

ISSUES FOR CORPORATES AND REGULATORS IN SECOND LIFE AND VIRTUAL WORLDS

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Introduction

The Federal Government has recently relaxed regulations governing the more mature media/information distribution platforms, however rapid advances in distribution technologies may require regulation by the Government. This regulation of media distribution may move into areas previously unknown to traditional media law such as taxation, money laundering, and the regulation of crimes such as sexual assault.

This paper considers:

- (a) the challenges to regulators of the dramatic rise in popularity of Virtual Worlds like *Second Life* as an alternative to traditional entertainment and information services like TV, radio and newspapers;
- (b) the risk issues for corporate entities when setting up presences in Virtual Worlds like *Second Life*; and
- (c) relevant caselaw from around the world involving Virtual Worlds.

Why should we be interested in Virtual Worlds?

When we speak of Virtual Worlds, it conjures up images of spotty youths playing computer games involving mythic creatures and duels with magic swords. However such easy dismissal of this phenomenon is unwise. Virtual Worlds or Massively Multiplayer Online Games are a multi-billion dollar industry and are the fastest growing sector of the entertainment economy.¹ Far from being “just a video game”, they represent the leading edge of the movement of the Internet from the standard 2-Dimensional web interface to a fully immersive 3-Dimensional web experience.

Take for example *Second Life*, a Virtual World much discussed in mainstream press of late. The average age of *Second Life*'s over seven million inhabitants is 32 years,² with 45% of the inhabitants being women.³

Over 50 universities have established presences (so called “Islands”) in *Second Life*, including Harvard, Duke, INSEAD, MIT and Vassar. These universities are running courses solely “in-world” for students all over the world.

¹ On Virtual Worlds: Copyright and Contract Law at the Dawn of the Virtual Age, Erez Reuveni, Indiana Law Journal Spring 2007, 82 Ind. L.J. 261.

² Media Tunes in Second Life, Hollywood Reporter, 13 February 2007.

³ Media Tunes in Second Life, Hollywood Reporter, 13 February 2007.

Most of the world's leading consumer brands have Islands, including ABN Amro, Accenture, Adidas, BMW, Calvin Klein, Coca-Cola, General Motors, H&R Block, ING, Kraft, Lacoste, Mazda, Mercedes-Benz, MTV, NBA, Nissan, PA Consulting, Philips, Samsung, Sears, Sony, Starwood Hotels, TMP Worldwide, Toyota, Vodafone, Wells Fargo Bank and Xerox.⁴ The prestigious news agency Reuters has even set up a news bureau in-world covering events in *Second Life*. In Australia, the ABC has an Island and Telstra has built 11 highly interactive Islands. Telstra are also supporting customers to explore *Second Life* by making bandwidth used by BigPond customers on *Second Life* not count towards that customer's data cap.

Islands in *Second Life* today are like websites were back in the late Nineties, corporates have Islands but they are, generally, viewed more as experiments with a new form of interaction with and between their brand, their people and their customers. For example, Coca-Cola has given *Second Life* residents permission to use the "Coke" trade mark in *Second Life* in an almost unrestricted manner.⁵

All the major technology companies have significant presences in *Second Life*. CISCO use its Islands to display its equipment and even sets up virtual prototypes. For example, CISCO recently set up a working prototype of a virtual hospital, where potential customers could move around and use CISCO's wireless communication within the virtual hospital environment.⁶ A technology company that is betting big on Virtual Worlds is IBM. IBM have committed to spending US\$100 million on its Virtual World developments over the next few years.⁷ One of IBM's main use of its 24 Islands in *Second Life* is to have virtual meetings of its people (on closed IBM-only Islands). IBM sees Virtual Worlds as a potential video conference replacement.

Governments too are getting involved, for example, there is a Swedish Embassy in *Second Life*. The politicians, eager for any edge, are also engaged, with the likes of Barack Obama and Hilary Clinton both having Islands.

