



**STATE OF PLAY II
PRIMERS**

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Table of Contents

The Law

Contract Law Primer3
Copyright Law Primer7
The Free Expression Law Primer11
Property Law Primer15
Trademark Law Primer19

The Technology

Virtual World Primer23

Writers

- Alexander Macris, The Themis Group
- Anna Chau, New York Law School
- James Grimmelmann, Yale Law School
- Matthew Hollander, New York Law School
- Ann McGraw, New York Law School
- Deborah Twardowski, New York Law School

Written, Edited and Produced by: James Grimmelmann,
Yale Law School

What is a Contract?

Contracts are the legal backbone upon which all modern commercial life rests. Because people deal with contracts so regularly, from employment contracts to credit card contracts, their intuitive idea of what a contract is—an exchange of promises that the legal system will enforce—is more or less accurate.

There are two basic requirements that govern the process of contract formation:

- There must be *manifestations of assent* by both parties. It's not strictly accurate to say that each side has to agree to the contract; what matters is what you communicate. Keeping your fingers crossed behind your back while saying you'll agree to a contract while won't let you off the hook. If a reasonable person would think that you'd indicated your intent to be legally bound by the contract, you will be legally bound by it. Similarly, you will be bound by a contract whether you negotiated the deal individually or accepted a standard set of terms (such as those that comes shrink-wrapped with a new piece of software).
- There must be *consideration*: both sides have to give up something of value. Consideration may be a large amount of cash, but it may also be the performance of a service, or the value agreeing not to do something, or even the proverbial "peppercorn," something whose only purpose is to be worth slightly more than nothing. Contracts can't be completely one-sided: there has to be at least a nominal exchange taking place.

How Does Contract Law Work?

In order to make the process of determining whether there really has been a mutual manifestation of assent simpler, states impose various requirements on the *formalities* of making contracts:

- Contrary to folk wisdom, many oral contracts are legally binding.
- But, because it is often hard to prove the existence of an oral contract, every state has a *statute of frauds*, which requires that various "important" contracts be in writing and signed. Typically these include contracts involving real estate and those that involve more than a set amount of money or time. These laws give people a strong incentive to write down their contracts.
- American law recognizes *electronic signatures* as being the legal equivalent of paper ones. Clicking "confirm" on a web site can generate a binding contract.

In the U.S., when one party to a contract fails to follow through on her commitment ("breaches" the contract), the other party's usual legal remedy is *expectation damages*. If Alice breaches a contract with Bob, then a court will order Alice to pay Bob enough money to make him as well off as he would have been if Alice had kept her end of the bargain. Occasionally, especially when it is hard to measure the actual value of Alice's promise, a court may order *specific performance*, in which Alice is required to fulfill her promise. Some other important points about contract damages:

- Once Bob learns that Alice has breached, he is under a *duty to mitigate damages* and act as he would even if Alice wouldn't be required to pay him back. If he behaves wastefully, Alice won't be liable to pay for the excess damages he's run up on his spending spree.
- If Alice and Bob want, they can decide in advance how much in damages one of them should owe the other in case of a breach. A court will uphold such *liquidated damages*, unless the amount specified is clearly disproportionate to the actual loss suffered by the innocent party.

The most complex part of contract law involves determining the conditions under which one party to a contract will be *excused* from carrying out her side of the bargain regardless of what is written on the page. These excuses are either exceptions to the general principle that contracts freely negotiated between parties will be binding on them or involve cases in which the negotiation didn't really work as intended. Examples include:

- *Impossibility*: When circumstances change so much that the "essential purpose" of the contract will be frustrated, no matter what the parties do, the law lets them both walk away. If Alice promises to build Bob a house on a tract of land that falls into the ocean in an earthquake, the law won't try to figure out how much that house would have been worth.

- *No “meeting of the minds:”* If, despite their superficial agreement, the parties had completely different ideas in mind about the contract, a court may also agree to cancel it. The classic such case involved a shipment that was to be delivered on a ship named “Peerless,” but there were two ships named “Peerless,” and the two parties had different ships in mind.
- *Duress:* If one side was unfairly forced into signing a contract, performance will be excused. No one will hold you to a contract you signed with a gun at your head.
- *Illegality:* If you make a contract that calls for one side to act illegally, no court will enforce it. Despite their name, “contract killings” are void as a matter of law.
- *Forbidden terms:* Every state has laws that disallow certain kinds of contractual terms; these terms will simply be read out of a contract that contains them. For example, insurance contracts are very heavily regulated: the maximum and minimum rates that insurers can charge are often set by state officials. Similarly, federal consumer-protection laws prohibit various terms that credit-card companies might otherwise put in their contracts.

Contracts and Virtual Worlds

Virtual worlds are governed by contracts. When players subscribe to a game, they exchange a subscription fee for the right to play the game for a certain length of time. The contract that governs that agreement is generally referred to as the End User License Agreement (EULA) or the Terms of Service (ToS). These contracts give game companies control over players that goes beyond the control provided by the software. They require players to promise to do or not to do various things and to forego various legal rights as a condition of playing the game. Among the legal issues that EULAs control are:


- Intellectual property rights in game content, which players are often required to assign to game companies. (See the Copyright and Trademark Primers for more).
- Real-world property rights in virtual items, which players are often required to disclaim explicitly. (See the Property Primer for more).
- First Amendment rights to self-expression within the game world. EULAs generally provide that game companies may terminate the contract and ban a player from a virtual world—thus leaving a player “censored” by a game without legal recourse. (See the Free Expression Primer for more).

In light of their comprehensive control over so much of virtual world life, EULAs play an important role in enforcing both real-world law and the virtual laws imposed by the game designer. The appropriate scope of the EULA was among the most-discussed topics at last year’s State of Play. Some speakers praised the way EULAs allow game designers to insulate games from the fantasy-ruining aspects of modern life and to create genuinely ‘other’ realities. Others blamed EULAs for what they saw as severe power disparities within these realities, in which players are at the mercy of designers.

