REAL WORLD TOYS AND CURRENCY TURN THE LEGAL WORLD UPSIDE DOWN: A CROSS-SECTIONAL UPDATE ON VIRTUAL WORLD LEGALITIES

Ian W. Gillies, Arizona State University

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Ian W. Gillies, Candidate for J.D., 2008

Sandra Day O’Connor College of Law at Arizona State University

Articles Editor, Jurimetrics Journal of Law, Science and Technology


ian.gillies@asu.edu

(480) 234-1848

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ABSTRACT

With 40 million members on the leading virtual world and overall user growth at 22%,¹ some experts are saying virtual worlds are to the new millennium what websites were to the 90s.² Just as the technological and economic growth of the internet drove numerous moral and legal issues to the forefront of society, so also will virtual world growth expand the overlapping moral and legal boundaries between virtual and real world experience. This paper provides a technology and market overview of virtual worlds and explores the intersection of some social and legal issues arising from the financial opportunity and virtual sexuality emerging from this growing online society and economy.

BACKGROUND

Virtual Worlds for Dummies

Computer-savvy technocrats originally referred to virtual worlds as "Massively multi-player online role-playing games," or MMORPGs. The first versions of these computer games typically involved a multitude of participants, interacting together in a fantasy world inhabited by elves, dwarves, wizards, trolls, and other Tolkienesque characters. Like many games, virtual world players have to complete various tasks, independently or in conjunction with other players, to increase skill levels, in-world currency ("plat"), or property within the game.

Since the first two-dimensional, limited MMORPG "Ultima" went live online in 1998, virtual worlds have grown to include thousands of simultaneous participants in dozens of countries across the world. Virtual worlds are distinguished from many games because of their highly interactive, realistic, three dimensional and evolutionary nature: a virtual world continues to thrive regardless of any single individual’s entry or exit from the game (even though "thrive" could mean complete obliteration by active players of an offline player's virtual castle). Virtual worlds also allow individuals to design and assume a

3 Caroline Bradley & Michael Froomkin, Virtual Worlds, Real Rules, 1 N.Y.L. Sch. L. Rev. 103, 121 (2005).
4 Id. See also J.R.R. Tolkien, The Lord of the Rings.
5 Plat is short for platinum, referring to in-world, or virtual world, currency. This term is used throughout this paper to distinguish between real-world currency (referred to as real dollars or U.S. dollars). Andrew D. Schwartz & Robert Bullis, Rivalrous Consumption and the Boundaries of Copyright Law: Intellectual Property Lessons from Online Games, 10 Int'l Prop. L. Bull. 13, 16 (2005).
6 Bradley & Froomkin, supra note 3, at 125.
7 Bradley & Froomkin, supra note 3, at 123.
8 Bradley & Froomkin, supra note 3, at 125.
unique three-dimensional (“3-D”) identity on the game, aptly named “avatars,” which means “a god’s embodiment on the earth.” Many virtual worlds allow players to create their own 3-D property and designs within the world, because the game technology is designed to use the resources of the player’s computer to minimize the load on the virtual world’s server. Not all virtual worlds are fantasy worlds, with social virtual worlds such as “Sims Online” and “Second Life” developed purely to replicate features of real life, although they may be glamorized or enhanced per the game developer and player’s imaginations. This paper focuses not on the differences between social and gaming virtual worlds, but instead explores a small border along the expanding frontier of social and legal issues arising from their commonalities of creativity, interactivity, and recent explosive growth.

Why Do Virtual Worlds Exist?

Escapism

Virtual worlds provide a highly interactive, three-dimensional, international, computer-driven extension of the same escapism that society has historically sought through movies, plays, books, games, rock and roll concerts, television shows, and other forms of entertainment. Much of this entertainment is built upon the basic premise within the entertainment consumer's mind that “I will never be

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10 Bradley & Froomkin, supra note 3, at 123.

11 Bradley & Froomkin, supra note 3, at 123, 124. The line between a gaming virtual world and social virtual world is difficult to draw, because gaming worlds have social elements and social worlds have gaming elements. This paper does not focus on the differences, even though the social worlds have been given a slightly different acronym of MMOG's (Massively Multiplayer Online Social Games).
that rock and roll star” or “I will never kick that game winning Superbowl field goal,” but “I can live the dream” through immersion in the entertainment medium in which the dream is presented, ie by attending a concert or football game.\textsuperscript{12}

Like many forms of common entertainment, virtual worlds provide social interaction with people of similar ideals, values, and interests. However, virtual worlds and their non-computerized ancient cousins, role playing games (RPGs), provide a greater level of psychological escapism than many entertainment media because of their anti-structural, creative, and highly interactive nature. Additionally, RPGs and Virtual worlds both provide players with a greater opportunity to escape the constraints of their own socio-cultural identity through the adoption of a fantastic or alien persona.\textsuperscript{13} Some scholars believe that by allowing people to fabricate and experiment with various artificial identities in a highly interactive social setting without real world implications, virtual worlds and role playing games may assist in the development of an individual’s true identity and core value system.\textsuperscript{14} Real world experience has also demonstrated the

\begin{itemize}
  \item Virtual vacations have also provided escapism and an inexpensive means to visit remote places with friends or family members without stepping on a plane. Betsy Book, \textit{Traveling through Cyberspace: Tourism and Photography in Virtual Worlds}, June 2003, \url{http://www.virtualworldsreview.com/papers/tourism/tourism.html}
  \item David Waldron, \textit{Role-Playing Games and the Christian Right: Community Formation in Response to a Moral Panic}, 9 Journal of Religion and Popular Culture *1-*45, at *4 (2005), \url{http://www.usask.ca/relst/jrpc/art9-roleplaying.html}. A role-playing game (RPG, often role playing game) “is a type of game in which the participants assume the roles of characters and collaboratively create or follow stories. Participants determine the actions of their characters based on their characterization, and the actions succeed or fail according to a formal system of rules and guidelines. Within the rules, they may improvise freely; their choices shape the direction and outcome of the games. A role-playing game rarely has winners or losers.” \url{http://en.wikipedia.org/wiki/Role_playing_game} Dungeons and Dragons is an example of a well-known role playing game.
  \item Waldron, \textit{supra} note 13 at 4.
\end{itemize}
potential for virtual worlds to provide therapy for people with real social disorders like autism or Asperger's syndrome.\textsuperscript{15}

