



Virtual Currencies: Real Legal Issues for Retailers

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"Points," "coins," "bucks" and other forms of virtual currency are becoming standard offerings for online game sites, social media sites, retailers and other businesses. Virtual currency systems generate revenue, provide low cost alternatives to credit cards for micropayments, offer prepaid solutions appealing to youth and other users without credit cards, and help companies build attractive loyalty programs.

Although virtual currency systems are often used to sell digital content, they continue to become more complex – approximating real world currency as they allow purchase of physical goods and services from multiple merchants, offer cash redemption options, and facilitate P2P payments.

Even though the currency may be virtual, these systems pose real legal issues – both for "issuers" of the virtual currency and potentially for other network service providers and partners. Issuing virtual currency could subject an issuer to various state and federal regulatory regimes with wide ranging operational, financial and liability implications. These implications include restrictions on an issuer's ability to expire the virtual currency or impose inactivity fees, requirements to give cash back for unused virtual currency, obligations to remit unused virtual currency balances to states, potential regulation as a financial institution, and privacy and data security issues.

Retailers – especially online retailers – collide with virtual currency in many ways. Retailers' loyalty programs often offer virtual currency and other purchasing power, retailers increasingly allow consumers to purchase electronic equivalents of prepaid gift cards and store the value in online accounts or wallets, and more and more retailers distribute and activate third party virtual currency through "gift card malls" and other distribution arrangements. Retailers are also joining various "open loop" loyalty programs, where, for instance, their consumers receive third party virtual currency for making online purchases from e-commerce retailers that are part of a network of participating retailers.

As retailers deal with increasingly complex virtual currency systems and attempt to allocate responsibility between various players in the system, they should keep several key legal considerations in mind.

First, although virtual currency may seem different from paper gift certificates and plastic gift cards, virtual currency sold on a prepaid basis for later use or redemption by a user may be subject to state and federal gift certificate laws, including gift card provisions of the Credit Card Accountability Responsibility and Disclosure Act of 2009. Broadly speaking, state and federal gift certificate laws apply when "consideration" is paid for a "record" that reflects a promise to provide goods or services of a certain value to the bearer of the record. State and federal definitions vary, but can apply to virtual currency digital "records" and account balances.

Gift certificate laws could restrict an issuer's ability to expire virtual currency, impose inactivity or service fees on virtual currency accounts, require conspicuous disclosure of key terms, and require an issuer to provide cash refunds of unused virtual currency. Certain exemptions apply, however, for "gift certificates" or loyalty points provided on a promotional basis without payment of money or other consideration from users.

To comply with gift certificate laws, a retailer can build a virtual currency system that takes into account applicable restrictions on expiration and fees, and establishes consumer disclosures describing key terms. If a retailer is participating in a third party virtual currency program, it should make sure it is clear to consumers and others involved that the retailer is not the issuer of the virtual currency. If a retailer will

sell virtual currency and give it away for loyalty purposes, it should build into its system the ability to differentiate between virtual currency that can be expired and virtual currency subject to restrictions on expiration.

Second, state unclaimed property laws, as they apply to virtual currency breakage, should also be taken into account. "Breakage" refers to revenue from virtual currency that was purchased but never redeemed for virtual goods or other products and services.

If virtual currency breakage is deemed to be "property" under state unclaimed property laws, the issuer could have an obligation to pay the value of unused or "unclaimed" virtual currency to one or more states after an applicable "dormancy period" (often 3-5 years). The state or states to which the issuer might have to remit the breakage is determined according to established jurisdictional rules that take into account the location of the owner of the property (i.e., the user) and the state of incorporation of the company holding the breakage.

Unclaimed property compliance in the virtual currency context is more complicated than programs involving paper gift certificates and plastic gift cards because virtual currency issuers often maintain online user accounts with information about the identity and location of the user, whereas paper gift certificates and plastic gift certificates are often anonymous. Nevertheless, online systems with social networking features may, depending how they are structured, provide unique benefits unavailable in paper or plastic programs for providing full value of virtual currency to users or members of their social network – essentially minimizing the likelihood that users' "property" will become "abandoned" or "unclaimed."

To ensure compliance with unclaimed property laws, retailers need to understand who has responsibility for unclaimed property issues. A retailer should scope the unclaimed property implications for its proposed virtual currency system early so there are no surprises several years later when dormancy periods have run. Relevant financial and tax advisers should be involved in the discussion.

A third consideration for retailers using virtual currency systems relates to financial services laws. As virtual currency shifts from being a prepayment for goods or services redeemable with one company to a widely-accepted proxy for real currency or a means of transmitting money between various participants, issuers need to consider state and federal services laws such as money transmitter laws and money service business laws. Financial services laws involve significant compliance obligations, costly and time-consuming licensing requirements, and civil and criminal penalties for non-compliance.

Unless retailers fully understand the implications of broadening the system and are prepared to comply with complex financial services laws, it is best to limit the scope of the virtual currency system to resemble a "closed loop" gift card redeemable for goods or services of one company,

Privacy and security issues are a final consideration for retailers. Simple virtual currency programs raise the same privacy and security issues that arise in any e-commerce context, such as compliance with the Payment Card Industry Data Security Standard, because consumers must provide their payment information when purchasing virtual currency. In addition, complex virtual currency and virtual wallet programs involve more complex privacy and security issues, such as joint ownership or sharing of customer information. Each program warrants thoughtful allocation of responsibility for privacy and data security issues, as well as related fraud management.

To combat privacy and security concerns, retailers should determine which privacy policy or policies apply to the virtual currency program or platform. With the understanding that each virtual currency program is unique, it is worth taking the time to understand the flow of money and personal information through the

program and then thoughtfully allocate privacy and security and fraud responsibility between the parties involved.

In summary, virtual currency offers retailers exciting opportunities to increase revenues and decrease payment processing costs, but also presents increasingly complex legal issues. Retailers will be well served by structuring their virtual currency systems taking into account consumer protection, unclaimed property, financial services, and other key laws.

About the Author

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