

Show me the money

Social Games, Virtual Currency and Gambling

by Marcos Charif

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The rise of social networks and a multi-billion dollar virtual currency market have placed social gaming sites on centre stage. Through games like Farmville and World of Warcraft, non-gamers have become gamers. These new virtual worlds create virtual realities where players can fight battles, buy virtual real estate, or even play poker. Many of these virtual worlds have a dedicated player following and continue to grow in popularity and... in profit! However this success story is inadvertently generating much unwanted attention the legal uncertainties of a sector that has managed, until now, to stay away from the gambling regulatory straitjacket.

Social gaming sites continue to emphasise the “social” element of entertainment and player interaction, as opposed to the monetary benefit that players expect when joining a gambling site. The distinction nevertheless becomes somewhat blurred when money is involved. Until now, social gaming sites felt safe from gambling regulations, as long as players pay in real money, but don’t get real money out.

Although the fine dividing line between social gaming and gambling ensured that social gaming sites remained below the radar of gambling regulators, the successful application of this legal divide may in itself trigger its downfall. To clarify: the more that social gaming sites exploit the grey area that separates gambling from non-gambling, the more likely it is that gambling regulators will become more interested in social gaming sites. Whether social gaming sites are, in fact, newly packaged gambling sites with a social element attached to them, will not only depend on the actual games, but also on the potential of winning a prize.

What is Gambling?

In a way, social gaming exists outside the sphere of gambling because it does not combine all components required to be classified as gambling. Generally speaking, most jurisdictions define and restrict gambling as a combination of consideration, chance and prize. The UK Gambling Act 2005 (the Act), for example, defines gaming as “playing a game of chance for a prize”. The following components must therefore be present to fall within the Act:

- (a) The game must contain an element of chance: a game of chance is any game in which chance plays any part, however small. Even if a game, such as poker, requires considerable skill, the random dealing of the cards introduces an inevitable element of chance that makes it “a game of chance”; and
- (b) There is the chance of winning a prize: games of chance are only covered by the Act if they are played for prizes of “money or money’s worth”. According to the UK Gambling Commission, “money’s worth” relates to the realistic value of the prize offered and can include emoluments, vouchers, goods or other items that have value. Put simply: money or money’s worth can be anything that has a monetary value in the real world.

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Both these components must be present in a game to be classified as gambling. However, social gaming sites argue that only one, if any, of these components is present, therefore making them free to enter any market they wish, without the regulatory and compliance risks associated with gambling sites.

Some social games could, for example, offer real money prizes, as long as their games are purely skill based, which isn't always easy to establish. It may be easier to determine when it comes to a live singing competition, but the "pure skill" justification becomes somewhat more complex when considering virtual worlds, where players are dependent upon technology that contains an in-built element of randomness and "chance".

Of course many social gaming sites already offer clearly defined games of chance, such as poker and casino games. These sites must work around the second component by avoiding any prize that is reducible to a monetary value. So far so good; legal experts and regulators alike are likely not to be too concerned about this. But what happens when social gaming sites provide games of chance and offer prizes in virtual (as opposed to real) currency?

Virtual currency and money's worth

Virtual currency can take many shapes and forms, ranging from virtual tokens to virtual real estate - with the emphasis being clearly placed on "virtual". In other words; the currency is not worth anything in the real world, so is not "money or money's worth", has no tangible value, and is simply a virtual creation with no connection to the real world... Or is it? If virtual currency does have a monetary value in the real world, then, if any chance element also exists in the game, gambling regulators and HMRC will be waiting around the corner with a genuine (non-virtual) smile.

In a way, virtual currency has blurred the line between pure entertainment and entertainment for profit and is frequently used to purchase virtual goods from a gaming site or a social network. The rising popularity of virtual currency has led to a thriving black market economy for rare items and in-game currency, because some players prefer to pay real money for virtual goods rather than earn them the hard way through actually playing on the site – playing a game is supposedly the main characteristic of "social gaming" as opposed to gambling. So, if social gaming sites actually allow, or even encourage, the purchase of virtual goods and virtual currency through real money, where is the gaming element in all that? And how much of the fragile dividing line into gambling territory is left?