One of the major reasons for the success of *Second Life* is that the Participant (which for the purposes of this paper includes individuals using the Virtual World and corporates with businesses/presences set up in Virtual Worlds) earns currency in-world (so called "Lindens") and can exchange these Lindens for US dollars. The GDP (i.e. the amount of money that changed hands between Participants) for *Second Life* in 2006 was US\$220 million and is estimated to rise to US\$700 million in 2007.⁸

Second Life is not a quest/contest game, i.e. there is no specific goal in *Second Life*. It is just an environment where people can go to meet each other and/or create things. In relation to quest-based Virtual Worlds, it is worth noting that one of the most popular, *World of Warcraft*, has over 8 million subscribers (more than the populations of New Zealand and Ireland together), each paying a monthly subscription fee to participate.

What is a Virtual World?

Wikipedia defines a Virtual World as:

"A computer-based simulated environment intended for its users to inhabit and interact via avatars. This habitation usually is represented in the form of two or three-

⁴ Second Life Business Communicators Wiki, 28 June 2007.

⁵ *Coca-Cola Gives Away its Trade Mark in SL*, Reuters SL News Centre, 28 June 2007.

⁶ *Global Trends: Virtual B2B*, Brand Strategy, 16 April 2007.

⁷ CnetNews.Com, 13 November 2006.

⁸ *Deloitte Media Predictions TMT Trends 2007*.

dimensional graphical representations of humanoids (or other graphical or text-based avatars).

The world being computer-simulated typically appears similar to the real world, with real world rules such as gravity, topography, locomotion, real-time actions, and communication. Communication has, until recently, been in the form of text, but now real-time voice communication using VOIP is available. This type of virtual world is now most common in massively multiplayer online games (Active Worlds, Second Life, Entropia Universe, The Sims Online, There, Red Light Center, Kaneva, Weblo), particularly massively multiplayer online role-playing games such as EverQuest, Ultima Online, Lineage, World of Warcraft, or Guild Wars.”

Second Life, one of the most well-known of the Virtual Worlds, was developed by Linden Labs in California and is served from Linden Labs’ servers located in the USA. A Participant is able to move an avatar (of their own design) through the world, creating things, buying things (with their Lindens) or trading things and generally interacting with other avatars. In this regard *Second Life* sees itself as a natural extension of popular 2-Dimensional social networking websites such as MySpace.

Linden Labs’ goal for *Second Life* is “to create a user-defined world of general use in which people can interact, play, do business and otherwise communicate”.

While there are other Virtual Worlds, the critical factors of *Second Life* that distinguish it from other Virtual Worlds are:

- a) Participants own the creations that they make in-world; and
- b) Participants can exchange their Lindens for US dollars at the Linden Labs-operated currency exchange. The exchange rate moves but hovers around the 270 Lindens to US\$1 mark.

Whether *Second Life* is the future of the 3D web or whether another platform will become dominant is the subject of conjecture. The competition between Virtual World platforms has been likened to the “Browser Wars” with respect to the 2D web between Netscape Navigator and Internet Explorer in the late Nineties.

What are the regulatory implications?

Sexual assault and pornography

Police in Britain, Belgium and Holland are considering whether users of *Second Life* are committing a crime if their avatar sexually assaults or stalks another avatar.⁹

While that may seem a highly unusual suggestion, it needs to be borne in mind that the Participants in these Virtual Worlds spend so much time with these characters that they become emotionally connected to them and an assault on their avatar has a traumatic effect (in the Participant’s mind) similar to the effect that would occur if the assault occurred in real life.

In Australia, the criminal laws related to sexual assault would not extend to virtual sexual assault and it is likely that law enforcement would have to rely on the provisions of the

⁹ www.timesonline.com, 13 May 2007.

relevant criminal statutes related to use of a carriage service to menace or harass¹⁰ or stalking via electronic communications.¹¹

Further, police in Germany are investigating the practice of “Ageplay” in *Second Life*.¹² Ageplay is where one Participant takes on the avatar of a child and engages in sexual acts with an adult avatar. Virtual depiction of sex with a minor is dealt with differently around the world. In Germany and Australia, such depictions would likely be considered unlawful publication of child pornography.¹³ While in the USA, such depictions may not be unlawful.