\textit{Social and Economic Concerns}

Some critics have suggested that the depth of immersion inherent to a virtual worlds' sea of escapism may drown some players' concepts of reality, leading them to engage in immoral or anti-social activities.\textsuperscript{16} Unlike the social nature of RPGs which are generally played by groups of people in living rooms or dormitories sharing beers or Mountain Dews, virtual world games are often played alone with no direct human contact.\textsuperscript{17} Concerns have been raised regarding the social and psychological effects of virtual worlds as some players prefer their virtual lives or identities over their real lives, and forget the game-like nature of their activities.\textsuperscript{18} The \textit{average} time spent per individual in some virtual world markets is twenty hours per week, and studies have shown that some people spend more waking hours as an avatar in fantasyland than as a homo-sapien on Planet Earth.\textsuperscript{19} Also, the sexuality and violence portrayed and encouraged in some virtual worlds has subjected them to the same criticisms of


\textsuperscript{16} Waldron, supra note 13, at 5; see also Chinese Gamer Sentenced to Life, BBC News, June 8, 2005, at http://news.bbc.co.uk/2/hi/technology/4072704.stm (discussing a Chinese man who killed another gamer in real life who refused to return his virtual sword.)

\textsuperscript{17} Waldron, \textit{supra} note 13, at 5.

\textsuperscript{18} 22\% of Everquest participants desire to spend all of their time there. F. Gregory Lastowka & Dan Hunter, \textit{The Laws of the Virtual World}, 92 Cal. L. Rev. 1, at *9 (2004). \textit{See also} Bradley & Froomkin, \textit{supra} note 3 at 137.

\textsuperscript{19} Lastowka & Hunter, \textit{supra} note 18 at *6, *9.}
morality as other realistic, less interactive video games.²⁰ Like video games, the addictive nature and huge time commitments devoted to virtual worlds have raised additional economic productivity concerns for individuals and society, particularly when employees begin spending unauthorized time at work playing them.

**Utility**

The high level of human social interaction and realism within virtual worlds provides a valuable 3-D testing platform to explore real world issues. Because a virtual world host generally supplies a 3-D modeling tool for use by its gamers, parties with a potential 3-D application may prefer to buy virtual real estate and create their designs in-world rather than purchase an expensive 3-D engine to implement their designs through their own websites.²¹ These factors have expanded potential virtual world applications beyond the initial gaming/escapism model to include consumer and public focus groups, sociological and psychological studies, support networks and online community building, political expression, personnel training and other educational programs.²² Bradley and Foomkin suggest that using virtual worlds to test rules


²¹ Christopher T. Heun, *Online Virtual World is Part Fantasy, Part Civics Experiment*, Internet Week p.1-3 (Nov. 8, 2005), http://www.informationweek.com/story/showArticle.jhtml?articleID=173601081&pgno=1

²² For example, the virtual world “Second Life” has been used or considered for use as a 3-D testing platform for proposed public park layouts, to study urban planning, as a support group for people with Aspergers syndrome, to provide emergency response training, as a global warming educational program, and to provide an after-school program for low-income teens. *Id.* at 1-3.

or law proposals will parallel the real world more accurately than existing economic models used by behavioral economists, and may help prevent the implementation of economically or psychologically harmful laws.\textsuperscript{23} The broadening of virtual worlds beyond adolescent escapism is further demonstrated through their consideration or adoption by many well-known governmental and media organizations looking to develop virtual world applications or to establish a virtual world presence.\textsuperscript{24}

**Money, Money, and Money**

Although the number of active virtual world subscribers is a disputed, moving target, the numbers are clearly in the tens of millions, and growing at a rapid rate.\textsuperscript{25} As subscribers grow, so do the game developers’ profits, with Sulake, the leading virtual world developer, reporting 8173\% growth from 2001-

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\textsuperscript{23} Bradley & Froomkin, *supra* note 3, at 134, 146. The Department of Transportation has considered a test of this very nature, using the virtual world “Second Life” to test whether cell phone use should be allowed on airplanes. Heun, *supra* note 21 at 1.

\textsuperscript{24} Projects have been supported or considered by the Department of Homeland Security, Chicago Public Schools, the World Bank, the USC Center on Public Diplomacy, the International Center for Automated Information Research, the New York Law School’s Institute for Information Law and Policy, the Queens Community Board, and the Department of Transportation. Schools in Panama, Tokyo, and Israel have also purchased virtual world real estate to develop educational projects. Heun, *supra* note 21 at 1, 3; see also [http://www.dmwmedia.com/tags/virtual-communities](http://www.dmwmedia.com/tags/virtual-communities) (discussing virtual world investments by Liberty Media); [http://www.secretlair.com/index.php?/clickableculture/entry/avatar/](http://www.secretlair.com/index.php?/clickableculture/entry/avatar/) (discussing NBC’s entrance into the virtual world market, 11/29/06).

Most online gaming companies currently earn their primary income through monthly subscription fees, which has also shown significant growth from approximately $500 Million in 2001 to $3 Billion in 2006 to nearly $7 Billion estimated by 2011. Sixty percent of this total is derived from virtual world-type games, and does not include the additional income from other sources such as advertising and licensing within the games. Online games are particularly popular in South Korea, Taiwan, and China, with players in these countries generating approximately 50 percent of all worldwide online gaming revenue. In South Korea, one virtual world has surpassed television in popularity. World of Warcraft, a popular game by Blizzard Entertainment, will reportedly do over $100M in its opening year within several markets. In addition to the subscription revenue, game developers earn income through in-world advertising and through income generated by in-world virtual property sales.