Questions debated at the first State of Play included:

- What terms of EULAs should be enforced by courts? Are some terms more likely to be enforced than others?
- Might incentives, such as limitations of liability, be offered to game designers to get them to have more player-friendly contract terms?
- Do EULAs provide game companies with truly unlimited power to seize player property, censor player speech, and control all aspects of the game?
- How much should contracts written by game companies be used to regulate relations between players?

Already, games are starting to differentiate themselves based on their EULA terms. EverQuest, for example, is very aggressive about asserting rights rooted in its EULA in order to preserve what it sees as an enjoyable game experience. Second Life, on the other hand, has adopted a more permissive EULA that asserts fewer intellectual property rights—also in the name of creating a more enjoyable game.



Keeping your fingers crossed behind your back while saying you'll agree to a contract won't let you off the hook.

The federal copyright law defines the subject matter of copyright as “original works of authorship fixed in any tangible medium of expression, now known or later developed, from which they can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device.”

What is Copyright?

Copyright in the United States stems from the Constitution: “The Congress shall have Power . . . [t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.” The first Congress took up this power and gave authors of any “map, chart, or book” the exclusive right to make copies of it for 28 years. Over the years, Congress has expanded copyright protections by increasing the scope of all three of these elements:

- The *subject matter* of copyright, originally just maps and books, now includes “original works of authorship fixed in any tangible medium of expression.” Songs, sculptures, software, and short stories are now also protected by copyright.
- The *exclusive rights* protected by copyright, originally just the right to make copies, now also include a number of related rights:
- To *distribute* the work to the public (e.g. by renting copies of DVDs).
- To *perform* the work publicly (important for plays and music).
- To *display* the work publicly (important for paintings and movies).
- To *make derivative* works—mixtures of a copyrighted work with new creative elements.
- The available term of copyright protection has increased from the original 28 years: works by individuals are copyrighted for the life of the author plus another 70 years.

How does Copyright Law Work?

The basic rule of copyright is that the holder of a copyright in a work can sue anyone who makes a copy of it (or violates another exclusive right) without advance permission. The copier—called an *infringer*—will be liable to pay money damages to the copyright holder, including *statutory damages* of up to \$150,000 per work copied. In addition, the copyright holder can get an *injunction*—a court order telling the infringer to stop immediately or suffer severe consequences. The ability to sue unauthorized copiers enables business models in which authors sell copies (such as books and computer games on CD) and ones in which they sell the right to make derivative works (such as the movie rights to a book).

There are also a number of very important limitations on copyright:

- Ideas by themselves aren’t copyrightable; only particular *expressions* of the idea are. Had he lived today, Shakespeare could have copyrighted the text of *Romeo and Juliet*, but not the idea of two star-crossed lovers.
- Purely factual information, such as phone numbers, can’t be copyrighted.
- Copyright does not prohibit independent recreations: if you and I write very similar songs without hearing each others’ version, neither of us is an infringer.
- A balancing test called *fair use* shields many uses of copyrighted material that would otherwise be considered infringing. Classic examples of fair use include quoting passages from a book in a review, copying a page from an old newspaper article as a classroom handout, and writing a parody of a

song. There is no definitive list of uses that are or are not fair, only a set of four factors that courts balance:

- The “purpose and character of the use:” works for nonprofit purposes are more likely to be considered fair.
- The “nature of the copyrighted work:” the smaller the investment of creativity in the original work, the more likely that a use of it will be considered fair.
- The amount of the work copied: using small excerpts is more likely to be considered fair than copying an entire work.
- The effect of the use on the market for the work: uses that don’t compete with the original are more likely to be considered fair.

Why Do We Protect Copyrights?

It is usually said that the purpose of copyright law is to encourage creativity. The exclusive right lets authors make money by selling copies of their work, which gives them a financial incentive to be creative and to share their creativity with the public. On the other hand, by giving one person the right to prevent copying and derivative works, copyright restricts the flow of information and may discourage subsequent creativity. Scholars often say that the goal of good copyright policy is to balance these concerns to maximize the amount of creativity that reaches the public.

Copyright and Virtual Worlds?

Speaking generally, possible copyright issues involving virtual worlds can be divided into three large groups:

- Copyrights in the game software itself.
- Copyrights in the creative elements contributed by the designer, such as the game's interface, its graphics, its story elements and text, and its music.
- Copyrights in the creative elements contributed to the world by the players, such as text they type, textures they upload, and digital objects they create.

The game designer almost always has a copyright in the game's software itself. At the most basic level, because it's copyright infringement to copy that software, game designers can make money by selling copies. As last year's theft of the source code to Half-Life 2 shows, the software itself can be extremely valuable. Other interesting legal issues arise when players try to set up their own game servers by reverse-engineering the behavior of the client: Blizzard Entertainment has used a copyright-like provision of the law to sue a group of independent developers who created server software to mimic the functionality of Blizzard's servers for playing Warcraft online.

Many virtual world developers want to use their copyright over creative elements as a way of prohibiting players from buying and selling virtual assets for real money. Companies that ban eBaying sometimes argue that because they do not authorize such sales, anyone who buys a virtual item despite the company's prohibition is a copyright infringer. The copy involved, typically, would be the one made on the user's screen when she uses the virtual item she bought from another player on eBay. (These anti-eBaying legal arguments can also be rooted in the terms of service that players must agree to in order to join a virtual world).


As for player copyrights in other creative elements, almost all virtual worlds give players techniques to express themselves, techniques that might be used to produce or insert copyrighted material. Whether a player types the lyrics of a copyrighted top-40 song while virtually talking to another player, uploads a texture she created herself at home, or makes a digital object that could only "exist" in the virtual world itself, all sorts of creative elements are possibly copyrighted. Major questions these copyrights raise include:

- If a player uploads a copyrighted work into a game without the copyright holder's permission, who is liable for any resulting infringement? The player? Other players who make copies of that work (perhaps just by playing the game)? The game company whose software is actually "making" the copies?

- Who should own the creative elements created by players: game designers, game players, or no one at all? For people "filming" videos in virtual worlds, this question is pressing.
- Should players be able to sue other players for copyright infringement for in-game actions that involve creative elements? How should game designers respond?

In almost all of these questions, copyright law interacts with contract law in ways whose implications are not yet clear. Games' terms of service may require that players assign all copyrights in content they upload to the game designers and may also affect players' rights to sue for various claims, including copyright infringement.