It is also possible for Virtual Worlds to be used for the sale of age-restricted goods and services to minors. This area has received a lot of regulatory attention in relation to mobile phone and Internet content and the potential issues in Virtual Worlds will need to be considered.

Money laundering

Virtual Worlds are especially popular and advanced in South Korea. In fact more South Koreans participate in Virtual Worlds than watch television.¹⁴ However, because of the ease of creating false identities, Virtual Worlds have been used to launder money in South Korea.¹⁵ More dramatic commentators have suggested that Virtual Worlds could be the 21st century’s equivalent to hiding funds offshore.

The United Kingdom’s independent watchdog, the Fraud Advisory Panel, has released a report of its study into financial services regulation and Virtual Worlds and it has recommended that the UK Government must act to ensure that funds exchanged in Virtual Worlds “count as genuine financial instruments covered by existing laws and regulations”.¹⁶

Tax

Even in the Virtual World, the taxman is a certainty. Generally speaking, tax authorities are able to tax earnings made in Virtual Worlds when these earnings are taken out of the world. However, what is less clear is whether income and capital gains can be taxed if they do not leave the Virtual World. This topic is the subject of a report due soon from the Joint Economic Committee of the US Congress.¹⁷

The Australian Tax Office has cautioned Australian corporates involved in *Second Life* to be aware of the GST implications of their in-world activities.¹⁸

Gambling

Australia has strict restrictions on online gambling. Arguably the types of gambling opportunities which can be found in Virtual Worlds breach these laws (though it should be noted that *Second Life* has recently forbidden gambling). The major issue is how to effectively police these transgressions. Does Australia have the ability to enforce criminal sanctions

¹⁰ s.474.17 Commonwealth Criminal Code Act.

¹¹ s.21A Crimes Act (Vic), s.359B Criminal Code Act (QLD), s.35 Crimes Act (ACT), s.189 Criminal Code (NT), sections s.45AB and 562D Crimes Act (NSW), s.338D Criminal Code (WA).

¹² Brave New World on Virtual Pedophile Paradise, The Age, 10 May 2007.

¹³ s.67A Crimes Act (Vic), s.91H(1) Crimes Act (NSW).

¹⁴ *Virtual Property*, Joshua A.T. Fairfield, Boston University Law Review, October 2005 85 B.U.L. Rev.

¹⁵ *Identity Theft in a Virtual World*, Cnet News.Com 7 July 2006.

¹⁶ www.fraudadvisorypanel.org.

¹⁷ Financial Times, 29 May 2007 and www.house.gov/jec.

¹⁸ *Virtual World: Tax Man Cometh*, Sydney Morning Herald, 31 October 2006.

against residents of foreign countries? The answer is likely to be yes given that the Internet has, in effect, created a global jurisdiction where an individual could face criminal proceedings in another country regardless of the fact that he/she did not ever set foot in that other country.

A case in point is the recent sentencing of Australian, Hew Griffiths, to 51 months jail in the USA.¹⁹ Griffiths never went to the USA, but rather ran an Internet site from his home on the NSW central coast. This site contained material and information that enabled users to circumvent the copy protection protocols on commercial software. Because there was mutual criminality (i.e. circumventing copy protection is a crime in the US and in Australia), the Australian Government ultimately allowed Griffiths to be extradited to the USA.

Promotions and lotteries

Many corporates are running promotions or competitions in *Second Life*. For example Lacoste held a promotion with a prize in Lindens for the best design of a virtual Lacoste shirt. Australia has a patchwork of state-based legislation governing promotions, competitions and lotteries. It is likely that such promotions/ competitions, where accessible to Australian residents, technically need to comply with Australia's promotions, competitions and lotteries legislation.

Market manipulation

Virtual Worlds are economies and with *Second Life* having a GDP of US\$700 million, quite significant ones at that. Like all economies there are capital inflows and outflows and Participants investing in these Virtual Worlds need to have transparency and certainty about the way these economies are run. In the real world, there are layers of financial regulation which ensure the markets operate in an appropriate manner and minimise market manipulation. In Virtual Worlds, there are stock markets, complex financial transactions and multi-layered derivative structures. Therefore, it is possible to manipulate these markets and cause financial damage to the other Participants and, indeed, crash the economy. The Virtual World, *EVE Online* has complex financial structures and has been hit by several frauds on the markets which has had significant impact on Participants.²⁰

What are the issues for corporates setting up a presence in a Virtual World?