Advertising

As the number of players grows, corporations see virtual worlds as a new venue for product placement and market exposure, while hosts and specialized
virtual world advertising firms see a new source of revenue. Although the response from gamers has been mixed, hosts have nevertheless negotiated multi-million dollar contracts with corporate behemoths such as Intel and McDonalds in exchange for in-world advertising. Advertisers enjoy the same creativity, flexibility, and interactivity of the virtual world 3-D environment that has attracted gamers, and corporations with famous brand names have innovated in-world clothing stores, record release parties, and movie premieres. Additionally, the costs for an ad campaign are fairly inexpensive, and some clever corporations have offset their advertising costs by selling their products in-world. Wells Fargo was possibly the first company to create a “game-within-a-game” when it purchased several in-world islands and developed an in-world accessible video game which teaches financial responsibility to teens. In spite of some objections by gamers, hosts and corporate advertisers will likely


37 Note that a V-clothing store may offset its V-world real estate and advertising costs by selling V-clothes to avatars. See id and “Trademark” discussion later in this paper; See also Renna Janna & Aili McConnon, *Second Life Lessons: Real-world businesses face the costs and learn the benefits of setting up shop in the online universe*, Businessweek.com, October 30, 2006 [http://www.businessweek.com/innovate/content/oct2006/id20061030_869611.htm?chan=innovation_game+room_game+room](http://www.businessweek.com/innovate/content/oct2006/id20061030_869611.htm?chan=innovation_game+room_game+room), (discussing Toyota’s recent marketing campaign which sells V-World Scions to offset the advertising costs).

continue to encourage and develop advertising opportunities, with the overall in-game advertising market estimated to reach $400 million by 2009.\(^{39}\)

**In-World Income**

To more fully enhance the realism of their in-world experience, virtual world players have demonstrated their willingness to purchase a plethora of in-world items and services for real dollars, including such basic real world necessities as food, shelter, clothing and sex. Less patient participants will also directly purchase digital property in the form of special powers to play at a higher gaming level instead of spending the time required to develop their avatars through game play. Although plat or virtual property may always be purchased from the host using a real-world credit card, the popularity of virtual worlds and the cumbersome nature of in-world bartering have created a real world secondary market for both digital property and plat, driving numerous real world and in-world business opportunities.\(^{40}\) Although some game developers claim this external secondary market for items obtained in-world infringes upon their intellectual property rights, other developers have embraced the concept.\(^{41}\)

Regardless of game developers’ approval, gamers make millions “exporting” and auctioning their virtual world property and currency,\(^{42}\) and one

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\(^{39}\)Estimates by Parks Associates. Howard, *supra* note 34  
\(^{40}\)David Becker, “Everquest” Spins its Own Economy, CNET News.com, January 25, 2001,  
\(^{41}\)David Becker, *Real Cash for Virtual Goods*, CNET News.com, February 8, 2005,  
\(^{42}\)One study indicates that 2002 auctions for Everquest alone reached $5Million, and this is a game that prohibits auctioning of its items. Becker, *Everquest Spins, supra* note 40.
report estimates the annual sale of virtual assets at $7 billion by 2009, overtaking the primary gaming market. In addition to executing these sales on eBay, players have supported the development of other auction websites which specialize in the liquidation of virtual world items, and have also formed their own in-world classified advertisements. Although consistent currency exchange rates have been elusive, they are continually estimated and reported, along with in-world acreage values and average hourly wages. In spite of the clear market risk created by hackers, dupers, and game developers, reports of six figure incomes and a real-world millionaire from virtual world business have driven investors to sink significant real world dollars into the in-world market, with an auction for an in-world island in 2005 closing for U.S.

43 http://www.ige.com/about
49 Hackers hack into the game code to steal others’ virtual property; whereas dupers look for software bugs to allow them to counterfeit or duplicate virtual property or currency, causing virtual world inflation. However, the biggest economic risks to digital asset entrepreneurs arise from the game developers, who may on a moment’s notice change game policy to disallow auctioning of their items or dilute their value through issuance of property at a lower market price. Julian Dibbel, The Unreal Real Estate Boom, Wired.com Issue 11.01 at 3, January 2003, http://www.wired.com/wired/archive/11.01/gaming.html?pg=3&topic=; Anshe Chung Becomes First Virtual World Millionaire, Nov. 26, 2006, available at http://www.anshechung.com/include/press/press_release251106.html.
$26,500, and an in-world space station purchased later that year for an even U.S. $100K.\textsuperscript{50} The amount of real world money flowing from in-world property exchanges has driven game developers to hire economists for advice on monetary and fiscal policy and has recently prompted an investigation by the U.S. House of Representatives Joint Economic Committee.\textsuperscript{51}


LEGAL ISSUES

“Clearly, virtual economies represent an area where technology has outpaced the law.”
– Jim Saxton, Chairman, U.S. House of Representatives Joint Economic Committee, October 17, 2006

Just as internet innovation and economic growth in the 90’s created legal challenges for domain name registrars, internet service providers, search engines, website owners, courts and lawmakers, so will the recent technological and market expansion of virtual worlds raise unique unanswered legal questions to gamers, game developers, courts, and lawmakers. If the beauty of Helen of Troy or the taxation of tea upon colonial America can create war, so could the real world implications of virtual world sex and currency cause conflict. For example, the direct exchange of plat for real dollars has created economically driven legal issues surrounding intellectual property and digital assets, taxation, fraud, and gambling. Socially driven issues have arisen regarding the legality of virtual world obscenity and the potential fallout from virtual sex, recently exacerbated through technological advances in the adult industry. Due to the international availability of virtual worlds, any cases that do arise may face jurisdictional complexities that exacerbate the legal controversies. Further intertwined with these legal issues are the unanswered questions of whether resolution will be best achieved through court interpretation of existing laws, statutory revision, or through industry regulation.
Money and Economically Driven Issues

The real world marketability of virtual world goods should not have surprised the technological community, economists, or even Marxist political theorists.\textsuperscript{52} With a huge existing resale market for spells, wizards, and demons through fantasy collector card games such as Magic: The Gathering,\textsuperscript{53} an extension of these goods to an online gaming software context is inevitable. However, the increasing ease with which players can convert virtual world currency and property to real world dollars has blurred the line between Monopoly money and the Federal Mint. Therein arise specific legal challenges that might not have been anticipated by players and V-developers, and might not have existed without a plat/US dollar currency exchange. The huge international economic growth of virtual worlds discussed supra, and the creativity and freedoms extended within the virtual world environment will bring many of these unanswered legal questions to the forefront of real world courts, lawmakers, virtual world hosts and players. In this section, the author addresses the legal impact which a virtual world currency exchange has created within some specific topics of property fraud, trademarks, taxation, and gambling in a virtual world context.

\textsuperscript{52} http://en.wikipedia.org/wiki/Commodification, under a Marxist political theory, commodification is defined as occurring “when economic value is assigned to something that traditionally would not be considered in economic terms.”