One approach, announced by Linden Lab at last year's State of Play conference, is to let players retain copyrights in any content they upload, while giving them tools to announce to other players the copyright status of that content. Players will be able to use Creative Commons licenses to tag items as being either copyrighted or free for reuse and modification. The interaction between such legal elements and game software is a rich and complex topic.



Almost all virtual worlds give players techniques to express themselves, techniques that might be used to produce or insert copyrighted material.

“Congress shall make no law
...abridging the freedom of
speech, or of the press; or the
right of the people peaceably to
assemble. . .”

What is Free Expression?

The First Amendment says, “Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances.” Collectively, these provisions are understood to protect rights of free expression: individuals’ rights to believe what they want and to say what they want. Where government wants to impinge on these freedoms, the First Amendment stands in its way.

While the law protects speakers against incursions by governments and those acting at the behest of governments, the value of free speech in the United States goes beyond the legal protections of the Constitution. Our free speech tradition not only prohibits censorship but also seeks to promote robust dialogue, creativity and openness. A wide range of laws—from liability protections for internet service providers to discount postal rates for Congresspeople—are intended to encourage a flourishing “marketplace of ideas.”

Why Do We Protect Free Expression?

There are several theories underlying the protection of free speech.

- *Political:* In a democracy, we must be free to criticize government officials and to voice unpopular opinions. Free speech produces political accountability: a free press roots out corruption and informs citizens so that they can participate fully in political life. Only through free and unfettered discussion can truth emerge.

- *Personal:* We also regard freedom of expression as essential to self-fulfillment. We have to be free to speak our conscience if we are to be truly autonomous and able to develop ourselves as individuals.
- *Social:* Freedom of speech also helps create the kind of rich and vibrant society we want to live in. Disputes aired openly are less likely to fester and lead to social violence. When artists are protected from government reprisal, society will have more and better art. When people can speak and associate freely, the wheels of commerce run more smoothly.

How Does Free Speech Law Work?

Generally, the First Amendment acts as an absolute prohibition against government censorship of speech, where “speech” is understood to be any conduct intended to convey a message (such as burning or waving a flag). Where a regulation would impinge upon free speech, courts will “strictly scrutinize that law,” which usually results in striking down the regulation. Although the First Amendment speaks of “no law,” this general principle is subject to a number of important exceptions:

- *Intrinsically wrongful speech:* Speech that is intended to and does harm others in concrete ways others often receives little protection. Fraud, blackmail, libel, and slander may be curtailed, as may shouting “Fire!” in a crowded theater. Similarly, obscenity is also unprotected, along with other speech considered “worthless.”

- *Commercial speech:* According to current caselaw, speech that simply proposes a transaction, with no expressive component, receives lessened protection. The FDA, for example, extensively regulates the “speech” involved in nutritional information on food.
- *Time, place, and manner restrictions:* While government cannot censor a speaker or her views, it can regulate the time, place and manner of her speech with “reasonable” restrictions. A city, for example, can require protesters to march during the day rather than in the middle of the night.
- *Intellectual property:* Copyright and trademark, by their very nature, restrict what some people can say by giving exclusive control over certain forms of expression to the intellectual property rightsholder. IP law contains “fair use” exceptions to these otherwise-exclusive rights as a way to accommodate First Amendment concerns.

Courts will only very rarely ban speech in advance. The fear is that such bans (called “prior restraints”) create too much *chilling effect*, in which people who faced with the ban are unwilling to engage in perfectly acceptable speech out of fear of the risk of punishment. Courts will almost never compel someone to speak against her will.

Virtual Worlds and Free Expression

- A man carrying a high-powered machine gun shoots and kills his neighbors. No one arrests him, but several people shoot back while others cheer.

Cont...The Free Expression Law Primer

- A woman posts a sign supporting John Kerry on her front lawn, but her neighborhood has a rule banning all political messages.
- In response to serious overcrowding at a protest, the police transport some of the protestors to the next town over.
- A reporter breaks a story about minors engaging in sexual conversation with adults for money. The local authorities run him out of town and confiscate all of his property.

These are common scenarios arising in virtual worlds that give rise to questions of what should be the role of free speech law in virtual spaces—spaces that are privately owned and controlled. There are many kinds of possible speakers and speech in virtual worlds, and there are even situations in which protecting one speaker may impinge on another's ability to speak freely.

First, the computer code on which games run is a kind of speech. Courts recognize that source code is a way in which programmers express their ideas to each other.

Games also contain speech by designers directed at players. The code produces story-like aspects of the game that may be speech in the same way that movies or novels are. Scholars have argued over whether the interactive nature of games makes them more or less speech-like. Jack Balkin has argued that games are akin to improvisational theater and deserve the same protections, but other scholars think that the expressive "speech" involved in a player's choosing to pull a virtual trigger is minimal.

The question of whether games should be considered protected speech has arisen most strikingly with respect to games that depict acts of violence, such as martial arts games and military simulations. Several states and cities

have attempted, largely unsuccessfully, to restrict the sale of violent games to minors; other countries, such as Germany and Thailand, have strictly regulated such access.

Next, because virtual worlds often support rich chat systems and other in-game communications, speech issues also arise within games, based on the things players say there. When players role-play scenarios in a virtual world, their speech there may have meanings other than that which it would have in the real world. Sometimes shooting other players' avatars is "part of the game;" sometimes lying to them and defaming them is, too. Whether and when players should be punished for what they say in games raises difficult policy questions.

Almost all games have policies requiring some form of civility and reserve the right to kick out a player if they don't like what the player says. But what if the offensive speech takes place outside of the game, as allegedly happened with Peter Ludlow and *The Sims Online*? And what if the speech wasn't offensive to other players, but merely critical of the game designers? In a purely legal sense, because the game companies aren't governments, the First Amendment is unlikely to apply to them.

However, players have also appealed to the policy values underlying the First Amendment to claim that game designers *ought* to encourage players to speak openly and to guarantee them freedom from reprisal for certain kinds of speech. Many large games have had rich internal debates about what kinds of speech should be allowed or not. Ted Castronova has proposed creating a legal status of "interration" (a pun on "incorporation"), in which virtual worlds that agreed to protect players' rights to free expression would receive limited liability in other areas.

