these currencies with exchange rates that fluctuate against major international currencies.

These currencies have many of the same issues as government-backed currency. They have fluctuations in value and tend toward inflation. Yet, compared to some government-backed currencies, they have thus far done remarkably well over time. For instance, most anyone would rather have World of Warcraft gold, supported by its 10 million player subscriber base, than the Zimbabwe dollar, which is currently in the midst of a hyper-inflation crisis.

Microtransactions

A second way to monetize an online world through RMT is to sell objects, additional content, or some other "perk" using what are called microtransactions. These transactions are deemed microtransactions because of their relative size to a subscription price. These commonly range from one to five dollars. The goal here is to have devoted fans of the online world spend substantially more each month on these items than the standard user would spend on a subscription. These items can be useful in the virtual world, such as some object that leads to great success accomplishing the goals in the world, or they can be purely ornamental, a fashion statement or status symbol. Both types of items have shown promise in RMT models. Even the Apple iPhone briefly had an "ornamental" application that sold for $1,000 with the sole function of displaying a particular ruby design. Facebook, online games, and other online social networks have also experimented with lower-cost, purely ornamental virtual property.

All the major game consoles, Xbox360, PlayStation 3, and the Nintendo Wii are using microtransaction models to sell additional game content. Games like Guitar Hero have downloadable songs. Other games have entire expansion packs of content available for download. In some cases, dollars are converted into a currency like Microsoft Points and in other cases, the intermediate "currency" is skipped and purchases are made in dollars.

Virtual Real Estate

Finally, land sales are one of the most robust forms of RMT available. With virtual real estate sales, a company is offering the user a part of the virtual world. These sales range from selling housing and small pieces of land to entire "island" sales that are capable of generating their own revenue. In one virtual world, Entropia Project, a man in 2008 paid $100,000 for a virtual space station. The major complexity here is balancing land creation and sales with the influx of new members of the virtual world. If too much land is made, the world feels empty because the population density decreases and if not enough land is made, the company loses out on revenue opportunities.

IV. Potential Issues

This area is ripe with business and legal complexity because RMT is a frontier topic in online worlds. Online worlds themselves have only been a major economic force for about five years. It almost goes without saying that legal frameworks are slow to build around ideas that are as new and fast moving as these.

Nonetheless, there have already been several cases in the U.S. concerning virtual property. In *Eros LLC v. Leatherwood*, Eros alleged that a player in Second Life stole a copyrighted piece of virtual property, a "sex bed." As the name suggests, the "sex bed" allowed players in the virtual world to interact with each other in an intimate way. Leatherwood began to sell lower-priced, unauthorized versions of the virtual property. After the case was filed in Florida, Eros settled with Leatherwood in an agreement that provided that Leatherwood would no longer sell unauthorized reproductions.

In *Hernandez v. IGE*, also filed in Florida, a number of players have come together as part of a class action suit against a third-party provider of RMT (IGE). The players are arguing that IGE buys virtual property from contractors, many of them from Asia, that are actually working in the game for a profit in a process called "farming." The farmers play games in groups and in shifts, literally "farming" profitable areas of the game for virtual property in an effort to resell that property to players directly or companies like IGE. Furthermore, the plaintiffs allege that IGE is providing this RMT service for games that do not authorize RMT. The players say this activity devalues their experience in the game and contributes in large part to destroying the virtual world's economy through inflation.

In the Pennsylvania case of *Bragg v. Linden Lab*, a player (and attorney) was caught cheating on land sales. Linden Lab terminated the player's account and confiscated his virtual property. The player argued that Linden Lab had unjustly taken thousands of dollars worth of property away from him. The case, initially brought in small claims court, eventually found its way into federal court before settling. However, intermediate decisions in this case challenged some of the most fundamental elements of the virtual world End User License Agreement (EULA), including the enforceability of arbitration clauses in these agreements and personal jurisdiction over company executives.

These cases all suggest many other unresolved issues that may arise in the coming years. For example, acknowledging the value in virtual goods may actually increase the customer service burden on companies when it comes to termination. Traditionally, companies could merely terminate any user that violated its EULA. However, the *Bragg* case shows us that acknowledging the value of virtual property may create some additional obligations.

Another outstanding issue associated with virtual property is ownership. Who actually owns these objects, characters, and land after they are "purchased" from the company? Most EULAs state the game company owns the intellectual property in the objects and the players are merely purchasing a limited license. Still, this is changing with some companies, such as Linden Lab, experimenting with EULA provisions that grant limited ownership rights in user-created virtual property. In fact, the Bragg case was only possible because that particular world, Second Life, acknowledged some limited player rights in virtual land. There are also companies like Metaplace that are developing technology that allow users to build their own virtual worlds, literally creating the world with their own IP.

In addition to the above, we can readily ponder questions such as what taxation policy makes sense, should some virtual worlds submit to banking and securities regulation, and how do companies prevent money laundering through virtual currencies? These, and many other questions, are largely unanswered. However, with the growth of RMT as a business model, the answers in the form of judicial decisions, statutes and other regulations are likely to come in the near future.

***Richard Eisert** is a Partner and **S. Gregory Boyd** is an Associate in the Advertising, Marketing and Promotions practice group of Davis & Gilbert LLP.*

[1] *Dibbell, J. The life of a Chinese gold farmer, New York Times, Jun 17, 2007.*

Please email the authors at reisert@dglaw.com or gboyd@dglaw.com about this article.