Property Rights and Fraud

One underlying issue resulting from the attachment of real world value to digital property is the rights of ownership to gamers’ in world creations. Some game designers’ policies allow gamers to own and exchange their virtual world creations, encouraging creativity and in-world growth similar to the real world intellectual property policies of patent and copyright law. Other game developers have banned the real world sale of virtual property, likening it to an athlete who throws games in exchange for mafia payoff.

Game developers who do not allow their gamers to sell their in-world property have been sued by gamers for that right, but a case has yet to reach a U.S. court decision. In response to litigation, game developers have also attempted to wrap their digital property ownership rights into their user licensing agreements, hoping to retain the rights to any property created within their worlds. At least one scholar believes these agreements would be considered adhesive contracts unenforceable in courts.

One reason game developers want ownership of their digital rights is to prevent them from having to police ownership disputes within their games.

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54 The value of virtual world property/currency and its exchange for real world dollars has already been discussed supra p. 9 and discussed in detail by legal scholars. However, the brief overview of virtual property is provided to place some of the other issues in context.

55 Lastowka & Hunter, supra note 18, at 41-43. A lengthy discussion of copyright ownership issues between gamers and game developers is not part of this paper. For a detailed discussion see Molly Stephens, Sales of In-Game Assets: an Illustration of the Continuing Failure of Intellectual Property Law to Protect Digital-Content Creators, 80 Tex. L. Rev. 1513 (2002).


58 Lastowka & Hunter, Virtual Crimes, supra note 56, at 310.

disallowing any claims of ownership by their players, the game owners will not have to mediate claims of stolen property or fraud between players, because that which is never owned by a player cannot be stolen from that player. This allows game developers to maintain a “hands off” or “free for all” attitude within their world.\textsuperscript{60} Game companies may also be hesitant to condone a system of economic gain achieved through the use of their virtual worlds without receiving a percentage of the profits.

A court in Beijing has rejected these arguments by game developers, showing sympathy to gamers’ digital property rights by issuing a court order to a game developer, forcing them to return in-world property to gamers who were allegedly defrauded by another player.\textsuperscript{61} On its face, this landmark decision demonstrates that some courts will recognize gamers’ in-world digital property rights, and will mandate game developer policy to extend these rights. This case also paints a larger picture by demonstrating that courts will override game developer policies and the “it’s just a game” philosophies because of the real world value attached to virtual property rights.

\textbf{Gambling}

The U.S. government has not outright criminalized online gambling, but has recently passed a law which prohibits U.S. gamblers from using their banks and credit cards to deposit or withdraw money from internet gambling sites, and prohibits internet gambling sites from accepting money from U.S. financial

\footnotesize{\textsuperscript{60} Hunter & Lastowka, supra note 56 at 310.  
\textsuperscript{61} Fairfield, supra note 59 at 1084-85. (discussing Li Hongchen v. Beijing Artic Ice Tech. Dev’t Co., a landmark case in digital property rights.)}
In an effort to find a loophole around these restrictions, some existing internet gambling sites have instead formed ‘virtual world’ casinos, with all gambling transacted solely through plat. If V-gamblers and the V-casinos exchange their plat through a real world auction, they may successfully circumvent the intention of U.S. lawmakers to inhibit internet gambling.

Resolving this issue through new legislation or interpretation of the recent internet gambling legislation could make a judge or congressman’s head spin like a Vegas roulette wheel: An interpretation of the current legislation to prohibit credit card transactions for in-world gambling will require a difficult interpretation by banks and game developers of what does or does not constitute gambling. Financial organizations may simply choose not to work with virtual worlds, causing market failure for game developers. If game developers take a conservative, less creative approach in their game designs by eliminating all ‘monopoly-esque’ types of activities in their worlds, the entertainment value (and market value) of the games will suffer. Additionally, even if designers completely eliminate “official” casinos from their games, the creative nature and freedom provided by virtual worlds will allow gamers to conduct their own gambling activities “in secret”, like a mafia family’s operation in the basement of a night club. Are virtual world developers or banks contributorily liable or responsible for enforcement of gambling activities within a virtual world? This could also cause

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63 Balkin, supra note 57 at 77.
market failure, and would require developers to inhibit the creative freedoms and activities of their gaming customers.

Many of these questions are distinguished from the internet, because unlike the internet, which has a number of privately run websites, the gamers within a virtual world are all being routed through a virtual world host. Additionally, this issue is being driven by the creativity and independence provided to gamers which is inherent to the virtual world business model, and has been exacerbated by the value of the plat in real world dollars. New legislation prohibiting all sale of plat or virtual world property on internet auction sites might reduce the motivation behind virtual world gambling, and could be more easily enforced than policing “gambling activities” in virtual worlds, but raises questions of fairness by transferring the enforceability and contributory liability questions to the internet auction sites. Additionally, eliminating or reducing the plat to real world currency exchange will destroy a growing international economy supported historically by a foundation of primarily non-gambling in-world uses. To further complicate this issue, some virtual world hosts have provided in-world ATMs providing currency exchanges, withdrawals, and deposits, through the host or through external websites.64

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(discussing independent websites servicing in-world ATMs).
http://www.marketwire.com/mw/release_html b1?release id=133995 (discussing in-world ATMs supplied by virtual host)
Taxation

The exchange market of plat or virtual property for real dollars also presents interesting tax questions not yet addressed by Congress or tax courts. State and federal government have begun scrutinizing the internet auctions of items by private individuals, and may begin increasing enforcement of income and sales tax collection in those areas.\textsuperscript{65} As the virtual world economy grows, gamers will also be subject to closer inspection by federal and state tax collecting agencies. Clearly, any real world gains from the sale of plat or virtual property on e-Bay is subject to taxation by the Internal Revenue Service. However, what about an avatar blacksmith who works 20 real world hours a week to build breastplate armor which is sold in-world with an annual income of 25,000 plat? What about the avatar knight who barters with a naïve avatar wizard and exchanges his V-Castle worth $100 on e-Bay for a magical V-Dragon worth $999 on e-Bay? Assume both parties never exchange their items for real world dollars, and therefore argue, as most people would, that taxing these exchanges within a gaming environment would be preposterous.\textsuperscript{66}