Another special free speech problem that arises in virtual worlds involves intellectual property. Because copyright applies to work fixed in a tangible medium of expression, ordinary conversations in real life aren't copyrighted. But in a virtual world, everything is "written down" on the screen and on the game's servers. Who owns the copyrights in these words, and are there any First Amendment issues with the enforcement of these copyrights?

Nor are the free expression issues in virtual worlds confined to free *speech*. Some games deal with the slowdown associated with large crowds of players by randomly teleporting some of them to other parts of the world, a response that many players perceive as a restriction on their right of free association. Tal Zarsky has also claimed that in a virtual world, intrusions of privacy are possible on a scale unprecedented even on the World Wide Web, raising the question of whether expanded privacy protections are necessary for virtual worlds to protect the right of free association. Beth Noveck has suggested that the unique properties of virtual worlds are particularly conducive to fostering collective action as well as free expression by groups.

These are common scenarios arising in virtual worlds that give rise to the question of what is and what should be the role of free speech law and free speech values in virtual spaces — spaces that are privately-owned and controlled.

Paradigmatically, when something is “property,” its owner has the exclusive right to use it. The legal system protects property owners when others interfere with that right. Several important ideas are typically associated with this idea of a property right.

What is Property?

Property law, loosely put, is the body of law that governs people's rights in *things*.

The traditional breakdown of property is into three categories:

- *Real property*, which includes land and buildings. Think of "real estate."
- *Personal property*, which includes everything tangible that isn't real property. Cars, corn flakes, and computers are examples of personal property.
- *Intangible property*, which includes everything that isn't real or personal property. Copyrights, trademarks, and other intellectual property fall in this category, as do stock and other securities.

How Does Property Law Work?

Paradigmatically, when something is "property," its owner has the exclusive right to use it. The legal system protects property owners when others interfere with that right. The actual legal work of property law typically involves two related functions:

It sorts out competing claims to the same thing. If a dishonest developer sells the same house to two different families, the legal system will have to decide which of them is the true owner. Sometimes, as with intellectual property or hunting animals, the system needs to figure out whether a person has done the right sort of work to create a property right at all.

It decides what an owner can do to enforce her property rights against others. A homeowner can have trespassers arrested, but not shoot them. A landlord can choose to whom to rent an apartment, but not in a racially discriminatory way.

Several important ideas give shape to the basic rules of property law:

- *Property is not possession.* Indeed, much of the point of property law is to help the owner to recover her property from a thief who has taken wrongful possession of it. Sometimes, however, property law conveys full ownership rights to those who have "mere" possession, such as the first person to claim property abandoned by its previous owner.
- *Property is not a single right.* Instead it's a collection of closely associated rights, sometimes called a "bundle of sticks." It may be possible to have some of these rights without having others. Some of these rights include:
 - The right to keep others from using the property.
 - The right to use the property yourself.
 - The right to sell the property, or to give it away.
- *Different people may hold different sticks in the bundle.* A landlord has a property right in a building, including the right to sell the property, but the tenants in that building also have property rights, including the right to use the property.
- *Not all property rights can be reduced to contracts.* While contracts are typically binding only on the people who agree to them, property rights are "good against the world." You can have me arrested for

trespassing on your land even if I've never signed a contract with you. Contracts often, however, adjust property rights or trade them: a landlord and tenant are altering their property rights when they sign a lease.

- *There are often systems for keeping track of property.* These include car title deeds, land registries, and stock certificates. These systems don't themselves constitute property, but they are an important kind of evidence about who owns what. Thus, a title deed may be considered conclusive proof of ownership unless someone can show that the deed itself was forged.

Why Does The Law Protect Property

In John Locke's famous words, "As much land as a man tills, plants, improves, cultivates, and can use the product of, so much is his property. He by his labor does, as it were, enclose it from the commons." Locke's ideas about the value of property have stayed with us to this day.

Property rights are a way of handing out resources in a way that gives people incentives to put them to productive use. This view suggests that property rights should be assigned in a way that maximizes the overall social benefit from those uses. Locke's tiller is adding value to the land by cultivating it, so he should be given a property right to encourage his work.

Property rights are also a way to protect freedom and personal autonomy. In Lockean political theory, property rights give the individual a sphere that is safe from outside intrusion—particularly intrusion by an abusive government.

Virtual Worlds and Property?

Many of the most perplexing questions about virtual worlds involve issues of property law.

Game servers are generally the property of the game company. This would seem to imply that the game company always has a right to “take its ball and go home,” by shutting down the servers and ending the game. But many players are deeply attached to a game and often wish to keep playing. Some games, such as *Meridian 59*, have survived the original company’s complete withdrawal, thanks to servers set up by others. At last year’s State of Play, Jack Balkin suggested that under some circumstances, a court might order a game company to keep a game going against its wishes.

From virtual swords to virtual saunas to the ability to play under a particular name, players acquire in-game resources that resemble all three kinds of property. The game’s software will certainly help them exclude other players from using these resources. Does that mean that the law would or should step in to protect this ability, as well? Dan Hunter and Greg Lastowka examined this issue in their article *The Laws of the Virtual Worlds*, in which they suggested that perhaps real-world law ought not be brought to bear to enforce in-game property rights.

Questions of players’ rights in virtual property are not only academic. Since players buy and sell virtual items for significant sums of real-world money, it matters a great deal to them whether they have a legally-enforceable property right in these items. Such rights make it easier for them to safeguard their investments and to get restitution after a fraudulent trade. A Chinese court has ruled that players do have

property rights, ordering the return of a valuable ‘stolen’ virtual weapon. Many game companies disagree: they consider such purchases to be the equivalent of black-market trading and would like to be able to ask courts to shut down these markets by ruling that players do not have property rights in virtual items.

If players do have property rights inside a virtual world, these rights might also be used to defend against cases of alleged censorship, in which players are ejected from games for behavior the game company deems anti-social. Since the First Amendment does not protect against censorship by private parties, players might, instead assert interference with a property right.