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Broadly speaking, there are two main categories where virtual currency is flourishing: first, the increasing use of virtual currency in social networking sites, such as Facebook; and, secondly, virtual currencies offered by social gaming sites. This is how it works:

- **Social Networks:** With Facebook introducing its own Facebook credits, a virtual currency is “virtually” being thrown at us, whether we like it or not. In a way, Facebook will act as a currency exchange, with most of its commercial Facebook advertisers accepting Facebook credits as methods of payment. In addition, PayPal and Facebook have struck a deal to allow people to buy Facebook credits with cash in their PayPal accounts. When looking into the crystal bowl to determine the future, one cannot help but think of similar developments in China, where in 2002 Tencent instant messaging software offered its own QCoin virtual currency for use on its own websites. However, the demand for this virtual currency quickly spiralled out of control and catapulted the virtual currency into trading forums for real money. In light of that that example (and the multitude of possibilities open to this new currency), the conversion of Facebook credits into “money or money’s worth” would not appear to be too remote a possibility. But where is the gambling chance element in that? The answer may be that the gambling element comes into play if Facebook credits are not only accepted as a method of payment by gaming sites, but are also offered by gaming sites as potential prizes in the form of virtual currency – the golden rules of “pay in but don’t pay out”. At present, it appears that Facebook credits will only be used to join gaming sites, but not to be paid out as winnings.
- **Social gaming sites:** social gaming sites are especially careful to ensure that their products continue to be seen as firmly distinct from “real” gambling. Social gaming has evolved from granting virtual currency for game play to allowing players to purchase virtual currency. Virtual currency purchases are used to gain access to different levels of games and to purchase virtual goods. Especially Massively Multi-Player Online Roleplay Games (MMORPG) have been a particularly remarkable success story. The largest and best-known virtual world is “Second Life” which was created by Linden Research Inc. Interestingly, the users create most of the content, and the impetus for many users to participate is Second’s Life thriving virtual market economy with its own virtual currency: the Linden Dollars. It did not take long for users to offer gambling products in this virtual world, opening their own casino halls and poker rooms, all paid for in virtual currency and all winnings paid out in virtual currency of course. This “second life” was soon investigated by the FBI for providing gambling to US residents illegally and Linden Research shut all gambling rooms and brothels (yes, there were even virtual brothels!) overnight.

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What these examples have in common is that their virtual currency could potentially be exchanged publicly in other forums for “money or money’s worth”. This, in turn, may trigger the application of gambling regulations. This is why most social gaming sites explicitly prohibit the exchange of their in-game virtual currencies outside their virtual realities. As long as these virtual worlds remain closed communities, the imaginary virtual currency has no monetary value – or so it is thought.

Pay in but don’t pay out

So, let us recap the argument that establishes the fine dividing line between social gaming and gambling: first, no real money is paid out to players, second, anything paid out to players cannot have a monetary value and therefore should not be exchanged, traded or otherwise offered for money or money’s worth.

Having said that, this development essentially means that social gaming sites cannot outgrow their own virtual worlds and venture into other virtual worlds, with virtual currency being freely exchanged at monetary value like social networks can do. In fact, Facebook recently announced prohibiting all gambling related advertising in its realm (save for social gaming that is). This move should be seen in light of the recent introduction of its own currency, which, if “tainted” by gambling, will die in its infancy. The current rules of the game therefore appear to be that “closed social gaming sites” as opposed to “open sites” like Second Life, can offer games of chance for prizes in virtual currency, as long as this currency cannot be exchanged outside its own limited enclave. In a way, they are creating their own insulated silos, forced to close all open exchange of their currency.

Interestingly, US based social gaming giant Zynga recently applied for a patent for the use of cash-purchased virtual playing chips in its virtual poker rooms. The underlying idea for this patent application is that Zynga does not allow cash to be paid out to its customers. Although the application is likely to be rejected because its use is wide spread and not unusual, this move should be seen as a strategic pre-emptive strike aimed at setting the scene and distancing itself from the future opening of the US online gambling market.

It may be instructive in this context to consider a real life example, with real tangible elements: for example a Monopoly board game. Imagine paying real money to receive the colourful monopoly currency to start the game. Does this add any value to the Monopoly money or make it “money or money’s worth”? Probably not: the player would simply agree to pay money in order to play and use the paper money for fun. But what would happen if a third person wished to join the game and the original play could sell his worthless monopoly money for real cash? This is where otherwise worthless paper money become money or money’s worth and start having a real monetary value; and this is precisely the stage where the risk of gambling arises. Is it enough to avoid that risk if the Monopoly bank were to

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prohibit the sale of the original player's Monopoly money? Would that "devalue" what this paper money is actually worth? Arguably not: the value is there and remains the same, with or without permission to sell it, and whether or not the Monopoly bank's proscription against sale is disregarded and a sale goes ahead. The illegality of selling doesn't influence the actual value of the Monopoly money; it simply makes it illegal for a player to sell. But what is virtual currency as a result of this analysis? Show me the money!