However, under the I.R.S. Regulation §1.1001-1 and \textit{Cottage Savings v. Commissioner of Internal Revenue}, any materially different barter transaction is a realization event, allowing for the taxation of any gains resulting from the transaction.\textsuperscript{67} The I.R.S. has offered no relief to this concern, by stating that it

\textsuperscript{\textit{65}}E-Bay reported $34B of sales through its portal in 2004. Of the 135 million users, an estimated 800,000 are “power sellers” who might be of particular interest to the IRS. Knowledge@Wharton, \textit{The Taxman Cometh...Or Does He?}, (Apr. 20, 2005), http://knowledge.wharton.upenn.edu/article.cfm?articleid=1182&CFID=2632394&CFTOKEN=95885369


\textsuperscript{\textit{67}}Cottage Savings Ass’n v. Commissioner of Internal Revenue, 499 U.S. 554 (1991); IRS Reg 1.1001-1
currently expects players only to report real world income, but that it might consider at least some of the virtual barter exchanges.\textsuperscript{68} Preposterous as it seems, the first virtual sword that was sold for real dollars on the internet provided the I.R.S. with a cutting argument that all \textit{in-world} gains and losses resulting from income or barter transactions could be taxed, \textit{regardless of whether the transactions were realized in real world dollars.}

Although the low value of most virtual world gains will likely deter the I.R.S. from pursuing actions against most players, tax-conservative players who are earning a significant real-world income through virtual world transactions\textsuperscript{69} may consider including all virtual world transactions in their real world taxes, even if they have not yet realized a real world exchange of currency on some of them. This theory will create an accounting nightmare and inhibit the profitability of virtual world entrepreneurs, who will need to account for gains, losses (and business expenses), in both plat and real world dollars, while also accounting for the adjusting real world/virtual world currency exchange rate. If the burden for reporting these transactions is placed on game developers, their business models will likely become unprofitable.\textsuperscript{70} Congress appears to be favoring gamers, as House Representative Jim Saxton believes taxing virtual world transactions would “be a mistake,” and the House Joint Economic Committee is investigating the public policy behind virtual world economies.\textsuperscript{71}

\textsuperscript{68} Terdiman, \textit{supra} note 66 at 2; see generally Julian Dibbel, \textit{Dragon Slayers or Tax Evaders?}, Legal Affairs: the Magazine at the Intersection of Law and Life, Jan/Feb 2006, \url{http://www.legalaffairs.org/issues/January-February-2006/feature_dibbell_janfeb06.msp}.

\textsuperscript{69} See earlier discussions of in-world players earning six-figure incomes selling virtual property.

\textsuperscript{70} Terdiman, \textit{supra} note 66 at 2.

\textsuperscript{71} \textit{Virtual Economies Need Clarification}, \textit{supra} note 51.
Until a tax court or Congress addresses this issue, a virtual world entrepreneur has the choice of paying increased taxes on both virtual world and real world transactions in parallel with a burdensome accounting nightmare, or of paying taxes only on the real world transactions while preparing legal arguments contrary to I.R.S. Regulation §1.1001-1 and Cottage Savings v. Commissioner of Internal Revenue.  

Just as the growth of internet auctions is currently driving governmental scrutiny on tax collection from private, successful internet auctioneers, so too will the ongoing growth in the virtual world economy eventually drive an increased risk of tax audit to successful virtual world entrepreneurs. Without clear direction regarding the tax realization of in-world barter transactions, in-world entrepreneurs are forced to make ambiguous tax decisions with potentially great financial consequences.

**Trademarks**

Like any single person looking for Mr. or Mrs. Right, or Mr. or Mrs. “Right Now”, an avatar looking to “dress to impress” before going to a trendy in-world dance club might wear a sophisticated outfit to induce attention from another avatar of romantic interest. As every in-world metrosexual man knows, an Armani suit will get you into the hottest clubs in town and gets you the hottest avatar ladies (or alien if therein lie his interests). Depending on the freedom of

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72 One argument in-world entrepreneurs might use is to parallel the current legal stance of gambling: financial gain is not realized until the ‘playing is done’ and the gambler cashes in his chips and leaves the casino; for example, the in-world transactions aren’t realized until the player leaves the world and ‘cashes in’ his plat for real world dollars.

73 As has been the case with individual e-Bay sales, where state and federal tax collectors are looking for the big players who might owe in significant back taxes. The Taxman Cometh, supra note 65.

74 “Metrosexuality is, according to British journalist Mark Simpson, the trait of an urban male of any sexual orientation (usually heterosexual) who has a strong aesthetic sense and spends a great amount of time and money on his appearance and lifestyle.” [http://en.wikipedia.org/wiki/Metrosexual](http://en.wikipedia.org/wiki/Metrosexual)
creativity and control allowed by the virtual world host, the avatar might create its own designer Armani suit or might purchase one through the host. But what if Armani thinks that virtual worlds are juvenile games and believes that use of its trademark in such a setting will dilute its mark's goodwill? What if the host provides no internal software control to prevent its users from creating an Armani suit regardless of Armani's wishes? What if Armani is amenable to the use of its brand, but expects compensation through a license?

Some well known brand names such as Nike and Levi have embraced the concept of licensing the use of their trademarks to virtual world hosts, and have viewed virtual world licensing of their trademarks as an easy way to make money without the costs of supplying a tangible product. In order to pay the licensing fees to trademark owners, a virtual world host will charge the computer user real dollars via a real credit card to purchase the plat to dress the user's avatar in virtual Nike or Levi outfits. Problems arise if a host disregards the potential profits and complexity of entering licensing agreements with trademark owners and simply provides its users the freedom and creativity to create their own trademarked outfits or characters without trademark owner permission.

If a virtual world host allows its players full freedom of expression to design its own clothes, vehicles, restaurants, etc., branded with real world trademarks, a blurred vision of trademark infringement arises similar to that

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75 Lastowka & Hunter, supra note 18 at *10. [FN33] Leslie Walker, Will Women Go There?, Wash. Post, Jan. 12, 2003, at H7. Nike and Levi Strauss have reportedly entered into licensing agreements with There.com whereby the clothing companies promote their real products through the sale of virtual renditions of these items to There's avatars. The virtual transactions for Nikes and Levis, however, are also sales for virtual equivalents which are transacted using Therebucks. See also ‘Advertising’ section of this paper.