Even without involving the real-world legal system, there are interesting property-themed questions in virtual worlds. Susan Crawford has proposed using virtual worlds to enable law students to experience the confusing doctrines of property law both visually and interactively. Virtual worlds are also, in effect, conducting vast experiments in different property systems; various studies of virtual economies have pointed out ways in which design decisions have consequences for the property systems those decisions generate.

Since players buy and sell virtual items for significant sums of real-world money, it matters a great deal to them whether they have a legally-enforceable property right in these items.

Trademark law gives the exclusive right to use the trademark in commerce to the person who first uses and registers the mark. Crucial is that to be a trademark, a name or logo must be used in the marketplace.

What is a Trademark?

A trademark is the exclusive right to use a particular phrase or symbol in connection with selling goods or services. Unlike a brand, a trademark identifies the source of the goods. Consumers who see a trademark can be confident that it identifies goods that come from a source approved by the trademark holder and are prepared to quality standards set by the holder. Thus, trademarks allow consumers to rely on their prior experiences and make quick, meaningful choices among competing products and services. From a business's perspective, trademarks are a way to make a name for themselves (often called "good will") and to maintain repeat customers.

How Does Trademark Law Work?

The rules of trademark law are designed to ensure that consumers can rely upon a meaningful connection between a trademark and an approved source. Thus, the central rule of trademark law is that competitors cannot use the mark in a way that confuses consumers. Other doctrines of trademark law surround this central rule and help it to operate sensibly:

- Trademark protection isn't available for phrases that are merely descriptive. If one restaurant could trademark the word "hamburger," consumers would have more trouble ordering a good hamburger, not less. The more imaginative (and thus less descriptive) the mark, the stronger the legal protection.
- Similarly, a trademark that consumers start using as a generic term for an entire class of goods (e.g. Kleenex for tissues) becomes ineligible for trademark protection.
- Trademark-type protection is available for any distinctive decoration, not just words and symbols. A particular color of insulation or a particular style of restaurant décor may stick in consumers' minds just as much as a name or logo would.
- Trademark holders must exercise some degree of quality control over the connection between the mark and the goods it identifies. A trademark holder who issues a "naked license" to a third party to use the mark without exercising some quality control can lose the right altogether.
- Trademark holders can sue for anything that "dilutes" the suggestive power of a trademark or "tarnishes" it in consumers' minds. These additional rights help trademark holders to build strong brand identities by preventing others from polluting the meaning of the trademark.
- It is legal for others to use the trademark "nominatively," that is, to describe goods on which the trademark holder has used the trademark. This rule permits Coke to mention Pepsi by name when advertising the results of taste tests or for us to do so here.
- Because the same trademark may be associated with different styles of goods in different countries, trademarks also give their holders some exclusive rights over the importation of trademarked goods. The chocolate bar called a "Milky Way" in the U.S. is not the same as the "Milky Way" sold in the United Kingdom; unrestricted cross-border candy flow might lead to that bane of trademark law, consumer confusion.

Trademark is part of a broader set of doctrines, known as *unfair competition*, that generally regulate false or misleading advertising by businesses. Most of the rest of unfair competition law remains a matter of state law; only trademark has been nationalized, in a series of federal statutes known as the *Lanham Act*. Administratively, the American trademark system is overseen by the Patent and Trademark Office, which maintains a centralized, searchable register of valid trademarks.

Trademark Law and Virtual Worlds?

The most obvious connection between trademarks and virtual worlds concerns the "commercialization" of virtual spaces. Advertising-sponsored games are nothing new: for years, Yahoo, MSN, and others have offered free browser-based games that come along with banner ads. Sometimes, the advertisers' brands and trademarks are directly integrated into the game play. Lego offers a large selection of Lego-themed games at its web site, and Life Savers provides a set of candy-themed mini-games at Candystand.com. A number of companies have tried to place banner or billboard ads inside of virtual worlds; sponsoring gaming tournaments is becoming increasingly popular with advertisers.

Some virtual worlds have included representations of branded goods for their players to encounter. There.com, for example, offers its players the ability to purchase Levi's jeans or Nike sneakers for their avatars. Such commercialization also has its opponents: when The Sims Online announced plans to include McDonalds stands in its virtual world, activists threatened virtual boycotts and other virtual protests. This gives rise to the question of whether trademarks in virtual worlds are desirable. How should the law treat trademarks placed on virtual goods? Do they constitute naked licenses? How would they be enforced against those wishing to copy and use the brands? Is their use to be considered in commerce? Would the Sims protesters be engaged in nominative free speech?

Another twist on the idea of a branded virtual world is the didactic branded world, one created to educate players about a particular topic. The entire game functions as a form of advertising and may, itself, be considered a trademark entitled to protection as such. The U.S. Army has developed a free multiplayer action game, America's Army, as a recruiting tool. In addition to providing gamers with a positive view of military service, the Army hopes to teach them about the actual conditions soldiers face and about the importance of military teamwork and respect for the laws of war. The Army also uses virtual worlds extensively in training its own soldiers. Similarly, Daimler-Chrysler developed Mokitown, a virtual world designed to teach children about road safety.

The names and logos of games are entitled to trademark protection. Last year, Mythic Entertainment sued Microsoft, the makers of a forthcoming virtual world named "Mythica," for trademark infringement. (The case settled out of court; Microsoft also cancelled the game, due to the crowded virtual world market.) Synergistic, trademark-driven marketing is also responsible for an increasing number of crossovers between the gaming and non-gaming worlds. Star Wars and Star Trek have launched dozens of games over the years; Star Wars Galaxies is now one of the most successful virtual worlds and a Star Trek virtual world is on the way. In the other direction, many famous game franchises have become movies of their own, from Tomb Raider to Resident Evil.

Inside of virtual worlds, players are facing many of the challenges of building and maintaining stable reputations that trademark law was designed to handle. How to adapt trademark doctrines to virtual worlds—or to find appropriate virtual replacements for them—remains a wide-open question. Many games, allow players to open their own shops, buying and selling virtual items. Others, such as There, give players who upload new designs a kind of trademark-like exclusive right to market those designs inside the game. In Second Life, which has a particularly rich set of options for player-designed clothing, owning an outfit made by a known designer has the same cachet that it does in the real world.