For social gaming sites however the use of virtual currency is legal and based on contractual obligations governed by the terms and conditions which users have to agree to before starting a game. This makes sense, considering that the virtual currency should stay within the control of the social gaming site, and should only be used according to the rules governing the website and laid down in contract between user and operator. It is also expected to see clear language explicitly disclaiming any ownership or interest of players in the site's virtual currency. In addition, the terms and conditions will include standard arbitration provisions in case of dispute, barring the player from starting legal proceedings against the gaming site, until the internal arbitration process is finalised. However, aside from the fact that these terms have already been challenged and disapplied in US courts, social gaming sites are now prepared to defend their virtual currency in UK courts as well.

The recent first virtual currency crime in the UK, although not really news for Asia, is, in a way, ground breaking, if not "law breaking" for the UK. A hacker was found guilty and faced a substantial prison sentence after stealing Zynga's poker chips/ virtual currency. The hacker managed to sell part of these virtual chips on the black market for approx. £50,000. However, more interestingly Zynga values these poker chips at \$12 million! What is ground breaking about this case, is not only that it is the first virtual currency case in the UK, but also that it is the first time that social gaming sites have placed a monetary value on their worthless currency! How come? Needless to say, the prosecution somehow struggled with the idea that virtual currency does not constitute a transaction for value, and the \$12 million are therefore allocated to the "Pay in" value and not the "pay out" side of the transaction. This fine legal argument is becoming more and more interesting, considering that not only players on the black market attribute value to it, but also the creators of the virtual currency. The court in effect confirmed that virtual currency deserves legal protection— money or money's worth? Are we there yet?

And finally...

In a way, this first UK virtual currency case brings the gambling regulatory focus back to social gaming. Until now, social gaming sites have viewed virtual currency as a purely contractual matter, which is ultimately governed by the sites' restrictions, imposed in their terms and conditions, prohibiting the exchange of currency for money or money's worth and requiring the player to approve various disclaimers from the outset.

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However, once these virtual currencies are stolen, social gaming operators have to concede that there is some monetary value attached to virtual currency - for both social gaming sites and interested buyers. Even if virtual currency is used in a way that is not permitted by the terms and conditions, it does not alter the fact that some value is apparently attributed to "virtual" currency. While regulation of the virtual world is still a long way off, the recent case does show that there is a gambling case to answer, and the law will have to deal with this issue sooner or later.

The rule of "pay in – don't pay out" remains the main distinction between social gaming and real gambling. However, what is changing is the way in which virtual currency is used. Take, for example, the following scenario:

- a social gaming site has its own virtual currency, which can be purchased for real money. Ten virtual currency dollars are bought for £10;
- the site has various games on offer, including a casino game where virtual currency and even a virtual currency jackpot can be won. It also has an entire virtual world game, where additional improvements and virtual goods can be bought using virtual currency;
- a game of chance is played in the casino room, winning the virtual currency jackpot. The currency cannot be changed or used in the real world, but it can be used to buy virtual goods for a virtual castle in a virtual world game:
- these virtual goods can, however, also be purchased using money or money's worth. They have a set value of 5 virtual currency dollars for a new roof, which equates to £5 of real money.
- Bearing in mind that the recent UK case resulted in awarding protection to virtual goods, which means they are in existence somehow somewhere, the next step is allocating a value to them.

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Virtual currency = money or money's worth? Even if social gaming sites offering games of chance do not provide a way to pay out, there appears to be a market place, or some value associated with this virtual currency. This fact alone may not be good enough anymore to keep social games of chance out of gambling. It is not always down to legal interpretation, but gambling regulators also have a degree of discretion to evaluate whether the overall "game" is actually social gambling and should therefore fall under its jurisdiction. The more profit is generated, the more cases on this issue are publicly reported, the more emphasis is placed on an increasingly blurred dividing line, - the more likely it is that gambling regulations will kick in. Let the gam(bl)e begin!

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