76 Lastowka & Hunter, supra note 18 at *10
created by other internet technologies. Questions have already arisen in court on whether a host may be held liable for contributory trademark infringement by allowing its players to create avatar likenesses of comic book characters without the mark owner’s permission. Questions also arise on whether the shallower pockets of an individual V-player who is not profiting from his use of a trademark in a virtual world context meets the “use in commerce” requirement of trademark infringement or is a permissible “fair use” defense under trademark law.

Other hypothetical trademark infringement questions may flow not just from real world trademark use by virtual world avatars, but also from virtual world recognition of virtual world trademarks and real world use of virtual world trademarks. Consider the following unanswered hypothetical: Real world Joe Za creates Za’s Za, a purely Virtual world pizza parlor in V-ville, which after five real world years of steady growth, has become the most successful and profitable restaurant in all of V-ville. Through the millions of plat coming in through Za’s Za, and by exchanging them on e-Bay, Joe is making a modest real world income of $70K annually. M.E. Weasel, a real world cyber law attorney known also as the shrewd avatar businessman Dr. Infringer, uses an exact duplicate of Za’s trademark without a franchise or license fee to open several of his own pizza parlors in V-ville. Is this trademark infringement? What if Dr. Infringer is not

77 Trademarks: Zest for Search Engine Optimization Places New Demands on Trademark Lawyers’ Ethics, 11 Elec. Commerce & Law Rep. (BNA) 688 (West Jun. 21, 2006) (discussing how the use of trademarks in metatags, pop-up advertising, and keyword-triggered sponsored advertising has created unsettled law in regards to whether these technologies constitute the “use in commerce” element of trademark infringement; trademark liability is imposed on any person who on or in connection with goods or services uses in commerce a word, term, name, symbol or device which is likely to cause confusion 15 U.S.C. § 1125(a)(1)); some definitions of this use require the trademark infringer to be profiting from the use; a “fair use defense may be allowed if a user is not profiting.
78 Marvel Enterprises, Inc., v. NCSOFT, F.Supp.2d, 2005 WL 878090 (2005)(holding that the portrayal of the comic characters within a virtual world were not a use in commerce supporting trademark infringement)
charging money for his pizzas, implying no “use in commerce”? Would in-world income by Joe Za’s avatar even be recognized by the US PTO and the Lanham Act as sufficient “use in commerce” for federal trademark registration? Does the intention of the Lanham Act extend to a “use in virtual world commerce?” If Za has not registered for a Federal or State trademark in the real world, does he own a common law real world trademark when his pizza parlor does not directly bring in real world dollars?  

What about an in-world common law trademark recognized and enforced by the V-ville game developer? If Za has no cause of action in the real world courts, but the V-ville developer provides its own enforcement, what prevents Dr. Infringer from going to another virtual world game to open a Za’s pizza? Are virtual worlds expected to form their own version of the Madrid Protocol? Finally, what if the success of Za’s Za and the growth of users in V-ville provide enough hype to the common real world public, that Dr. Infringer opens a real world pizza parlor under Za’s VWorld mark? These are all unanswered, but not completely preposterous hypotheticals that could arise as the virtual world market continues to grow.

Sex and Socially Driven Issues

“Across the world, thousands are logging on to virtual worlds like Second Life to meet, flirt and experiment with others. Free from the constraints of real life, they use text chat and sexy avatars to get it on in the digital realm.”

- Bonnie Ruberg, Wired.com, June 13, 2006

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Virtual worlds have provided a realistic and interactive extension to the already popular culture of telephone, internet and online romance. The increasing number of international virtual world players provides a multitude of opportunities for an individual to meet a mysterious foreign love that might not be available without a huge travel budget. The anonymity and creative flexibility provided by an assumed avatar persona allows an insecure individual to “design away” their self-perceived imperfections. This freedom of expression could lead to a courtship, engagement, and wedding of celebrity proportions at a pauper’s price.81 But with the joys of virtual world romance arise real world legal concerns of virtual adultery, obscenity, prostitution, polygamy, and rape.

Love, Marriage and Divorce

Reports indicate that 6-30% of all virtual world players have gotten married in-world, with the average age being 18 for females and 24 for males.82 Although the majority of gamers believe in-world marriages are a part of the games’ fantasies without real social consequences,83 live, in-world marriages are increasingly occurring in parallel with a legally binding, real world ceremony.84

83 On a scale of 1 (silly) to 8 (meaningful), approximately 1/3 of gamers thought their in-world marriage was ‘silly’, while approximately 4% thought they were ‘meaningful’. For the full chart, see id.
84 Entropia Universe Holds the World’s First Live Legal Virtual Wedding on the Surface of an Asteroid, Marketwire.com, June 7, 2006,
Same-sex gamer couples living in a jurisdiction that does not recognize same-sex real world marriages may see an in-world ceremony as the closest alternative.\footnote{85 http://www.marketwire.com/mw/release.html?release_id=133995} With virtual marriages on the rise, and some occurring in parallel with real world marital agreements, will gamers lobby their state capitols to recognize in-world marriages performed by an in-world avatar whom is legally privileged to perform marriages in the real world? There are certainly other legally binding contracts held purely online (ie software end user licensing agreements), and the expediency sometimes extended to drunken marriages between strangers in Las Vegas should indicate the ease and anonymity of an in-world marriage as insufficient policy arguments for disallowing them. Should an in-world marriage between a less attractive, socially inept couple that has spent 1000’s of quality in-world hours together and found true love be less legally binding or socially accepted than a real-world marriage between a socially inept, attractive woman selected from a row of candidates by a bumbling millionaire on a reality TV show?