Finally, the extensive secondary markets that have developed in virtual items, such as eBay and IGE, raise issues of trademark law. On the one hand, trademark law may be among the legal weapons that game companies could use to shut such markets down, especially if some of the supposed auctions for game items are fraudulent. On the other hand, consumers who buy and sell such items are eager for assurances of reliability from their trading partners. The exclusivity of reference that trademarks promise is one route to that reliability; so also are reputation systems (both inside and outside of games) and other techniques of gathering information about other players.

The most obvious connection between trademarks and virtual worlds concerns the “commercialization” of virtual spaces. Advertising-sponsored games are nothing new: for years, Yahoo, MSN, and others have offered free browser-based games that come along with banner ads.

The popularity of persistent worlds in relation to games is already visible in a comparison of profitability of the top grossing MMOG EverQuest and top box office grossing movie of all time, Titanic.

Authored by: Nova Barlow, Julianne Greer & Alexander Macris.

1. Overview

Online games can be divided into three categories: Massively Multiplayer Online Games (MMOGs), Multiplayer Games and casual games. Casual games are those games which are generally free to play online and tend to be puzzle/board/trivia/card games, such as *Bejeweled*, *Chess* and some variations of *Poker*. These games account for 54.7% of the online games market. The advantage of playing these games on the computer is that you may play against people all over the world and it is generally easier to hide a window on your screen from your boss than it is to hide an entire set of Mah Jong tiles on your desk. Otherwise, there is very little difference from their real world counterparts.

MMOGs and Multiplayer Games, however, introduce the idea of playing a character, or group of characters, from a first or third person point of view, rather than being one's self directly manipulating pieces or answering in a game. In addition to the different point of view from a casual game, a hypothetical world is created, by game developers, in which the game-play takes place. This hypothetical world is experienced in two different ways; a persistent world in which all elements of the world are fixed, whether a player is logged in or not, and session-based play where the world is only there when the player is logged in.

Multiplayer Games are generally session-based games. These games can host 16 - 64 players able to play together at a time, due to small server capacity. In a game such as *Quake*, which falls into this category, a group of players who wish to play together,

plan to sign on to a particular server at a particular time so they may interact in the virtual world of *Quake*. When they are done with their session, the world in which they had just played is no longer occupied by any players and therefore is no longer exists.

Persistent worlds are nearly synonymous with MMOGs. The very nature of an MMOG, possibly thousands of players subscribed to and playing a game at any given time, almost requires a fixed world to be available at all times to accommodate players in varying time zones and at different levels of the game. These games have multiple, large-capacity servers that can hold anywhere from a few hundred to several thousand players at full capacity. These servers have contributed to games' abilities to create environments with thousands of players, playing simultaneously, such as the recent record in the US/European market set by *EVE Online* of 11,284 players. This record may be surprising, but not if you consider the over 1.7mm players in the US/European MMOG market currently. Not only that, but this number of subscribers is expected to climb to 2.2mm with over \$450mm in revenues by the end of 2005. Even still, these numbers pale in comparison to Asian market numbers, where reports of reaching 150,000 players online, simultaneously, are common (*Legends of Knights Online*, publisher: Soft World).

2. The Market Today

According to the latest surveys by the Entertainment Software Association, 50% of all Americans play video games. Of these,

43% of frequent gamers say they play games online. Sixty percent of online gamers are male and 40% are female, however the gap is slowly closing between the two groups. Nearly 8% of these gamers play MMOGs. According to Nick Yee's "The Daedalus Project" (<http://www.nickyee.com/daedalus>), the average number of hours played per week is 21.9.

This phenomenon of substantial time commitment to MMOGs is not limited by geographical region; online gamers in China spend an average of 53 hours per month in the virtual world of online games. A fascination with MMOGs helped spur the online gaming market to almost 46% growth in 2003, and over the next two years the MMOG market is expected to dominate its online gaming market. Currently Korea has the highest online gaming market penetration for the Asia/Pacific region, but China is catching up.

2.1 What's popular?

The over 1.7mm MMOG subscriptions in the US/European market have a vast array of options when choosing a game. The following list shows the ten most popular games, by total subscribers:

1. *EverQuest*
2. *Final Fantasy Online*
3. *Star Wars Galaxies*
4. *Dark Age of Camelot*
5. *City of Heroes*
6. *Ultima Online*

7. *Lineage 2*

8. *The Sims Online*

9. *Asheron's Call*

10. *Shadowbane and EVE Online* (tie)

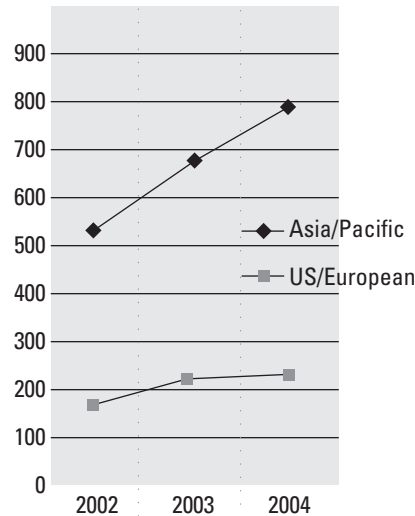
These estimates are as of September 2004. The estimates are drawn from public sources, where available; the remaining values are extrapolations from raw server load data samples, using functions derived from known virtual worlds and adjusted for demographic characteristics.

2.2 Recent Past/Near Future

Based on the launches of ten significant titles over 2004 and 2005, the US/European subscription gaming market is set to grow significantly in size over the next twelve months to \$440mm, with the top grossing games of the upcoming year being *Star Wars Galaxies*, *EverQuest*, *Final Fantasy XI*. The heavily anticipated 2004 titles *World of Warcraft* (not yet released) and *EverQuest 2* (not yet released) are expected to round out the top five. Other major titles already released this year include *Lineage 2*, *City of Heroes*, and *Saga of Ryzom* with *Guild Wars*, *Tabula Rasa*, *Middle Earth Online*, and *Matrix Online* coming soon.