There are significant risks, legal and otherwise, for corporates when they create their Virtual World presences or sites (**VW Sites**). These corporates (**VW Site Operators**) should be aware that, while there are many similarities between operating a standard 2D website and a VW Site, the risks and costs of operating a VW Site are greater.

Location releases

Corporates need to be careful to ensure they have relevant location releases for buildings and locations depicted in their VW Sites. It is settled law that a film of a building is not a breach of the copyright in the building.²¹ However recently arguments have been put forward that this exception may not apply to renderings of buildings in VW Sites.²² For example, it was

¹⁹ US District Court 1:03-cr-00105-CMH.

²⁰ *Biggest Scam in EVE Online History*, www.mmorpg.qj.net,

²¹ s.66 *Copyright Act*.

²² *Telstra Hit Over Virtual Uluru*, The Australian, 24 May 2007.

suggested in a recent newspaper article that the depiction of the Sydney Opera House on Telstra's Island in *Second Life* may have been a breach of copyright in the building. If a drawing of a building does not breach the copyright in a building, then arguably a graphic depiction of a building should also not breach copyright, however this is yet to be judicially considered.

Another potential claim which may be available to iconic structures like the Sydney Opera House is to allege that the use of images of the structure on a VW Site could be regarded as an endorsement by the relevant structure and constitute passing off. This is likely to be a very difficult argument to make out, however care should be exercised by VW Site owners in the choice of structure as the adverse PR from a claim (even if unfounded) can be damaging. For example, Telstra also came in for adverse publicity as a result of the depiction of Uluru on one of the Telstra Islands. The use of this icon raises some very sensitive issues as Uluru does have its own specific legislation which prohibits members of the public gaining access to, flying over or seeing certain sacred areas on and around Uluru. It was suggested that representatives of Uluru's traditional owners, the Anangu people, were concerned that it may be possible for Participants to view these sacred sites on the depiction of Uluru in *Second Life*. After review, this apparently is not the case. So while this issue and the Sydney Opera House issue appear to have been completely unfounded, these claims did create several days of difficult PR for Telstra.

EULAw

Every Virtual World is governed by an end user licence agreement (**EULA**) which sets out the terms upon which a Participant may use the Virtual World. If corporates are investing significantly in their VW Sites then that investment is completely subject to the terms of the EULA. These terms set out the rights and obligations of the Participants and are, generally, drafted very much in favour of the owner of the Virtual World (**VW Owner**). Similar to the way software companies are able to impose their EULAs on users without any opportunity for negotiation, a VW Site Operator trying to set up a VW Site is unlikely to have an opportunity to separately negotiate the EULA terms which apply to it. Therefore VW Site Operators need to understand the risks inherent in the EULAw construct.

These EULAs, generally in a "click-wrap" format (which of itself discourages review by Participants), create a system of private laws (so called "EULAw"²³) which often are at odds with the legal system in the physical world. Potentially this means that the 3-D Internet risks becoming ghetto-ized into "walled" Internet communities governed by private laws.

Some of the significant issues arising from EULAw are:

- A. Power of licensor: The EULA gives the VW Owner supreme power, including the ability to remove a Participant (including a VW Site Operator) and confiscate all their property.
- B. Jurisdiction: EULAs are often governed by US law (mostly Californian law because many of the game owners are resident in California) and require that any dispute go to arbitration in the US.
- C. Changes are binding: EULAs will generally allow the VW Owner to change the EULA at any time and such change becomes effectively immediately.

²³ EULAw: The Complex Web of Corporate Rules Making in Virtual Worlds, Andrew Jankowich, 8 TUL. J. TECH & INTELL. PROP. 1.