Other romantic questions raised by virtual worlds are even more tumultuous. If excessive time spent \textit{working} in a virtual world has already created real world marital strife and divorce,\footnote{86 Dibbel, \textit{supra} note 49. (discussing successful engineer who began selling virtual items in the evenings and weekends, ultimately ending in a successful six figure income selling digital property, but an unsuccessful marriage)} what might in-world extramarital affairs do
to a couple? Gamers may see the virtual world as an opportunity for inhibition-free sexual creativity, exploration, or foreplay, while their partners may not understand their gaming partners’ virtual world obsessions. Frustrated, and unable to share their passion with their partner, gamers may view interaction with sexy in-world avatars with similar interests as a healthier alternative than seeking a real-world affair.87 But due to the 3-D realism and highly interactive nature of virtual worlds, the line of adultery has been further defocused from the existing blurred line created by the arguably less harmful, less interactive online chat rooms, emails, or internet porn. Due to the heightened interactivity of virtual worlds, would a jurisdiction that has a fault-based divorce system recognize in-world sexual infidelity as sufficient grounds for a divorce suit? What about a second in-world marriage? Could an in-world marriage warrant criminal polygamy charges? What about an in-world affair or marriage assumed with a remote player living in a country where adultery or polygamy might be punishable by death?88 Could a US citizen, on a real-world trip to meet her in-world love for the first time, instead be arrested by foreign police and sentenced to death upon arrival, because unbeknownst to her, her love was already married? Is this a preposterous theory, worthy of a movie script such as “Return to Paradise?”89 If

88 "And the man that committeth adultery with another man’s wife, even he that committeth adultery with his neighbour’s wife, the adulterer and the adulteress shall surely be put to death." Lev.20:10 Although she was later acquitted on appeal, in 2003, a Nigerian woman was sentenced to be stoned to death for having sex outside marriage. Jeff Koinage, Woman Sentenced to Stoning Freed, Cnn.com, February 23, 2004, http://www.cnn.com/2003/WORLD/africa/09/25/nigeria.stoning/
89 In Return to Paradise, three American men who met while on vacation in a foreign jurisdiction were using hash on a social basis. When two of the men left, returning to America, they disposed of their ‘leftover hash’ but it was traced to the one remaining man. The combined quantity of hash left by the three men was
these questions are ridiculed, how might opinions change after considering the recent invention of an in-world sex-device that provides remote-controlled physical interactivity with a partner performing in-world 3-dimensional sexual fantasies?\(^9^0\) Although these devices are not yet fully developed or available, spousal reaction to players caught cheating with an in-world avatar *without* these devices has ranged from a somewhat mischievous in-world reprimand\(^9^1\) to service of divorce documents.\(^9^2\)

**Obscenity, Prostitution, and Child Protection**

Virtual world sex will broaden the ambiguity in obscenity laws and jurisdictional issues\(^9^3\) already presented during the widespread growth and adoption of the internet. Jurisdictions that currently accept a higher level of internet obscenity than others will need to re-draw their legal and social boundaries as the use of virtual worlds and their technologies develop. For example, a jurisdiction which currently allows online chat rooms of an adult

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91 One gamer’s wife, who had allegedly never been in the virtual world, responded to his in-world infidelity by breaking into his virtual world account, “shrinking” a specific portion of his avatar’s anatomy, and leaving him naked in an in-world mature nightclub. Au, *supra* note 87.


93 The internet has raised jurisdictional issues when providers of adult-websites were convicted in states with stricter obscenity laws than the states in which their website was legally operating. *See also Yahoo! Loses Nazi Auction Case*, CNN.com, November 20, 2000, [http://archives.cnn.com/2000/TECH/computing/11/20/france.yahoo.02/](http://archives.cnn.com/2000/TECH/computing/11/20/france.yahoo.02/) (discussing litigation between France and Yahoo, where France sued US-based Yahoo for allowing auctions of Nazi memorabilia to appear on France-based users’ computers.)
nature might not tolerate an in-world chat room that provides a 3-D animated sexual representation of the actions discussed within the parties’ chat room conversations. But the interactivity of in-world sexual content extends beyond simple issues of what constitutes pornography. The currency exchange between real and virtual worlds and the recent invention of interactive adult toys controllable by another in-world party present additional unique legal issues. Also, like the anonymity of the internet, the potential for children, posing as adults, to appear as a variable in the in-world-sex-equation further complicates the issue. Does an adult who unknowingly interacts with a child posing as an adult avatar in-world becoming civilly or criminally liable for purely in-world activities?

As already discussed, an in-world controlled adult toy blurs the line between real world and make-believe sex in the marital scope of adultery and polygamy. With an in-world currency exchange, this technological advancement could also potentially turn an in-world sex game into real-world criminal prostitution charges. A female avatar named Evangeline (allegedly a teenage boy in real life) has already run a brothel on “The Sims Online,” receiving payments of in-world currency worth up to $50 in real world money in exchange for “talking dirty” to other avatars.94

Ignore for the moment Evangeline’s age and assume instead the hypothetical situation that Evangeline had been remotely controlling an adult toy placed on one of her “customers’” bodies. Assume also that the direct exchange

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of currency between the two worlds (under one of the discussions elsewhere in this paper) would meet the ‘consideration’ requirement of any prostitution statute.\(^{95}\) With these assumptions in place, one could argue that the absence of direct body-on-body contact or sexual intercourse in this scenario would prevent a charge of prostitution in many states.\(^{96}\) However, some prostitution laws are broader, defining prostitution as “offering or agreeing to an act of sexual conduct for money for the purpose of sexual arousal or gratification; [a] completed act of sexual conduct [is] not required[,]” or “knowingly engaging in or offering to engage in a sexual act for hire.”\(^{97}\) Under this broader definition of prostitution, providing plat might meet the definition of “money” or “for hire”; and controlling a sex toy worn by another player through a virtual world might meet the definition of “sexual conduct . . . for the purpose of sexual arousal or gratification.”

Evangeline’s activities and the creation of in-world controllable sex toys also extend the existing issues of internet anonymity and child protection to the virtual world environment. However, child protection within virtual worlds may be more difficult to enforce, because the age of a minor performing sexual acts behind the cloak of an adult avatar’s anonymity may be more difficult to identify than a child operating a live, streaming-video, paid porn website. Although a minor’s 3-D character performing sexual animations in a virtual world may be considered less severe than a child performing actions for live-video, an in-world

\(^{95}\) Although not all statutes require money, a “fee” or consideration is an element for most prostitution statutes. 63C Am. Jur. 2d Prostitution § 2.