In the Asia/Pacific markets, NCSoft, Shanda, and Gravity Corporation are in firm control of the market with *Lineage*, *Legend of Mir* and *Ragnarok Online* respectively. The Asia/Pacific subscription gaming market will grow to \$792mm USD in 2004, thanks in part to many new games entering the Asia/Pacific landscape. To date, there have been no true crossover hits between markets.

Figure 2.2.1: Subscription Gaming Revenues by Region 2002-2004 (in millions)



3. How Games Online Make Money: Predominant Business Models

Contemporary business models in online gaming are primarily subscription-driven, although free play with retail box purchases and advertising-supported webgames both remain popular. Micropayments (small, incremental payments for content) are something that consumers are getting used to quickly, in no small part thanks to the music industry and the popularity of such services like iTunes. Micropayments are popular in Asia/Pacific markets, and increasingly in Europe, but have not yet reached the gaming market in full force. The following are predominant business models in the online gaming market, with a slant towards persistent world gaming.

3.1 Free

In this model, everything is free to the consumer, with revenue coming from sponsorship, or perhaps product placement. This model is commonly used for “web based” and casual games.

3.2 Pay for Play

- **Metered time (PC Baangs/PC Cafés)**
The original business models for online gaming were built on directly charging the consumer for game play on an a la carte basis, through connect time fees or pay per play. These fees can be quite small transactions and are referred to as micropayments. One legacy of the connect-time model (charging per hour of service) continues to affect the field at present; games are built to maximize the amount of time people spend online. Today, the most successful games continue to keep people online for many hours each month (anywhere from 40 to 80, in the case of some persistent worlds), despite the fact that revenues are no longer tied to connect-time. The dominant business model for persistent worlds in Asia are PC cafés, also known as “PC Baangs” (rooms). With over 200 MMOGs in Korea, and more on the way every year, over 50% of gamers play these games, and the rate of growth does not appear to be slowing down.
- **Subscriptions**
At present the predominant business model for online games in the US/European market is the monthly subscription. The current base fee for a “first class” game is \$14.95 per month. This monthly fee covers the on-going

community support and development of new content through the life of the MMOG, as well as the massive bandwidth requirements.

3.3 Other Models, Part I.

These models are designed to attract new customers.

- **Retail product, free time**

In this model, players purchase a retail product (client) and play for free online. The publishers of many session-based games and a handful of casual games find it worthwhile to offer free online play with the purchase of the client. For MMOGs, this is not a common model used throughout the life of a game, but it is industry standard to offer a month or two of free play with a retail purchase. MMOGs could not survive without a constant stream of revenue to cover the operational costs, and subscriptions are a good way to offset those. However, allowing a player to invest some time in their character(s) free of charge, frequently causes a kind of attachment to form to with their characters, and often increases their willingness to ante up for a subscription. Rather than being a stand-alone model for MMOGs, this is used as an introduction to reinforce the subscription model.

- **Expansion packages**

Expansion packages are historically released for an online title at a rate of one per year in order to add an amount of content to a game that is too cumbersome to download or simply to refresh the retail presence of a title. However, new avenues are being

explored within this model to offer more frequent expansions, some so often that charging a monthly subscription is not as necessary.

- **Collector editions**

Companies increase revenues through releasing Collector's Editions of their games. Collector's Edition packages tend to include pins, collector's maps, and other knick-knacks, as well as the latest expansion release for a game. *Star Wars Galaxies* perfected the concept of the Collector's Editions, making one abundantly available while restricting the concurrent release of the regular retail client; this tactic drove the hardcore players to pay \$20 extra to get into the game.

- **Pre-order incentives**

To lock-in all-important early sales, MMOG operators have begun offering pre-order incentives – for example, special items within the game.

3.4 Other Models, Part II.

These models are designed to promote customer retention. Given that enterprising players were performing services and making sales in and outside of the game for real world currency, it was only time before companies followed suit.

- **Virtual Services**

- > *Character Transfer*

With the rise of special servers, as well as the ongoing problem of server overcrowding, companies have started to offer character transfer services.

Character transfers from one server to another range from \$29.99 to \$50 for 1 character up to \$49.99-\$125 for a full set of characters.

- > *Account Transfer and Character Renaming*

Recognizing the trend in account sales, *Ultima Online* developed a fee-based "safe account transfer" service allowing players to transfer their account to another person, without risk of fraud. In conjunction with this service, *Ultima Online* adopted the "character renaming" service, which, when combined with the above service, allows the new account holder to personalize an account by changing the names of the characters. *EverQuest* adopted a similar service, but allows multiple character names on an account to be changed at a time for \$49.95 instead of *Ultima Online's* \$19.99 per name. *EverQuest* members may only change character names every six months; neither service allows the option to change the account name.

- > *Character Leveling Services*

This type of service allows players to circumvent the often tedious task of building a character. By paying a small fee to the game operator, a player's character is instantly leveled up, quickly making them competitive, if not in player skill, at least in "stats". Power Leveling is noteworthy for representing the first definitive steps by MMOG operators towards directly selling in-game property (in this case, character skill/level/stats). *Ultima Online* was the first game to pioneer this service,

charging \$29.95 for a "Power-Up!" to any of several basic character templates.

> *Multiple Account Incentives*

Fully recognizing that the most dedicated players would pay for multiple accounts if they could do so at a somewhat reduced price, *Ultima Online* allows current account holders to purchase an additional account for \$15.99.

> *Multi-Game Combination Accounts*

To help keep players loyal to a company's primary game offerings, as well as entice the player to try out their additional offerings, companies have begun offering multi-game combination accounts. Sony Online Entertainment (SOE) introduced a "Station Pass", allowing customers to access all games developed by SOE for \$21.99. Combination accounts will become more common as companies host multiple MMOGs, and these companies' initial offerings begin to show age and risk losing subscribers.