- D. Complexity of documentation: The EULA is often made up of a complex series of inter-related documents which the Participant will need to comply with. For example, in *EVE Online* the Participant must agree to be bound by the following documents: 1) End User Licence Agreement; 2) Terms of Service; 3) Forum Rules; 4) Chat Rules; 5) Subscription Fees and Payment Options; 6) Website Terms of Use Agreement; 7) Online User and Character Name Policy; 8) Online Reimbursement Policy; and 9) the Suspension and Bar Policy.²⁴

This complexity increases the likelihood of a Participant breaching the EULA.

- E. Virtual Property Ownership: *Second Life* is distinct from other Virtual Worlds because Participants own the IP which they create in-world. However a question is raised over what rights a Participant gets over the IP it creates in a Virtual World where the EULA expressly states that IP created by the Participant is owned by the VW Owner. For example *World of Warcraft* has a provision in its EULA that expressly prohibits the sale outside the world of any property created in-world. *World of Warcraft* players were ignoring this prohibition and selling virtual property created in-world on various internet auction sites. These sales generated millions of dollars for the Participant-sellers and created a business of “game gold” farms in lower wage countries. However such is the potential impact of this provision that eBay has now suspended the selling of any *World of Warcraft*-related virtual property on eBay.²⁵

Whether the prohibition is enforceable is a subject of conjecture though it is worth noting that the South Korean Government has specifically legislated to ensure Participants get some rights in the virtual property they create.²⁶

Publication liability

It is possible that corporates who develop their own VW Sites will be liable for the actions of Participants. For example, the VW Site Operator may face liability under defamation laws for defamatory comments made by a Participant-invitee (i.e. a Participant who comes to the VW Site Operator’s VW Site). Liability for the publication of child pornography is also possible where activities such as Ageplay occurs on the corporate’s VW Site or indeed IP infringement liability is possible where a Participant-invitee misuses a trade mark or uploads third party content to a corporate’s VW Site.

The risk is made greater by the fact that corporates want Participants to come to their VW Sites and the main way to attract Participants is to give the Participants the tools on the VW Site to create things (be it blogs, photos, music, or even 3D objects). It is that same user generated content that can then cause the problems for the VW Site Operator outlined above. This is, however, familiar territory, as the liability of a publisher in relation to chat rooms, etc on 2D websites has been clearly recognised. However, it is significantly more difficult to monitor the activities of avatars across a whole VW Site than it is to moderate a chat room.

The risk to VW Site Operators in relation to the activities of Participant-invitees is not limited to legal risk, there is also a significant risk of brand/reputational damage arising from poor behaviour occurring on a VW Site.

²⁴ EULAw: The Complex Web of Corporate Rules Making in Virtual Worlds, Andrew Jankowich, 8 TUL. J. TECH & INTELL. PROP. 1.

²⁵ Video Gaming Auction Banned, SSB World News Headline Stories, 31 January 2007.

²⁶ Game Industry Promotion Act 2007.

Disputes

Corporates should be aware of the most expeditious way to resolve disputes in relation to activities on the VW Site. Participant-invitees will lodge complaints with VW Site Operators in relation to the actions of other avatars which impacted on them while they were on the VW Site, for example, allegations of lewd conduct or inappropriate language. Corporates and their advisers need to know the most efficient method of resolving these disputes, which may often require expediting a request for action from the VW Owner. Corporates should ensure they have a clear policy (including escalation points) for such disputes.

Griefing

Griefing is where Participants intentionally cause trouble in a Virtual World. Forms of griefing include graffiti, placement of competitors' trade marks and marketing materials on a corporate's VW Site and sex-related harassment or assault.

A corporate with a VW Site needs to continually monitor the Site to ensure griefing does not occur or is remedied quickly if it does occur. However this is a significant ongoing cost.

Adverse publicity

As can be seen from the above risks, there is significant potential for brand damage in Virtual Worlds. Therefore, VW Site Operators require clear guidelines, dispute resolution frameworks and PR response procedures.