\(^{96}\) “Prostitution has been defined as the performance of sexual intercourse for a fee . . . [or] engaging in sexual intercourse for hire . . . [i]t includes sexual stimulation . . . by direct manual contact, in exchange for money.” 63C Am. Jur. 2d Prostitution § 1 (2006) (emphasis added).

controllable sex device could cloud this argument. Like adult websites, issues arise on whether age verification responsibility falls on virtual world hosts, the government, the parents, or the in-world avatar receiving the sexual “attention” of a potential child. Consider another hypothetical which asks for the legality and morality of in-world sex between consenting, real world adults whose avatar representations are children. Perverse, yes. But illegal, if no child is harmed? A violation of the First Amendment, if banned? Congress has answered this question by declaring “any computer generated image that is, or is indistinguishable from, that of a minor engaging in sexually explicit conduct” as meeting the definition of illegal child pornography.

**Virtual Rape**

They say he raped them that night. They say he did it with a cunning little doll, fashioned in their image and imbued with the power to make them do whatever he desired. they [sic] say that by manipulating the doll he forced them to have sex with him, and with each other, and to do horrible, brutal things to their own bodies. And though I wasn't there that night, I think I can assure you that what they say is true, because it all happened right in the living room - right there amid the well-stocked bookcases and the sofas and the fireplace - of a house I've come to think of as my second home.

This excerpt from Julian Dibbel's *A Rape in Cyberspace* was written in response to an incident in “Lambda MOO,” a text-based, simplified version of the

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98 Technically, the device could be redesigned to operate external to the virtual world environment, which would also extend these child protection issues pertaining to the device to live, paid porn websites.
100 Ashcroft v. Free Speech Coalition, 535 U.S. 234, 258 (2002) (declaring the initial language in 18 U.S.C.A. §2256(8)(B) defining one type of “child pornography” as a “computer generated image that is, or appears to be, that of a minor engaging in sexually explicit conduct” as unconstitutional under the First Amendment; “appears to be” was changed to “is indistinguishable from”).
modern virtual world, where a character named Mr. Bungle used a jamming device permitted within the world (this was not something he ‘hacked’ or programmed himself) to force other characters into performing many “crude and sexual acts.”

After enlisting support from the network of players, the enraged victims held an online community forum which eventually resulted in Mr. Bungle’s expulsion from the world by the LambdaMOO hosts.

This event divided the LambdaMOO community between users who felt that Mr. Bungle’s activities were not specifically forbidden and were therefore permissive, and part of the game, and those who felt that such intentional lack of civility warranted in-game punishment, and possibly warranted real world punishment under a philosophy of “virtual rape”. The victims were clearly distressed by the incident, as indicated through the anger and tears expressed by one victim. In spite of the eventual expulsion of Mr. Bungle, the LambdaMOO host initially did not want to police the social issues raised by the incident.

The LambdaMOO incident and the severe nature of the phrase “virtual rape” brings the social issues surrounding virtual sex and the balance of entertainment and real world consequences in game design, policy drafting, and policy enforcement to the forefront more than virtual adultery or prostitution. Nevertheless, the phrase virtual rape has been considered extreme, as one

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102 Although rape was never mentioned in the forced textual exchange, one forced action was the woman “sticking a steak knife up her a*s.” Jed Burgess, et. al., Controlling the Virtual World: Governance of On-Line Communities, http://cse.stanford.edu/class/cs201/projects-98-99/controlling-the-virtual-world/history/rape.html
103 Note although Mr. Bungle’s character was eliminated from the world, nothing prevented him from re-entering under a different name, which he promptly did. Id.
104Dibbell, supra note 101 at par. 16,17
105Burgess, supra note 102.
commentator believes that although an incident like LambdaMOO might be grounds for liability under laws such as the intentional infliction of emotional distress, or threatening communications, but without an element of physical contact, a virtual rape is not possible.106

Like the issues discussed under virtual adultery and prostitution, the development of an in-world controlled adult toy will complicate the issue of virtual rape beyond many earlier analyses. Rape may be defined as “sexual intercourse against a victim’s will by force, threat, or intimidation[,]”107 and generally requires “penetration . . . by the male sex organ”108 in the “absence of the victim’s consent.”109 This definition clearly falls outside the realm of the Lambda MOO incident, and also presents difficulty in construing a hypothetical where even with a controllable adult toy worn by a gamer in a 3-dimensional virtual setting, a violation could occur meeting this full definition of rape.

However, as was portrayed in the movie “Single White Female,” some jurisdictions contain a clause in their rape statute in which “fraud or impersonation” may override the element of “force.”110 Within these jurisdictions, a gamer who hacks into avatar A’s account and proceeds to have virtual sex with A’s in-world partner might come closer to a rape conviction. In a similar

106Susan Brenner & Rebecca Cochran, Online Article, available at http://www.cybercrimes.net/99MSCCC/MSCCC/Article3/3.04.1.html. Discussing the possibility of Lambda MOO supporting a case for intentional infliction of emotional harm or a threatening communication under 18 USCA 875(c). Although not a topic of this paper, this raises another interesting question on whether or not in-world communications directed at an individual might be sufficient to support an action such as these.
107AMJUR Rape Sec 1.
108AMJUR Rape Sec 2.
109AMJUR Rape Sec 3.
110AMJUR Rape Sec 9. In Single White Female, a psychotic, obsessive woman impersonated her roommate to the point of fooling her roommate’s husband into having sex with her, prior to murdering him with a stiletto heel through his eye socket. http://www.imdb.com/title/tt0105414/
hypothetical, while two avatars are enjoying consensual, virtual sex, a third party might ‘hack’ into their session without their knowledge and assume control of their device(s), meeting most elements of the statute. But to fully realize a conviction of virtual rape under these circumstances will require a broader definition of “male member” to include “sexual devices simulating a male member.” Therefore, even with the hypotheticals presented, a “virtual rape” may be difficult to find under the general rape statutes discussed. However, the physical violation presented by the hypotheticals arguably rise well above emotional distress, and may justify modification of existing laws or creation of future laws.

CONCLUSION

The explosion of growth seen in virtual world economies has shown no indication of cessation. Like the challenges faced during the introduction of any new technology, virtual worlds have developed their own set of unique legal intricacies, driven largely by the blurred overlapping boundaries they have created between game-like fantasy and real world economic opportunity and social utility. The interwoven issues portrayed in this paper are but a small slice of the escalating realities in the virtual world that will be presented to lawmakers, the courts, the virtual world hosts, and gamers in the present and immediate future.