> *Premium Service/Servers and Special Events*

Although selling "virtual experience" is taking off (paying money for additional in game events), concentrating that experience into a single server though additional service in game and a "special server" was first demonstrated to be successful in text based Simutronics games. *EverQuest* followed suit, making it the first graphic role-playing game to do so. Generally, for a premium server to be successful it must offer at least the following features: limited population, personalized/expedient customer service, access to private/new areas

and content not available to standard subscribers, and the ability to play on regular servers if desired. How much revenue is here? Presuming *EverQuest Legends* has approximately 8,000 subscribers, each paying a \$27 monthly premium over their normal subscription, this comes out to incremental revenues of \$2.6mm USD annually, or \$0.48 in incremental revenue per subscriber per month. Incremental revenue potential may be even higher, however there isn't a verifiable way to tell. Since *EverQuest* has only opened one premium server, it is unclear if a second server would also fill up; Sony apparently thinks not, or they presumably would open one.

• **Virtual Property**

"Virtual property" is the term used to describe artifacts in persistent world games that people value, in real money. Persistent worlds like *EverQuest* and *Ultima Online* are filled with things like magic weapons, armor, houses, in-game money, inventories and characters built up over hundreds of hours of play. People buy and sell these items on eBay or other websites, with thousands of dollars trading hands every day. Some accounts and items have been sold for over \$3,000 US on eBay. Currency and land in game are also included in this category. The topic of virtual property is further discussed here in section 4, **Real Money, Not-so-Real Items: Virtual property.**

3.5 Hybrid Models

Using many hybrids and combinations of the above revenue models are common,

and new approaches are constantly under consideration. Attempts to extend the model to other game styles are already underway. Most ambitiously, NCSoft is attempting to combine the "retail sale, play for free" model with frequent expansion packs to forgo subscriptions altogether. Its upcoming *Guild Wars* (developed by ArenaNet) will be implementing a "pay for content" model. Players will purchase the basic package, and buy "access" to various parts of the main continent in the game, instead of paying a monthly subscription. Console game publishers are also rapidly embracing free online play as a means to drive retail sales. Currently, only a small percentage of console gamers play online, but this number is growing fast.

4. Real Money, Not-so-Real Items: Virtual property

The virtual property economy is larger than most outside the gaming industry would believe. As of this writing (October 1), there are 19,784 items for sale in internet auction house eBay category 1654 (Internet Games); 10,759 of these items have to do with persistent virtual worlds. Writer Julian Dibbell chronicled his year-long experiment ("Play Money") in trading virtual items from the fantasy world of *Ultima Online* over eBay, resulting in \$3,917 for his last month of operations (about 47,000-a-year, annualized). While a good portion of these trades started from individual entrepreneurs, there have been an increasing number of companies such as Internet Gaming Entertainment ("IGE"), set up expressly for the purpose of virtual

trading. Item trading for real money is not a unique US only phenomenon. Korean based ItemBay is a significant player in this market.

The reaction to the growing trend of virtual property sales by players of persistent worlds is very mixed. These feelings range from outspoken loathing (reasons include “it breaks immersion”, and most often cited – “it is not fair”) to acceptance and sympathy for users who are disadvantaged by the inability to spend as much time in game as their counterparts but still wish to compete on an “even playing field”. There are even those who view the buying and selling of virtual property as an inevitable outgrowth of interacting in a virtual society.

The reaction of gaming companies is equally mixed. Several companies have banned outside sales of virtual items from their game outright, including Sony Online Entertainment and Turbine. Others, such as Electronic Arts, do not directly support the task, but instead offer services (see section 3) to make transactions easier, including a “safe account transfer” service. Games like *Project Entropia*, *There, Magic the Gathering Online*, and *Second Life* embrace the concept directly, offering in game items for real world cash (mostly currency, however *MtG Online* operates a money to playing card exchange, and *PE* and *SL* also sell property). One island in *Project Entropia* is being sold for \$16,000 PED currently, or \$1,600 at the listed PED/USD exchange rate.

All this exchange of virtual property and money has brought into question the ownership of virtual property. At the moment, the legal status is unclear. *Second Life* has taken steps in this area, by recognizing the ownership of in-world

content belongs to the subscribers who make it. This allows subscribers to retain full intellectual property protection for the digital content they create. There are still many topics to work out in this area, including ownership of content and how far real world laws can be applied within a virtual setting.

5. Persistent Worlds

Persistent worlds will present an interesting opportunity in the realm of entertainment over the next few years. The current base of people that are a part of one or more persistent worlds is expected to grow, spurred by the increased use of the Internet in daily life. This increased usage of the Internet, coupled with the increased availability of broadband, sets the stage for growth for all areas relating to the Internet, including persistent worlds.

5.1 Persistent Worlds v. Traditional Entertainment

The popularity of persistent worlds in relation to games is already visible in a comparison of profitability of the top grossing MMOG *EverQuest* and top box office grossing movie of all time, *Titanic*. On the surface, it would appear that motion pictures are substantially more profitable at the box office than MMOGs as their gross dollar amount is much higher than that of MMOGs. However, when you look at profit as a percentage of gross subscription/box office revenue, less development (ongoing for MMOG factored in) and marketing costs, the story is quite different.

5.1.1 Pitting the box office against MMOGs

	<i>Titanic</i>	<i>EverQuest</i>
Production/ Development & Marketing Budget	\$240mm	\$75mm
Revenue to Date (USA)	\$600mm	\$253mm (est.)
Profit Margin (less production/ development & marketing)	60%	70%

5.2 Persistent Worlds – Beyond Games?

Games are not the only application for persistent worlds. There are many opportunities within the persistent world arena to be excited about, with new ones being implemented every day.

- The Department of Defense has commissioned a persistent world for use as a training simulator based on Forterra’s *There.com* technology platform.
- From an economic standpoint, each persistent world has the potential to become a microcosmic economy, enabling economists to observe and experiment with economies in a way that’s never been possible before.
- Companies including Coca-Cola and Aeropostale are using persistent worlds to help strengthen their brand within their community by allowing users interact with each other and their

products in a persistent world.

- Academics have been able to use persistent worlds to carry out noteworthy studies in sociology and psychology.
- Persistent worlds have become interesting for business for example, advertising and product placement within the worlds, as well as a whole market surrounding virtual property.

Authored by: Nova Barlow, Julianne Greer & Alexander Macris.

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New York Law School

57 Worth Street
New York, NY 10013

www.nyls.edu/stateofplay