Caselaw

Bragg v Linden Labs²⁷

Marc Bragg, a *Second Life* Resident (and lawyer in the physical world) had worked out a way of acquiring land in *Second Life* at an undervalue. Linden Labs claimed Bragg's method of purchasing land broke the terms of the EULA. As a result Linden Labs terminated Bragg's account and confiscated all of his virtual property. Bragg has sued Linden Labs in the District Court in Pennsylvania claiming Linden Labs breached Pennsylvania's Unfair Trade Practices and Consumer Laws by unfairly terminating his account. Linden Labs tried to strike the matter out by relying on its EULA which requires any Resident to arbitrate any dispute with Linden Labs. On 30 May 2007, Judge Eduardo Ralerene refused to enforce the arbitration provision, ruling that Linden Labs' EULA constituted a "contract of adhesion". The suit continues.

Blacksnow Interactive case²⁸

The owner of *Dark Age of Camelot* was sued by Blacksnow Interactive, which was seeking a declaration that the EULA provisions prohibiting the sale of in-world property outside of the world did not infringe the VW Owner's copyright. The case was dismissed on procedural grounds.

²⁷ US District Court No. 06-4925.

²⁸ 02-00112 (C.D. Calif.)

Li Hongchen v Beijing Arctic Ice Technology Development Co²⁹

A Participant in the Mongyue (“Red Moon”) Virtual World, Li Hongshen, brought an action in the Beijing Second Intermediate Court (famous for its intellectual property decisions),³⁰ alleging that the developer of Mongyue had been negligent in protecting Li’s virtual property as Li’s in-world property had been stolen by hackers who had accessed the developer’s database. The Chinese court recognised Li’s rights in the virtual property and upheld the case, awarding Li, the amount he had spent on subscription fees.

Marvel Enterprises, Inc. v NCSOFT³¹

City of Heroes is a virtual world where Participants can create their own superheroes and fight crime. Marvel brought an action against the owner of *City of Heroes*, NCSOFT, alleging that *City of Heroes* infringed Marvel’s copyrights as it allowed Participants to make avatars that closely resembled Marvel’s own superheroes. The parties eventually settled.

Chaoyang District case³²

In December 2003, a court in Chaoyang District of Beijing recognised a plaintiff’s rights in virtual equipment and ordered the equipment be “returned” and 1560 yuan (US\$188) in compensation be paid.

Qiu Chengwei case³³

This case gives prominence to the potential consequences if the law does not recognise virtual property. In 2005, Qiu Chengwei contacted the Chinese authorities to complain that another player in *Legend of Mir III* had refused to return an enchanted sword (valued at \$870) lent to him by Qiu in-world. When the authorities failed to act, Qiu murdered the other player (in real life).

Conclusion

This paper has sought to address the real legal issues that are arising for regulators and corporates. It does not deal with the legal issues between the Participants themselves. This has been the subject of much research³⁴ and is too complex to deal with here. However, there appears to be an analogy between Virtual Worlds and professional sports in this regard. Players in professional sports have to comply with a given set of rules and face liability (both tortious and criminal) if they act significantly beyond those rules. The same may be said to apply to Participants in Virtual Worlds.

Virtual Worlds are a growing phenomenon and create many challenges for our regulatory structure as the platforms for entertainment / information dissemination become much more immersive and concepts of media law must expand to provide certainty and law and order. The 3D Web is a certainty and corporates are using Virtual Worlds like *Second Life* as a way

²⁹ cnn.com, 20 December 2003.

³⁰ Virtual Property, Joshua A.T. Fairfield, Boston University Law Review, October 2005 85 B.U.L. Rev.

³¹ Marvel Enterprises Inc. v NCSOFT Corp. No. 04 CV 9253 RGK (PLAx).

³² *Video Game: Real Murder*, China Economic Review, 26 October 2006.

³³ Finding a Place for Virtual World Property Rights, 2006 MICH. ST. L. REV. 779.

³⁴ A Practical Look at Virtual Property, Summer 2006, Allen Chein, St John’s Law Review, 80 St John’s L. Rev. 1059. Law and Liberty in Virtual Worlds, Jack Balkin, New York Law School Law Review 2004/2005, 49 N.Y.L. Sch. L. Rev. 63.

of learning about the opportunities and risks associated with this new marketing and transactional environment.

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